



**TWELFTH ROUND TABLE MEETING
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***FRAMEWORK FOR DEVELOPMENT OF A ROADMAP
FOR THE ECONOMIC DEVELOPMENT POLICY 2010***

**GROSS NATIONAL HAPPINESS COMMISSION
ROYAL GOVERNMENT OF BHUTAN**

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1. Background

“Globally, transformative changes in the social, economic, environmental and political spheres are compelling countries, both developed and developing alike, to take stock of their development strategies and embark on far reaching reforms to address new challenges and opportunities of the 21st Century. Bhutan finds itself in the midst of similar social, economic and political transformation. With our future increasingly linked to a globalized world, the rapid transformation of our nation has ushered in new realities that require innovative and creative approaches to address them. The Eleventh Plan has provided an opportune time to take stock of the state of our nation against these new developments and build on our strong foundations by ushering in new plans, strategies and preparations that reflect the new opportunities and challenges.”

LyonchenTsheringTobgay

Prime minister of the Kingdom of Bhutan

Bhutan’s development performance over the last five decades has been impressive. Its GDP growth rate has averaged about 6 percent a year since 1985 and by about 8 percent per annum over the Tenth Plan period (2008-1013). Bhutan’s GDP per-capita has increased from USD 1,387 in 2006 to USD 2,590 in 2011. The economy has undergone significant structural transformation with the share of secondary and tertiary sectors contributing to more than 80% of GDP in 2011.

GDP growth rate	2006	2007	2008	2009	2010	2011
Nominal	12.63	21.59	10.63	11.9	18.41	18.05
Real	6.85	17.93	4.67	6.73	11.68	8.51

Sectors share as % of GDP	1980	2000	2006	2007	2008	2009	2010	2011
Primary	55.90	28.40	23.57	20.47	20.71	20.50	19.03	18.00
Secondary	12.2	33.62	33.55	42.25	40.88	39.7	40.55	38.41
Tertiary	31.9	37.98	40.89	37.28	38.41	39.8	40.42	43.69

Growth rates and sectoral contributions to GDP have, however, exhibited high volatility. Most significantly, structural transformation of the economy has not translated into a diversified economic base and

productive employment opportunities for a rapidly growing and educated labor force.

GDP growth rate by major sectors	2006	2007	2008	2009	2010	2011
Primary	3.7	2.5	2.53	1.60	1.13	4.00
Secondary	8.4	41.6	5.48	4.10	12.72	3.23
Tertiary	7.3	5.9	4.82	12.19	15.22	15.67

The agriculture sector continues to employ about 60 percent of the population who are predominantly engaged in subsistence farming. This sector is also faced with significantly lower returns, which is evident from the primary sector's declining share in GDP from 55.9 percent in 1980 to less than 20 percent in 2011 (Agriculture proper and livestock's share was less than 13% of GDP in 2011). Evidently, the structural transformation of Bhutan's economy and the high growth rates have been driven primarily by Government expenditure and investments (36 percent of GDP in 2011), mainly in the hydropower sector which alone accounted for about 14% of GDP in 2011.

Government Expenditure as percent of GDP						
	2006	2007	2008	2009	2010	2011
Current	17.51	16.17	20.36	18.06	16.53	16.14
Capital	16.47	16.99	19.85	15.18	19.05	20.76

Other key drivers of the economy include construction at 16.3 percent of GDP and community and social services at 12.8 percent of GDP, both of which are in turn linked to government expenditure. Manufacturing, which contributed 8.2 percent of GDP, is dominated by a few mineral based industries, which are highly dependent on the availability of cheap hydropower, while the trading and transportation sectors are largely driven by hydropower and consumption related imports.

As a small economy, Bhutan is highly dependent on trade, with a trade to GDP ratio of about 115 percent in 2011. Bhutan's external sector has however been characterized by limited export orientation that is highly concentrated in hydropower exports to India which comprises more than

40% of total exports. The external sector is also characterized by volatile and persistent current account deficits averaging at about 13 percent of GDP during the period of 2001 to 2011, and as high as 33 percent of GDP in 2004-05. Imports averaged at about 42 percent of GDP while imports as a percent of exports averaged 133 percent during the same period.

The lack of economic diversification and the persistently high current account deficits, especially with its major trading partner India, recently culminated in an acute shortfall in Rupee reserves. The country is still reeling from the ensuing major macroeconomic challenge that have yet to be effectively addressed. Monetary policy measures to address the lingering Rupee shortfall has resulted in a severe credit crunch in the banking sector, which continues to adversely affect private investment and growth as evident from the drop in growth from 8.6 per cent in 2011 to 4.6 per cent in 2012¹. The lingering macroeconomic challenges caused by the rupee crunch underscores Bhutan's growing vulnerability to exogenous shocks which can be expected to increase given the imperatives and trends towards greater economic liberalization and integration with the global economy.

Bhutan's development has reached a stage where it can no longer be sustained through just the development of its hydropower sector, development assistance, and government expenditure. While these related three elements are vital catalysts for growth and development, Bhutan needs to diversify its economy through greater private sector participation to ensure sustained, inclusive and employment-oriented growth during the Eleventh Plan and beyond.

Given structural constraints to competing in low cost and high volume sectors of growth, the underlying strategy for Bhutan's economic diversification efforts needs to focus on quality and higher productivity gains. For this, the economy needs to move into higher value-added segments of its existing core sectors, be it the RNR, hydropower, manufacturing, tourism, and the services sectors, and gradually move into more sophisticated niche sector. Such a strategy would require significant

¹ Statistical Yearbook of Bhutan 2013, National Statistics Bureau.

investments and a well calibrated medium and long term strategy that is grounded on its competitive advantages, such as its geo-political location and strong environmental record, and addresses key constraints related to strategic infrastructure, human resources and access to financing.

Against this background, the Eleventh Plan serves as a vital platform for achieving three key and integrally linked national development milestones by the year 2020. Firstly, "Bhutan 2020: A Vision for Peace, Prosperity, and Happiness" (Vision 2020) which, among other goals, envisages the private sector as the driving force behind employment and growth. Secondly, and pursuant to the Vision 2020, the Economic Development Policy 2010 was launched to enhance the productive capacity of the economy and provide a strategic direction for economic development up to 2020 with the objective to achieve self-reliance and full employment. Thirdly, and consequent to the achievement of the aforementioned milestones, is the successful graduation of Bhutan from the list of Least Developed Countries (LDCs).

The achievement of these three development milestones are vital to enable Bhutan to address its underlying development challenge of translating its rapid economic growth into effective structural transformation of its economy in a manner that diversifies its economic base to absorb a rapidly growing and educated work force; promotes inclusive development to improve distributional aspects of growth; and builds resilience against exogenous shocks to the economy.

Accordingly, underlying objective of the Eleventh Plan are to achieve "*Self-reliance and Inclusive Green Socio-Economic Development*". Pursuant to this objective, a key strategic thrust of the Eleventh Plan will be "*Green Accelerated Economic Development*" to operationalize EDP 2010 through targeted initiatives for economic diversification that will focus on the development of non-hydropower sectors and by fostering a dynamic private sector to catalyze Bhutan's transition to a green economy. Successful implementation of the EDP 2010 is therefore critical to achieving the overall objective of the Eleventh Plan and integrally linked to the realization of Vision 2020 and Bhutan's aspiration to graduate from the LDC category.

2. Overview of the EDP 2010

The Economic Development Policy was adopted in 2010 to provide the highest strategic direction for economic development up to 2020. With a vision to promote a green and self-reliant economy sustained by an IT-enabled knowledge society, the EDP's stated objectives are to achieve economic self-reliance and full employment (97.5 percent) by 2020.

The strategies set out to achieve the objectives include diversification of the economic base with minimal ecological footprint, harnessing and value addition to natural resources in a sustainable manner, increasing and diversification of exports, promoting Bhutan as an organic brand, promoting industries that build "Brand Bhutan"² and reducing dependency on fossil fuel especially for transportation.

3. Progress in implementation of EDP 2010

Since its launch in 2010, the implementation of the EDP has mainly been focused on creating an enabling policy and regulatory environment, preparatory works for infrastructure expansion and promotion of Bhutan as a potential destination for investments. These include adoption of a new FDI Policy in 2010, following which a total of 18 projects have been approved for hotels, mineral and metal based industries, agro and dairy products and the ICT sectors; the Bhutan Education City Act 2012 to facilitate the promotion of Bhutan as an education hub; the Cottage, Small and Medium Industry Policy (CSMI) 2012; and the Alternative Renewable Energy Policy 2013. Other policies that have been developed and are expected to be adopted in the Eleventh Plan include the Mineral Development Policy, Bhutan Telecommunications and Broadband Policy, Business Licensing Policy, Consumer Protection Act, Competition Policy, Trade Development Act, Investment Law, and Amendment of Companies Act 2000. A set of fiscal incentives was adopted under the Fiscal

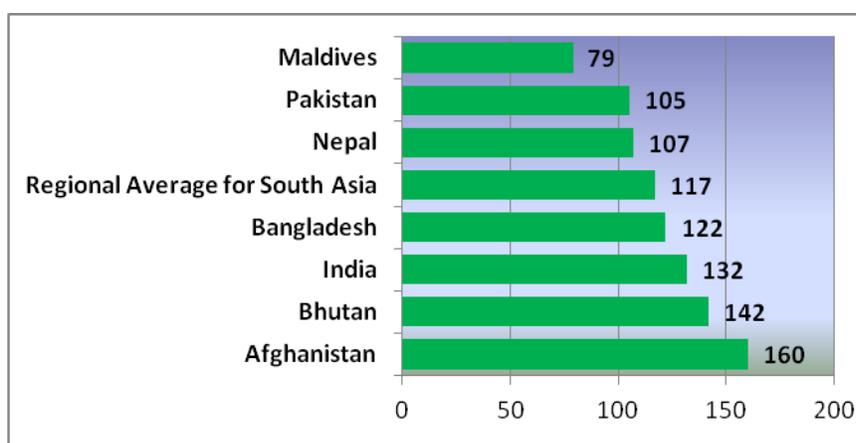
²Brand Bhutan –Natural and pristine environment; vibrant and living culture; nation of GNH; peace and security; reliable and competitively priced energy; will form some of the country's Unique Selling Proposition (USP) based on which Brand Bhutan will be developed.

Incentives 2010 to stimulate private sector growth and employment in the targeted sectors of the EDP.

4. Challenges, constraints and opportunities of EDP 2010

While significant efforts have been made in developing various legislative and policy frameworks to create an enabling policy and regulatory environment, the private sector continues to face major challenges in this regard. According to the 2012 IFC/World Bank Report on “Ease of Doing Business” Bhutan was ranked 142 out of 183 countries. Although an improvement by 4 ranks since 2011 it remains significantly below many of its peers in South Asia (refer to charts below).

Ease of doing business index and other indicators for Bhutan in the 2012



Source: World Bank

Furthermore, and more significantly, structural bottlenecks, especially in terms of lack of critical infrastructure, trained manpower, access to finance and macroeconomic issues related to balance of payments and foreign exchange continue to pose major challenges to deepening the development of the private sector and consequently the physical progress in the implementation of the EDP.

Vital Constraints listed in EDP	
High dependence on external aid	Inadequate infrastructure
High fiscal deficit	High transportation cost,
Weak balance of payment situation	Low productivity of labor
Rising public debt	Difficult access to finance,
Unsustainable FOREX reserves	Absence of R&D capability
Small domestic market	Inconsistent policies
Lack of management and professional skills	Access to land

Notwithstanding the constraints and challenges, Bhutan is endowed with a set of distinct characteristics that can be leveraged to its advantage. These include:

Smallness: Even its smallness can serve to be its greatest strength in terms of managing the country and planning its economy in a global environment that is characterized by rapid change.

Location: While being landlocked has its disadvantage, in terms of building a strong economy, Bhutan's geo-political location, particularly its proximity to India and strong economic linkages that are underpinned by a free trade agreement, can serve to be its biggest advantage.

Human resources: Although small, Bhutan has an existing pool of highly qualified, skilled and experienced professionals in government and private sector in diverse fields that it can build upon.³ Given the relatively small and manageable size of its population, Bhutan can disproportionately invest per capita in human resource development as well as more efficiently calibrate its school, vocational and tertiary education system to quickly meet the knowledge and skills needs of its economy in a dynamic and highly competitive global economic environment. Given the age structure of its population, with appropriate investments, the economy is poised to reap significant demographic dividends over the next two decades.

³These include engineering, environment, agriculture and RNR, education, administration, finance, management, medical and bio-sciences, transport and aviation, geology and mining, ICT, to name a few. In 2007 alone there were 263 civil servants pursuing Masters Programs and 10 pursuing PhD programs in various fields. Over the period of 1980 to 2007, more than 1500 civil servants have completed Masters Degree in various fields.

Stable and predictable labor market: Given the absence of unionized labor, Bhutan does not suffer from disruptive union activities allowing for a flexible labor market.

Political stability and good governance: Bhutan's has made significant progress in promoting good governance over five decades of planned development that have laid strong foundations for a vibrant democracy that is based on transparency, accountability and the rule of law. The democratic system is supported by a well-qualified, efficient and transparent civil service system. Despite, a respectable ranking of 33 among the 176 nations in Transparency International's 2012 Corruption Perception Index, an improvement by five positions from a ranking of 38 in 2011, combating corruption remains an utmost priority for the Government, which is reflective of its strong commitment to promote transparency and accountability.

Environment: Guided by its development philosophy of GNH, Bhutan has significantly invested in developing an environmentally friendly and ecologically advanced economy, even at cost of foregoing short-term financial benefits. With the global economic trends gradually moving towards a green economy, this intrinsic characteristic of Bhutan constitutes a key strength that effectively harnessed could be leveraged to its economic advantage, particularly in transitioning into a green economy and perhaps serving as a regional hub for environmental friendly industries, including research and development.

Critical mass of established core sectors: Bhutan can capitalize on the above factors through a well calibrated medium and long term cluster strategy that incorporates both traditional sectors that need expansion and upgrading, with new economic sectors that need building capabilities for.

Hydropower, construction and mineral based industries: With several mega hydropower projects under construction and many more in the pipeline, the hydropower sector could catalyze the much needed diversification of Bhutan's economic base through up gradation of the construction sector as well as spin offs in the manufacturing sector for construction materials,

including cement and steel which have already taken root. The nascent steel industry in particular could be revived and upgraded taking into consideration long term sustainability aspects. The availability of clean competitively priced and predictable power supply could also be strategically used to expand the small base of existing mineral industries or diversifying into similar industries in a manner that is consistent with the objective of transitioning into a green economy. Revenues from the hydropower sector could be earmarked to provide predictable financing to remove strategic bottlenecks related to infrastructure and enhancing productivity of human resources, while also spearheading investments to incubate new activities related to these three sectors.

Tourism, RNR, food and beverages and Cultural Industries: Bhutan has also established itself as a premier tourist destination, with emphasis on quality services and facilities for tourists which are being developed and managed in a culturally sensitive and an environmentally friendly way. The significant pool of over 100,000 tourists in 2012, about one-seventh of the country's population, provides a ready market for the expansion of other sectors such as the RNR, agricultural, food and beverages and cultural industries.

Additionally, the RNR sector has the potential to transition from subsistence to niche commercial ventures, including through backward and forward integration between RNR and the manufacturing and services sectors. For instance, commercial-level food processing has been picking up albeit on a small scale and as such agro-industries could have considerable potential for growth, mainly through exports of low-volume, high-value products. New ventures such as in hazelnut and Arabica coffee are indicative of the significant potential of developing the RNR sector. Given the significant forest resources and an established sawmill and furniture industry, there is strong potential to further develop this sector to meet domestic demand and potentially for niche-market exports.

Potential new growth clusters: The expansion of the traditional clusters has the potential to spin off new growth clusters that will complement each other so as to ensure the sustainability of Bhutan's economy in the long run. The new economic clusters should be those that support the

development of the core established sectors and yet have the potential to be developed into dynamic exportable sectors in future.

For instance, some of these sectors may include an efficient port, transport and logistics services to establish a reliable inter-region and intra-region cargo transportation system for domestic and external trade that is critical to support the development of core economic clusters in Bhutan; a viable ICT sector that will support the development and upgrading of targeted economic sectors within the short and medium terms and promote an export-oriented ICT industry; banking and financial services to facilitate access to necessary financing of the EDP and potentially promote Bhutan as a leading offshore financial center in South Asia; and cosmetics, pharma and nutraceuticals by leveraging the country's rich bio-diversity, pristine environmental image, organic farming potential and an established traditional medicine system.

Strategic Infrastructure: Bhutan has invested significantly in developing its strategic infrastructure, especially in education, power, roads, telecommunications and ICT network. While major challenges remain with regard to infrastructure, strong foundations have been laid that can be further built upon.

5. Rationale for a Roadmap for EDP 2010

The successful implementation of EDP rests on ensuring that its objectives are supported by clear-cut strategies, policies, and support systems that effectively address the constraints and harness the competitive advantages and opportunities for economic diversification in Bhutan. An analysis of the EDP reveals that significant gaps exist in this regard. Given that the private sector is still at an embryonic stage, strategic interventions, both direct and indirect, by the Government is critical to bridge the gaps and provide a clear and systemic roadmap for the development and promotion of sector identified under the EDP. Any such interventions by the Government needs to be in the form of carefully calibrated short, medium and long term strategies, especially in view of the time lag and resources required in addressing structural, institutional and human resource capacity constraints.

Such a roadmap would also enable strengthening of Bhutan's development cooperation with its development partners through deepening of engagements into new areas of economic cooperation and collaboration for the successful transformation of Bhutan's economy, which is vital to achieve the objectives and key development milestones of the Eleventh Plan.

6. Principles for development of the EDP 2010 Roadmap

Participatory process: To ensure success, it will be crucial to ensure the effective engagement of the private sector in both the rural and urban economy, key stakeholders of the government and development partners in the review of the progress in implementation of the EDP 2010 and the design, formulation and implementation of the roadmap to address key constraints and challenges.

Green Economy: Key considerations for transitioning towards a green economy will need to be factored into the design of the roadmap, including industry specific strategies for green development.

Focused and targeted strategy: The roadmap will be based on a comprehensive situational review and analysis to identify and prioritize key economic sectors and drivers, encompassing the primary, secondary and tertiary sectors.

Sequential approach: The structure of the roadmap needs to be categorized by short-term, medium-term and long term time frames to allow the Government, the private sector and other stakeholders, particularly in education and skills development, to implement them by these stages. This includes adoption of a dual track industrial strategy. Track 1 would focus on vitalizing existing core established or traditional sectors which need expansion and upgrading in the short and medium term. Track 2 of the strategy would involve incubating potential new economic sectors for a knowledge-based and green economy and developing advanced capabilities for such a transition in the medium and long term.

Centrality of Human Resources Development: Transforming school, TVET, and tertiary education system in a manner that address the human resources and technology needs in a rapidly changing economic environment is critical and needs to be an integral aspect of the roadmap. This will require timely and adequate investments as well as policy and regulatory reforms that enable the school, vocational and higher education system to provide quality education and continuous training and re-training of its human resources in some scale and that are tailored to meet the demands of a changing economic environment.

Integrating industrial and cluster development: Given the challenges of a small economy, developing a strategy for integrating sectors by industry and by clusters would yield economies of scale as well as promote synergies between different sectors, industries and clusters. The rationale for a cluster approach lies in synergizing the sectoral linkages to create stronger backward and forward, upstream and downstream integration.

Land and infrastructure: To address infrastructure challenges and create a more enabling and friendly business environment, establish targeted special industrial/economic and growth zones to remove barriers to enterprise development and foreign investments. Establishing of such zones or parks would also facilitate the formation of industrial clusters.

Innovative financing strategies: Effective implementation of the road map, particularly in addressing infrastructure and productivity constraints, would require a systemic approach and therefore substantial financial investments and technical support. This calls for more innovative domestic and external financing mechanisms and strengthening ongoing development partnerships by deepening them into new areas economic and technical cooperation. This will also require a review of existing regulations governing the financial sector so that a more competitive financial sector emerges.