



SEPTEMBER 2017

# Investment Climate Assessment of Bhutan

Removing Constraints to Private Sector Development  
to Enable the Creation of More and Better Jobs

MASSIMILIANO SANTINI  
TRANG THU TRAN  
ANDREW BEATH



**WORLD BANK GROUP**



# INVESTMENT CLIMATE ASSESSMENT OF BHUTAN

Removing Constraints to Private Sector Development  
To Enable the Creation of More and Better Jobs

©2017 The World Bank Group  
1818 H Street NW  
Washington, DC 20433  
Telephone: 202-473-1000  
Internet: [www.worldbank.org](http://www.worldbank.org)

All rights reserved.

This volume is a product of the staff of the World Bank Group. The World Bank Group refers to the member institutions of the World Bank Group: The World Bank (International Bank for Reconstruction and Development); International Finance Corporation (IFC); and Multilateral Investment Guarantee Agency (MIGA), which are separate and distinct legal entities each organized under its respective Articles of Agreement. We encourage use for educational and non-commercial purposes.

The findings, interpretations, and conclusions expressed in this volume do not necessarily reflect the views of the Directors or Executive Directors of the respective institutions of the World Bank Group or the governments they represent. The World Bank Group does not guarantee the accuracy of the data included in this work.

### **Rights and Permissions**

The material in this publication is copyrighted. Copying and/or transmitting portions or all of this work without permission may be a violation of applicable law. The World Bank encourages dissemination of its work and will normally grant permission to reproduce portions of the work promptly.

For permission to photocopy or reprint any part of this work, please send a request with complete information to the Copyright Clearance Center Inc., 222 Rosewood Drive, Danvers, MA 01923, USA; telephone: 978-750-8400; fax: 978-750-4470; Internet: [www.copyright.com](http://www.copyright.com).

All other queries on rights and licenses, including subsidiary rights, should be addressed to the Office of the Publisher, The World Bank Group, 1818 H Street NW, Washington, DC 20433, USA; fax: 202-522-2422; e-mail: [pubrights@worldbank.org](mailto:pubrights@worldbank.org).

Cover photos: Front: Unloading imported goods from a truck, Centenary Farmer's Market, Thimphu, February 2016.

Back: Local fruits and vegetables, Centenary Farmer's Market, Thimphu, August 2015.

All photos courtesy of © Olivier Jammes ([olivierjammes.com](http://olivierjammes.com))

# CONTENTS

<b>ACKNOWLEDGMENTS AND NOTES</b> .....	<b>VII</b>
Objective and Data Sources .....	vii
Acknowledgments .....	vii
Notes .....	viii
Structure of Report .....	viii
<b>EXECUTIVE SUMMARY</b> .....	<b>IX</b>
Economic Structure .....	ix
Constraints to Private-Sector Development .....	x
Recommendations .....	xi
<b>ACRONYMS</b> .....	<b>XIII</b>
<b>CHAPTER 1: ECONOMIC OVERVIEW</b> .....	<b>1</b>
1.1 Introduction .....	1
1.2 Macroeconomic Profile .....	2
1.2.1 Growth and Poverty .....	3
1.2.2 Sectoral Structure and Employment .....	3
1.2.3 External Sector .....	4
1.2.4 State-Owned Enterprises .....	6
1.3 Enterprise Sector Profile .....	8
1.3.1 Firm Characteristics .....	8
1.3.2 Dynamics .....	9
1.3.3 Labor Productivity .....	10
1.3.4 Export Orientation .....	12
1.4 Profiles of Key Sectors .....	13
1.4.1 Hydropower .....	13
1.4.2 Tourism .....	15
1.4.3 Information and Communications Technology .....	16
1.4.4 Agribusiness .....	17
<b>CHAPTER 2: CONSTRAINTS ON PRIVATE-SECTOR DEVELOPMENT</b> .....	<b>21</b>
2.1 Introduction .....	21
2.2 Access to Finance .....	24
2.2.1 Severity of Constraint .....	24
2.2.2 Sources of Constraint .....	26
2.3 Access to Skills .....	29
2.3.1 Severity of Constraint .....	29
2.3.2 Sources of Constraint .....	30
2.4 Access to External Markets .....	33
2.4.1 Severity of Constraint .....	33
2.4.2 Sources of Constraint .....	34

2.5 Market Competition	37
2.5.1 Severity of Constraint	37
2.5.2 Sources of Constraint	38
2.6 Taxation	39
2.6.1 Severity of Constraint	39
2.6.2 Sources of Constraint	39
<b>CHAPTER 3: THE WAY FORWARD</b>	<b>41</b>
3.1 Introduction	41
3.2 Crosscutting Reform Recommendations	42
3.2.1 Access to Finance	43
3.2.2 Access to Skilled Labor	45
3.2.3 Access to External Markets	48
3.2.4 Competition	52
3.2.5 Taxation	53
3.3 Sector-Specific Reform Recommendations	55
3.3.1 Tourism	55
3.3.2 Information and Communications Technology	57
3.3.3 Agribusiness	59
3.3.4 Hydropower	60
<b>CHAPTER 4: CONCLUSION</b>	<b>63</b>
<b>REFERENCES</b>	<b>67</b>
<b>ANNEX 1: THE ENTERPRISE SURVEY</b>	<b>73</b>
<b>ANNEX 2: BHUTAN LICENSING REGIMES AND ESTIMATED SIZE OF PRIVATE SECTOR</b>	<b>77</b>
2.1 Estimated Size of the Enterprise Sector	78
2.2 Extent of Informality	79
<b>ANNEX 3: ADDITIONAL TABLES AND FIGURES</b>	<b>81</b>
3.1 Measures of Labor Productivity	81
3.2 Price Levels	83
3.3 Determinants of Labor Productivity and Employment Growth	84
3.4 Physical and Human Capital	87
3.5 Labor Regulations and Perception on Labor Constraints in Bhutan	88
3.6 Main Corporate and Business Taxes Bhutan	89
<b>Tables</b>	
Table 1: Priority Policy Recommendations	xii
Table 2: Changes in Employment Composition	4
Table 3: Share of New and Young Firms	9
Table 4: Growth of Firms, 2012–14	10
Table 5: Firm’s Linkages to External Markets	12
Table 6: Average Firm Performance, by Export Status	12
Table 7: Major Hydroelectric Projects in Bhutan	14
Table 8: Agricultural Products in Bhutan	17
Table 9: Comparison of Bhutan’s Financial Sector Indicators with Those of Peer Countries	27
Table 10: Access to Finance in Bhutan (WBES 2015)	28
Table 11: Summary of Policy Recommendations	64
Table 12: Bhutan ES Sample Frame	74
Table 13: ES Achieved Sample	75
Table 14: Business Registration Framework	77
Table 15: Share of Informal Firms in Bhutan	80

Table 16: Median Labor Productivity (value added per full-time worker) by Industry in Bhutan .....	82
Table 17: Determinants of Labor Productivity .....	84
Table 18: Determinants of Employment Growth.....	85
Table 19: Drivers of Expansion Plans.....	87
Table 20: Quality and Investments in Physical and Human Capital.....	87
Table 21: Labor Regulations in Bhutan and South Asia .....	88
Table 22: Firm's Perception of Different Labor Constraints.....	88
Table 23: Main Corporate and Business Taxes in Bhutan.....	89

## Figures

Figure 1: Sectoral Composition of Bhutan's Economy.....	3
Figure 2: Share of Nonagricultural Private Employment .....	4
Figure 3: Export Indicators.....	5
Figure 4: Foreign Direct Investment.....	6
Figure 5: Government-Linked Companies with DHI Equity .....	7
Figure 6: Characteristics of Private-Sector Firms .....	8
Figure 7: Size and Sectoral Distribution of Firms of Small Geographically Isolated Economies .....	9
Figure 8: Business Entry and Employment Growth .....	10
Figure 9: Labor Productivity (value added per worker) .....	11
Figure 10: Median Labor Productivity by Sector (value added per worker) .....	11
Figure 11: Bhutan's Agricultural Exports, 2011-14.....	18
Figure 12: Business Environment and Competitiveness Ranking.....	22
Figure 13: Perception of Investment Climate Constraints, 2009 and 2015.....	23
Figure 14: Aggregate Credit.....	25
Figure 15: Share of Firms Indicating Access to Finance Is Biggest Obstacle.....	25
Figure 16: Financing Needs and Financial Access by Firm Size.....	26
Figure 17: Lending Interest Rate and Interest Spread.....	27
Figure 18: Demand-Side Factors Inhibiting Access to Finance .....	29
Figure 19: Share of Firms Citing Labor Regulations as Biggest Obstacle.....	30
Figure 20: Relative Cost and Productivity of Labor .....	31
Figure 21: Competition for Labor with Public Sector.....	32
Figure 22: Share of Firms Citing Customs and Trade Regulations or Transport as Biggest Obstacle .....	33
Figure 23: Logistic Performance Index 2016 .....	34
Figure 24: Time and Cost to Import and Export .....	36
Figure 25: Tax Rates and Tax Administration .....	40
Figure 26: Number of BIT Firms by Status in DRC Tax Database, 2016 .....	79
Figure 27: Correlation of Income and Labor Productivity.....	81
Figure 28: Price Levels Relative to 2000.....	83
Figure 29: Producer Price Index.....	83



# ACKNOWLEDGMENTS AND NOTES



## OBJECTIVE AND DATA SOURCES

---

This report was prepared upon the request of the Ministry of Economic Affairs (MoEA), Royal Government of Bhutan (RGoB), and represents Bhutan's third Investment Climate Assessment (ICA), building on previous assessments in 2002 and 2010. The analysis draws primarily on the 2015 World Bank Enterprise Survey, complemented by other quantitative and qualitative information.<sup>1</sup> The report aims to provide a detailed assessment of firm performance and constraints as they enter, operate, and exit domestic and international markets. The report provides policy recommendations that will support Bhutan to achieve an investment climate conducive to private sector growth and the creation of the productive and gainful employment envisaged by Bhutan's 12th Five-Year Plan.

## ACKNOWLEDGMENTS

---

The 2015 Enterprise Survey and this report have been developed in conjunction with the Royal Government of Bhutan. The 2015 Enterprise Survey was enumerated by the National Statistics Bureau (NSB), using a sampling frame and sample constructed with help from MoEA and its Regional Trade and Industry Offices. MoEA provided overall direction for the analysis and recommendations of the report.

Massimiliano Santini supervised the preparation of the report and led the policy dialogue around it. The research and writing was carried out by Trang Thu Tran and Andrew Beath, with substantial contributions from Sanjay Kathuria, Viridiana Rios, Siddharth Sharma, and Thomas Yates. Support for

---

1. See Annex 1 for a description of the sampling methodology of the Enterprise Survey. Other information includes data on macroeconomic indicators, including GDP, trade flows, price levels, and interest rates; data on regulatory and institutional quality as provided by the World Economic Forum Competitiveness ranking and the Doing Business reports; micro-level data on the country's labor force's characteristics; and other WBG studies at the sector levels on growth prospects and constraints in agribusiness, tourism, and characteristics of the labor market and financial sector.

data analysis was received from Jialiang Zhu. The report received inputs from Stefania Abakerli, Wafa Aranki, Om Bhandari, Christian Eigen-Zucchi, Tanvir Hossain, Kuk Hwan Jeong, Sebastian James, Charles Kunaka, Yoichiro Ishihara, Esperanza Lasagabaster, Tenzin Lhaden, Elaine MacEachern, Sumit Manchanda, Antonia Preciosa Menezes, Sabin Raj Shrestha, and Susanne Wendt. The report gratefully acknowledges the comments and advice provided by reviewers Andrea Goldstein, Jean Michel Marchat, and Gaurav Nayyar. Arvind Jain and Jorge Luis Rodriguez Meza managed the 2015 Enterprise Survey during the set-up and enumeration period, provided support to NSB, and finalized the dataset. Thanks to Susan Boulanger for copyediting and Shepherd Inc. for the design.

Analysis and recommendations pertaining to access to finance, labor policy, and the agribusiness sector have been drawn, respectively, from the Financial Sector Development Action Plan (Murgatroyd et al. 2016), Bhutan's labor market assessment (World Bank, Ministry of Labor and Human Resources, RGoB, 2016), and Bhutan's agribusiness sector assessment (World Bank 2017a).

The World Bank Group (WBG) team would like to thank the following for their inputs and insightful exchanges during the field visits and phone interviews: Bhutan Standards Bureau, NSB, Ministry of Finance's Department of Revenue and Custom, MoEA's Policy and Planning Division, MoEA's Industry Department (including the FDI office), MoEA's Cottage and Small Industry Department, Bank of Bhutan, Bhutan National Bank, Bhutan Development Bank, Bhutan Chamber of Commerce, the management team and tenant companies at Thimphu Techpark, private-sector companies, and government officials participating in the July 2016 workshop and roundtable discussion in Thimphu and subsequent phone interviews. Lastly, the team would like to thank the World Bank Group Bhutan country office for all the support provided.

## NOTES

---

To benchmark the performance and constraints of firms in Bhutan, this report employs comparisons with peer countries. In addition to neighboring countries such as India and Nepal and the South Asia region generally, comparisons are made with countries outside of the region including Botswana, Mauritius, Costa Rica, Lesotho, and Lao People's Democratic Republic. These countries were selected due to their similarities with Bhutan in terms of the quality of institutions, remoteness, strength of trade links with a large neighboring country, large natural resource sector, and/or a large tourism sector. As Enterprise Survey data rarely includes data on micro firms for peer countries, comparisons made between Bhutanese businesses in 2009 and 2015 or between Bhutan and other countries exclude micro firms.

## STRUCTURE OF REPORT

---

The report is divided into four chapters:

**Chapter 1:** describes the structure, dynamics, and performance of Bhutan's macroeconomy, private sector, and leading industries.

**Chapter 2:** uses data from the Enterprise Survey and other qualitative and quantitative sources to analyze the constraints that inhibit increases in private sector investments and productivity in Bhutan.

**Chapter 3:** presents crosscutting and sector-specific policy recommendations designed to alleviate constraints impeding the development of the private sector in Bhutan.

**Chapter 4:** presents the study conclusions.

# EXECUTIVE SUMMARY



## ECONOMIC STRUCTURE

---

**The development of the hydropower sector has fueled rapid growth and poverty reduction in Bhutan, although the stagnancy of the private sector hinders the creation of productive employment.** Between 2000 and 2015, Bhutan’s gross domestic product (GDP) per capita more than doubled to US\$2,500 and the incidence of poverty fell to just two percent. Beyond the booming hydropower sector, however, major sectors of Bhutan’s economy are stagnant. The growth of private-sector firms—particularly in manufacturing and services—is stunted by Bhutan’s small domestic market, high trade costs, and investment climate imperfections. Large private-sector firms are rare; only two percent of firms hold limited liability company (LLCs) status, and only two percent of firms attract foreign ownership. The lack of dynamism in the private sector limits the access of Bhutan’s population to productive employment, with the public sector and agriculture collectively accounting for 76 percent of jobs (Bhutan, MoLHR 2015c).

**By tapping markets for tradable services, Bhutan can leverage its institutional assets to attract investment and increase productivity.** The rapid growth of markets for tradable services—such as tourism and information and communication technologies (ICT)—provide Bhutan with an opportunity to develop high-value niche industries that are unconstrained by the geographical barriers that have historically inhibited the ability of local firms to grow and to provide stable, well paying jobs. While tourism is already providing Bhutan with substantial foreign exchange earnings, the economic impacts of the sector can be enhanced and broadened by better attuning policy to the changing technologies and preferences of the market. In comparison to tourism, Bhutan’s ICT industry is fledgling. However, the country’s special characteristics—good governance, low corruption, civil and political stability, an English-speaking workforce, and cheap and reliable electricity—present investors in the sector with an attractive value proposition. Properly nurtured, the ICT sector can emerge as a valuable driver of both high-value exports and high-wage employment for recent graduates.

**By developing niche premium products that draw on Bhutan's unique international reputation, the agribusiness and manufacturing sectors can benefit a broad section of the population.** Bhutan's agribusiness and manufacturing firms exhibit low levels of productivity due to a lack of innovation, underuse of quality certification, a reliance on foreign intermediaries, limited investment, and high transportation costs. However, by developing niche products and better leveraging the country's unique reputation—borne of the government's commitment to preserving the country's unique culture and environment—to exact a premium in high-value external markets and attract foreign investment, Bhutan can increase the productivity of its cottage industries and commercial agriculture. Given the extent to which such sectors are a major source of employment for the rural populations, the development of these sectors offers the potential to deliver broad-based benefits to the population.

## CONSTRAINTS TO PRIVATE-SECTOR DEVELOPMENT

**The ability of Bhutanese firms to develop high-value services and products, however, is constrained by imperfections in factor markets and limited access to product markets.** While recent reforms have improved Bhutan's investment climate, much work remains to be done to enable the private sector to fully exploit available opportunities in tradeable services and in markets for high-value premium products. Limited access to key factors of production—particularly finance and skilled labor—undermine the ability of small and large firms alike to increase productivity and grow. The access of firms to domestic and international markets is further limited by deficiencies in transport, logistics, customs procedures, marketing, and competition policy.

**Limited access to finance—caused by both supply and demand-side factors—constrains the growth of small firms.** In 2015, the World Bank's Enterprise Survey (WBES) conducted detailed interviews with managers of 367 nonagricultural firms in Bhutan. Managers—particularly of micro- and small enterprises—most

frequently cited access to finance as the constraint that most inhibited firm growth. Limits on access to finance stem from factors discouraging borrowing, as well as those discouraging lending. Lenders, on the one hand, are discouraged by a lack of credit information and by a complex, unpredictable, and ineffective restructuring and insolvency regime. Borrowers, on the other hand, are discouraged by the high prices, poor quality, and limited availability of financial services; by constraints on the types of productive assets that can be collateralized; and by low financial literacy.

**A limited supply of skilled labor constrains the development of high value-added products.** After access to finance, labor was the second most frequently cited constraint in the 2015 WBES, a complaint likely triggered by the limited access of firms to skilled labor. Due to Bhutan's historically low levels of education, the domestic supply of skills—such as auditing, accounting, and information technology—is limited. Moreover, generous public sector compensation packages discourage recent graduates from seeking private-sector jobs. Given its proximity to the skilled workforce of northeast India and its favorable quality of life, Bhutan could potentially address its skills shortage by attracting expatriate workers. However, current caps on foreign workers and the inconsistent application of labor regulations cause skilled migrants to be crowded out by unskilled construction workers.

**Transport and logistical deficiencies and limited foreign investment curtail the access of Bhutanese firms to external markets.** While relatively few firms rank access to external markets as a primary obstacle, data from Doing Business and the Logistics Performance Index suggest that exports are constrained by the high costs of accessing external markets. While Bhutan's road network and custom procedures have recently improved, transportation costs are exacerbated by insufficient capacity at Phuentsholing port, poor domestic connectivity, and cumbersome logistics. A lack of awareness among firms of standards and certification, insufficient access to trade finance facilities, poor contract management, and deficient knowledge of external markets also limits market access. Flows of foreign investment are suppressed

by regulatory barriers, skill shortages, and insufficient investment promotion, which further restricts the access of domestic firms to foreign markets and technologies.

**The state’s dominant role in the economy has narrowed the space for the private sector to mature, while the current public procurement system is insufficient to promote firm development.**

The state has played an important role in modernizing Bhutan by providing essential public goods and enabling the achievement of economies of scale in certain sectors. However, the large size of some state-owned enterprises and the extent to which affiliates of such enterprises enjoy access to policy makers potentially discourages private investments and thereby limits competition. Several enterprises also complain that regulations are applied subjectively and without consistency. While Bhutan’s public procurement framework performs well by international standards, it could also do more to promote the development of firm capabilities and thereby support the development of the private sector.

## RECOMMENDATIONS

**Improving the capacity of firms to grow requires further reforms to increase the supply of and demand for financial products.**

Bhutan has recently undertaken reforms to increase access to finance, including establishing a credit information bureau, three new commercial banks, and a minimum reference rate for lending. However, further measures are needed. By broadening and deepening the credit information system, reforming the restructuring and insolvency regime, and adjusting regulations to increase financial competition, the RGoB can increase the supply of finance. By expanding the scope of asset registries and bolstering financial literacy, the RGoB can increase demand for financial products.

**To enable the growth of high-value products and high-tech industries, the private sector must have access to a greater supply of skilled workers.**

To relax the constraint that skills shortages place on firms over the short term, the RGoB should develop channels for skilled migration while also providing vocational training to prepare the adult population for higher skilled

occupations. Over the medium term, the RGoB should address the discrepancy in compensation packages that causes graduates to prefer employment in the public sector.

**Better marketing, more efficient border management, enhanced transportation and logistical infrastructure, and increased foreign investment can improve access to external markets.**

The enhancement of firms’ marketing capabilities, creation of e-commerce initiatives and online platforms to match firms with export partners, and greater awareness of quality standards and certifications will enable firms to reach higher value export markets. The adoption of a risk-based border clearance regime, coordination of customs procedures, and support for the domestic transportation and logistics sectors can also help reduce export costs, while the development of sector-specific investment promotion strategies can help increase inflows of productivity-enhancing foreign direct investment (FDI). Finally, by reinforcing the “Brand Bhutan” strategy, the RGoB can assist firms in realizing a premium for their products.

**The competitive environment for firms can be enhanced by rationalizing the role of state-owned enterprises, establishing mechanisms for public-private dialogue, and revising public procurement procedures.**

The role of state-owned enterprises and the close relationship between DHI and policy makers potentially discourage private investment. To ensure that the development of the private sector is not being artificially stymied, the role of state-owned enterprises should be reviewed and, in cases where a rationale for continued public ownership is lacking, options for divestiture explored. Platforms for private-public policy dialogue should also be established to ensure that the private sector has appropriate access to policy makers. The RGoB should introduce a new competition law and revise public procurement procedures to help build the capabilities of private-sector firms.

**Addressing sector-specific constraints through targeted reforms will facilitate the growth of high potential industries.** The performance of the hydro-power, tourism, ICT, and agribusiness sectors will strongly

impact the diversification of employment and exports, as well as growth in household incomes. To realize the potential of the tourism sector, it is important to update policies to reflect the evolution of tourist flows, preferences, and technologies. To realize the promise of Bhutan's nascent ICT sector, it is important to address factors that unnecessarily exacerbate investment risks. The development of

high-value niche agribusiness exports can be encouraged by reforming the existing subsidy regime; implementing the Brand Bhutan strategy; and encouraging investments in storage and logistics. Finally, to maximize the benefits of hydropower generation for the rest of the economy, mechanisms should be explored to increasingly engage local firms and workers in project construction.

TABLE 1: PRIORITY POLICY RECOMMENDATIONS

Policy Area	Recommendations	Timeline
<b>Crosscutting Recommendations</b>		
<b>Access to Finance</b>	Expand scope of collateralizable assets. Deepen and broaden credit information.	Short
	Approve and implement new insolvency bill. Reduce risks of e-banking for customers.	Medium
<b>Access to Labor</b>	Introduce dedicated channel for skilled migration. Provide vocational training to adult labor force.	Short
	Realign public compensation packages with private sector.	Medium
<b>Access to Markets</b>	Promote use of e-commerce platforms. Increase awareness and use of quality standards and certifications. Develop and implement investment promotion strategy.	Short
	Introduce risk-based border inspections and coordinate border procedures.	Medium
<b>Competition</b>	Create a public-private dialogue platform to provide equal access to policy feedback. Monitor anticompetitive practices and effect of state-owned enterprises on private investment.	Short
<b>Taxation</b>	Increase awareness of taxation policy and accounting standards.	Short
<b>Sector-Specific Recommendations</b>		
<b>Tourism</b>	Build capacity of three-star accommodation and restaurant providers. Support development of programs to geographically and temporally diversify flows.	Short
<b>ICT</b>	Develop sector-specific high-skilled migration channel. Upgrade skills of existing and prospective ICT workers. Develop and implement sector-specific investment promotion strategy	Short
	Upgrade Internet infrastructure	Medium
<b>Agribusiness</b>	Develop regulations, oversight roles, and communication strategy for Brand Bhutan.	Short
	Promote storage and logistics investments to facilitate exports of high-value products. Reform subsidies and interventions to optimize incentives for private investment.	Medium
<b>Hydropower</b>	Commission study of involvement of local firms/workers in hydropower projects.	Short
	Increase capacity of local firms/workers to participate in hydropower projects. Ensure that hydropower agreements include appropriate provisions to facilitate contracting of Bhutanese firms and employment of Bhutanese workers.	Medium

# ACRONYMS

ACC	Anti-Corruption Commission	IFC	International Finance Corporation
ADB	Asian Development Bank	IFRS	International Financial Reporting Standards
BBIN MVA	Bangladesh, Bhutan, India, and Nepal Motor Vehicles Agreement	ISP	Internet service provider
BCAA	Bhutan Civil Aviation Authority	LCU	local currency unit
BDBL	Bhutan Development Bank Ltd.	LLC	limited liability company
BEA	Bhutan Exporters Association	MDPP	minimum daily package policy
BICMA	Bhutan Information, Communications and Media Act 2006	PPP	public-private partnership
BIT	Business Income Tax	m&e	monitoring and evaluation
BNB	Bhutan National Bank	MA-OTRI	Market Access Overall Trade Restrictiveness Index
BoB	Bank of Bhutan	MFI	microfinance institution
BOiC	Business Opportunity and Information Centre	MFN	most favored nation
BPO	business process outsourcing	MIPA	Movable Property and Immovable Property Security Act
CIB	Credit Information Bureau	MoEA	Ministry of Economic Affairs
CIT	Corporate Income Tax	MoF	Ministry of Finance
CRST	Central Registry for Secured Transactions	MoIC	Ministry of Information and Communications
CSI	cottage and small industry	MoLHR	Ministry of Labour and Human Resources
CSO	Civil Society Organizations Act	MoWHS	Ministry of Works and Human Settlement
DHI	Druk Holding and Investments Ltd.	NSB	National Statistics Bureau
DIT	Department of IT and Telecom	OECD	Organisation for Economic Co-operation and Development
DOAT	Department of Air Transport	PEMS	Public Expenditure Management System
DRC	Department of Revenue and Customs, Bhutan	RAA	Royal Audit Authority
EDP	Entrepreneurship Development Program	RAMIS	Revenue Administration Management Information System
FDI	foreign direct investment	REDCL	Rural Enterprise Development Corporation Limited
GDP	gross domestic product	RGoB	Royal Government of Bhutan
GLC	government-linked company	RKC	Revised Kyoto Convention
GNH	Gross National Happiness	RMA	Royal Monetary Authority
ICA	Investment Climate Assessment		
ICT	information and communications technology		

<b>RRCO</b>	Regional Revenue and Customs Offices	<b>TDS</b>	tax deducted at source
<b>RTIO</b>	Regional Trade and Industry Offices	<b>TPN</b>	Taxpayer Number
<b>SAARC</b>	South Asian Association for Regional Cooperation	<b>UNCTAD</b>	United Nations Conference on Trade and Development
<b>SANDRP</b>	South Asia Network on Dams, Rivers and People	<b>WBES</b>	World Bank Enterprise Survey
<b>SOE</b>	state-owned enterprise	<b>WBG</b>	World Bank Group
<b>TFP</b>	total factor productivity	<b>WCO</b>	World Customs Organization
<b>TCB</b>	Tourist Council of Bhutan	<b>WEF</b>	World Economic Forum

# CHAPTER 1

## ECONOMIC OVERVIEW

### Summary

Bhutan has experienced rapid economic growth and poverty reduction over the past two decades. However, despite ongoing structural transformation, employment remains dominated by agriculture and the public sector, with minimal job creation in manufacturing and construction. Private-sector firms are overwhelmingly small and struggle to attract investment and access international markets without assistance from intermediaries. Bhutan's large companies are generally state-owned enterprises overseen by Druk Holdings and Investments (DHI), several of which compete against private-sector firms.

Due to the small size of the domestic market and the high cost of transporting goods across the country's borders, Bhutan's prospects for economic development will rely on its ability to export services and premium products. Booms in hydropower exports and tourism have driven recent increases in economic growth, but both sectors are facing challenges in attaining their potential to stimulate the broader economy in an inclusive and sustainable manner. The country's nascent ICT sector is a potential source of high-value service exports, but it faces growing pains that are discouraging further investments. The agribusiness sector is beginning to export several high-value niche products, but is inhibited by a lack of supportive infrastructure.

## 1.1 INTRODUCTION

**Bhutan's natural endowments constrain economies of scale and gains from trade, but also have provided the basis for the development of hydropower and tourism.** The small size of Bhutan's population and land area, its landlocked geography, and its mountainous topography present deep constraints that inhibit the exploitation of two of the most fundamental sources of economic development: economies of scale and gains from merchandise trade. Bhutan's history of isolation—borne of the country's geography and topography—has also inhibited the incorporation of local producers into global value chains and resulted in minimal flows of foreign investment. However, natural endowments have also provided Bhutan with substantial wealth in hydropower generation and the ability to export surplus electricity to India. Bhutan's topography, cultural assets, and historical isolation also make it a coveted destination for international tourists.

**Bhutan's unique institutions present both complications and opportunities for private-sector development.** Historically, the Royal Government of Bhutan has—in accordance with the guiding principle of maximizing Gross National Happiness (GNH)—avoided foreign investment and curtailed the activities of certain industries due to concerns of adverse cultural and environmental impacts.<sup>2</sup> To promote economic development, the RGoB has instead undertaken public investments in strategic sectors. Despite this historical legacy and the small size of the domestic market, Bhutan is nonetheless attractive to investors due to its civil and political stability, low levels of corruption, and broadly Anglophone population, which collectively represent a package of characteristics unique in the South Asia region. Moreover, whereas cultural and environmental protections have sometimes been perceived as a constraint to private-sector activity, producers are now seeking to utilize GNH principles to exact a premium for Bhutanese in high-end export markets.

**Over recent years, Bhutan's economy has been transformed by growth in hydropower and tourism.**

In 1988, Bhutan opened its first major hydroelectric facility at Chukha and began exporting surplus electricity to India. Since then, a further five facilities have been completed, boosting exports, public revenue, and construction. Tourism has similarly grown rapidly in recent years. Virtually closed to tourists until 1974, Bhutan attracted only 7,158 tourists as recently as 1999, but welcomed 130,000 visitors in 2014. Developments of hydropower, tourism, and related industries have resulted in dramatic increases in economic growth, public spending, and reductions in poverty (World Bank 2014). In addition to underpinning the growth of tourism and hydropower, Bhutan's state-owned enterprises have promoted economic diversification. Despite these developments, however, Bhutan's employment structure remains overwhelmingly agrarian, and exports and foreign direct investment are low relative to comparable countries. Bhutan's macroeconomy is examined in greater detail in Section 1.2.

2. GNH attempts to balance spiritual and material advancement to achieve total well-being. GNH principles are anchored in Bhutan's constitution and implemented through medium-level strategies.

**Opportunities provided by the booms in hydropower and tourism have stimulated the creation of new firms.** Bhutan's private sector is in a state of transition as it seeks to develop market niches that are profitable yet consistent with GNH principles. While the economy is rapidly creating new firms, the overwhelming majority of these firms are sole proprietorships. New firms are also concentrated in the service sector, with relatively few in manufacturing or—given the extent to which Indian firms dominate hydropower contracts—in construction. In addition, very few firms export directly. Instead, firms often rely on middlemen from neighboring countries to trade goods across borders. The structure and dynamics of Bhutan's evolving private sector is detailed further in Section 1.3.

**The performance of four key sectors—hydropower, tourism, information and communications technology, and agribusiness—will likely shape Bhutan's future development.**

Hydropower, which accounts for very large shares of exports, imports, and government revenue, has substantial impacts on the broader economy that must be carefully managed. The rapid expansion of tourism has brought growing pains that will need to be resolved if the sector is to provide sustainable economic returns. The nascent ICT industry offers the potential to stimulate youth employment and high-value exports, but further policy adjustments are required to attract increased foreign investment. Finally, with agriculture currently employing two-thirds of Bhutan's private-sector workforce, improving agribusiness performance is critical to improving the well-being of the country's population. Each of these four sectors is profiled in greater detail in Section 1.4.

## 1.2 MACROECONOMIC PROFILE

**Despite changes in the structure of Bhutan's economy, employment remains overwhelmingly agrarian, and external integration is low relative to comparable countries.**

The benefits of the rapid economic growth experienced in recent decades have been shared broadly across the population, with Bhutan currently exhibiting very low levels of poverty and a high level of access to basic services (Subsection 1.2.1). The transformation of the economy has been driven mainly by a large increase in the

generation and export of hydroelectricity, with the importance of manufacturing and services falling below that of comparable middle-income countries. Agriculture and the public sector dominate employment, with relatively few people employed in manufacturing (Subsection 1.2.2). Bhutan's exports consist of a small number of products and are sent mainly to India and Bangladesh, while flows of foreign direct investment are increasing but remain low compared to peer countries (Subsection 1.2.3). Bhutan's state-owned enterprises—which, since 2007, have operated under the aegis of Druk Holdings and Investments—have been instrumental to diversifying the economy, although the strong linkages that persist between policy makers and state-owned enterprises potentially discourage the growth of the private sector (Subsection 1.2.4).

### 1.2.1 GROWTH AND POVERTY

**In the past two decades, Bhutan has experienced rapid economic growth and declines in poverty.** Between 2000 and 2015, Bhutan's per capita gross domestic product (GDP) doubled to US\$2,500. Bhutan has almost eliminated extreme poverty, with estimates

indicating that just 2 percent of the population live on less than US\$1.90 a day, which is the second lowest level of poverty in South Asia and substantially lower than the regional average of 19 percent. Bhutan's economy has also shared the benefits of increasing prosperity. Over the fifteen years prior to 2015, the average income and expenditure of the bottom 40 percent of the distribution grew at the same rate as the overall average. Access to basic services and asset ownership also improved over the period, with the Gross National Happiness Survey in 2015 indicating that 98 percent of households own mobile phones and 99 percent have access to electricity from the national grid.

### 1.2.2 SECTORAL STRUCTURE AND EMPLOYMENT

**Hydropower has transformed Bhutan's economy, although manufacturing and services have not achieved the importance characteristic of middle-income countries.** Between 1980 and 2015, the output share of agriculture declined from 44 to 17 percent (Figure 1). This structural transformation has,

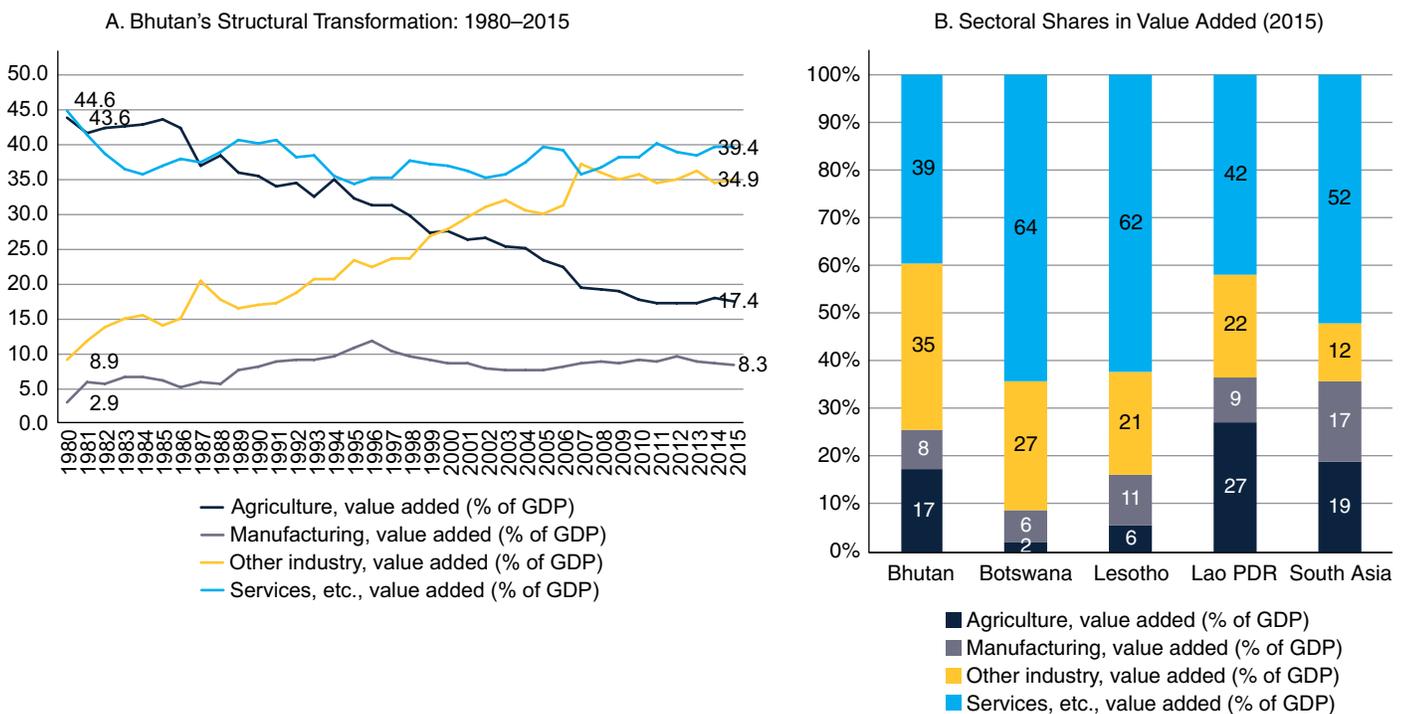


Figure 1: Sectoral Composition of Bhutan's Economy  
 Source: World Development Indicators data.

however, been driven predominantly by the sharp increase in hydropower generation—which comprised 34 percent of exports in 2015—and associated construction activities (Bhutan NSB and WB 2014). As such, the reduction in the economic share of agriculture has not—at least over the past 10 years—been accompanied by an increase in manufacturing or services. As of 2015, the share of services in value added was lower in Bhutan (40 percent) than the average for South Asian countries generally (52 percent), as well for other small, landlocked economies such as Botswana (64 percent) and Lesotho (62 percent).

**Due to the concentration of economic growth in capital-intensive sectors and the employment of foreign labor in the construction sector, employment remains concentrated in agriculture and the public sector.**

While Bhutan’s rapid economic growth of close to 8 percent over the past two decades would ordinarily be sufficient to absorb surplus labor, economic growth has been concentrated overwhelmingly in capital-intensive sectors, such as metals, mineral products, hydropower, and the chemical sector. In addition, labor-intensive sectors that have grown—such as commercial construction, infrastructure, and hydropower projects—have relied on foreign labor. As of 2014, Bhutan’s employment structure remains at the threshold of an agrarian economy (World Bank 2016a), with agriculture accounting for almost 70 percent of all private sector jobs (*ibid.*). Moreover, the public sector accounts for almost one-fifth of overall employment, which is approximately the share of the private nonagricultural workforce (Table 2). Per 2015 WBES data, service-sector firms

TABLE 2: CHANGES IN EMPLOYMENT COMPOSITION

	2004	2010	2014
Agriculture farming sector	63.20%	56.20%	56.70%
Nonfarm sector:	36.80%	43.80%	43.30%
<i>Nonfarm private</i>		24.60%	24.40%
<i>Nonfarm public</i>		19.30%	18.90%

Source: Bhutan National Bureau of Statistics 2015; World Bank 2016a. Public employment includes civil services, armed forces, SOEs, and other agencies.

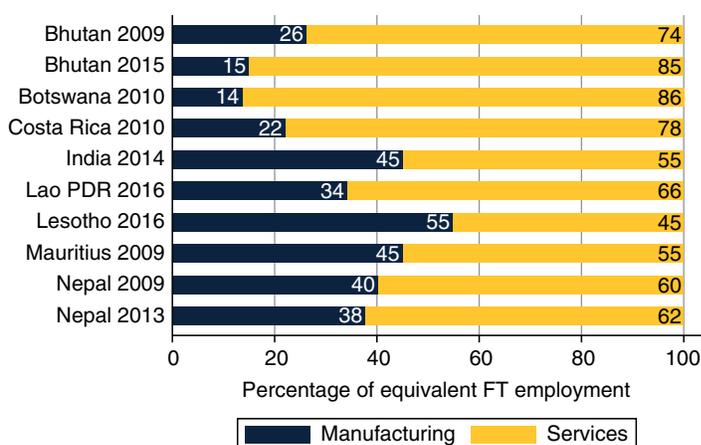


Figure 2: Share of Nonagricultural Private Employment  
Source: WBES. Unless otherwise indicated, the source of all tables and figures is the 2015 WBES.

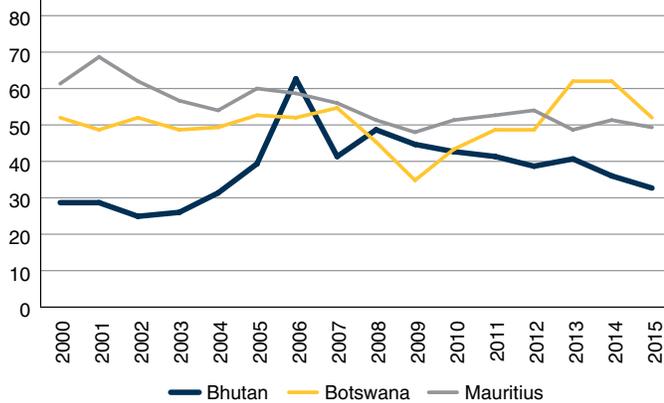
account for 85 percent of nonagricultural private-sector employment, a figure that is higher than other small geographically isolated economies (Figure 2).

### 1.2.3 EXTERNAL SECTOR

**Bhutan’s exports are concentrated, relatively unsophisticated, and are declining in real terms.**

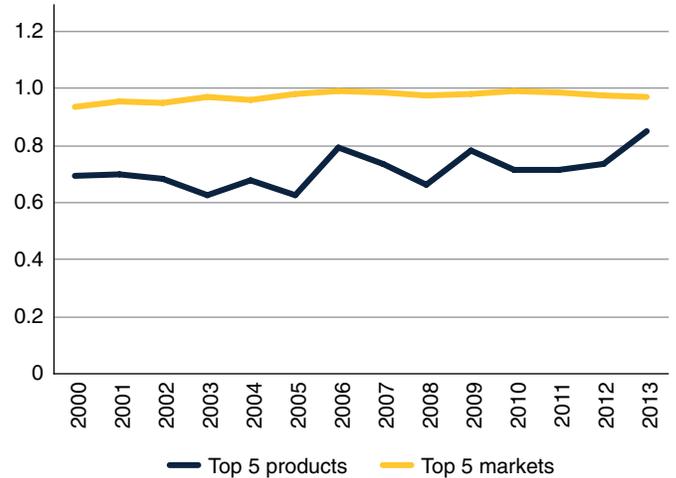
As a share of GDP, Bhutan’s exports of goods and services have steadily declined since 2008 and are below those of other small economies such as Botswana and Mauritius (Figure 3-A). In real terms, the total value of exports is less than in 2007. Bhutan’s exports and export markets are highly concentrated, with electricity and ferrosilicon accounting for 34 percent and 20 percent, respectively, of exports in 2014. Most exports go to India and, to a lesser extent, to Bangladesh (Figure 3-B). The sophistication of Bhutan’s exports, as measured by the weighted average of importers’ income levels, is also low, falling below that of all other South Asian countries (Figure 3-C). With the expansion of tourism, exports of travel and transportation services grew rapidly between 2009 and 2013 (Figure 3-D). As of 2014, however, Bhutan’s top five export products were: electricity (34 percent), ferrosilicon (20 percent), semifinished iron products (5 percent), cement (5 percent), and cardamom (3 percent).

A. Exports of Goods and Services as Share of GDP (%)



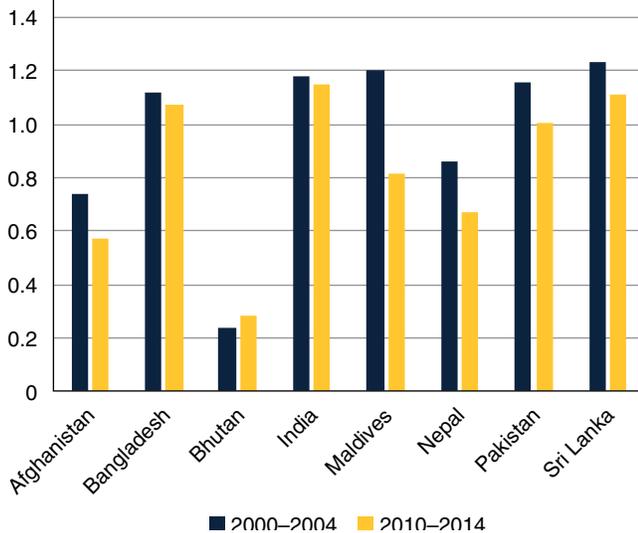
Source: World Development Indicators.

B. Share of Top 5 Products and Markets in Total Exports



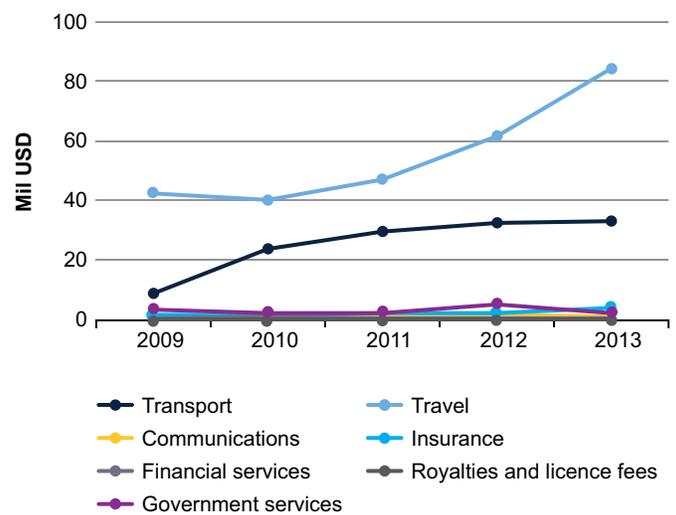
Source: Replotted based on Lopez-Acevedo et al. 2016 and COMTRADE data.

C. Normalized Weighted Average of Income of Importers



Source: Lopez-Acevedo et al. 2016 (based on COMTRADE data).

D. Services Exports: 2009-2013

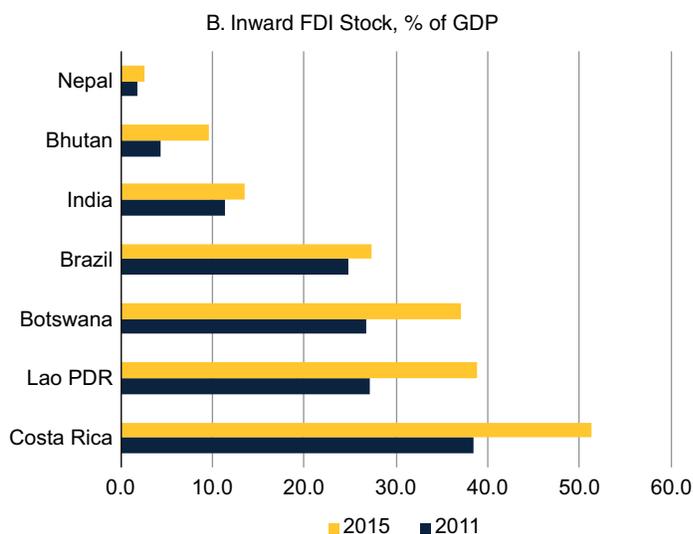
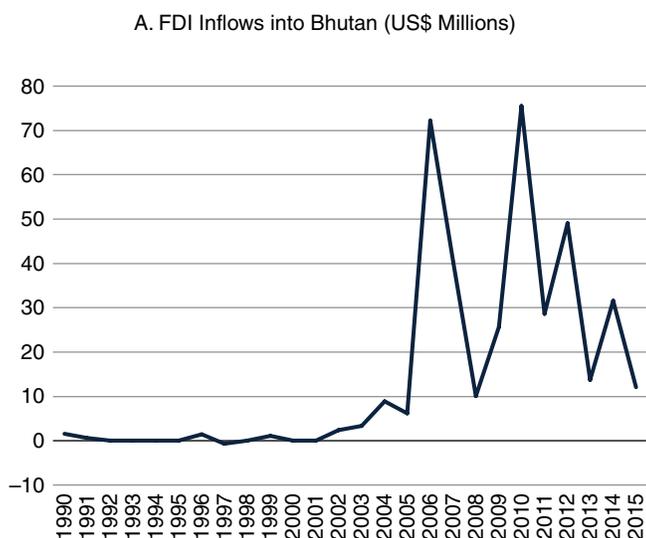


Source: UNCTAD.

Figure 3: Export Indicators

**Inflows of FDI have increased since 2005, but are low relative to comparator countries.** Bhutan received negligible FDI prior to 2005. Since then, FDI inflows have been volatile, but higher overall (Figure 4). The net inward stock of FDI in Bhutan rose from 4.3 percent in 2011 to 9.7 percent in 2015, although the

stock remains well below the South Asian average and levels exhibited by other small resource-based economies such as Lao PDR and Botswana. FDI inflows are heavily concentrated in the hotel sector and among regional investors.



Source: UNCTAD World Investment Report 2016 data.

Source: UNCTAD World Investment Report 2016 data.

Figure 4: Foreign Direct Investment

### 1.2.4 STATE-OWNED ENTERPRISES<sup>3</sup>

**Druk Holdings and Investments (DHI) was created in 2007 to oversee the operations of government-linked companies (GLCs), which have been critical to diversifying the economy.** Due to Bhutan’s small domestic market, sparse population, and high transportation costs, the risks associated with private investment are higher than for most other countries. For this reason, public investment in commercially oriented GLCs—that is, commercial ventures with full or partial public ownership—has been critical to diversifying the Bhutanese economy and stimulating several high value-added industries, including hydropower and information technology.

**Although autonomous, DHI maintains strong links with the Ministry of Finance.** Under the terms of the Royal Charter establishing DHI, the company assumed ownership of all shares of GLCs and the responsibility for implementing “commercially oriented projects . . . developed by the government.” Although the Royal Charter describes DHI as an “autonomous” entity, there are strong

operational links between DHI and RGoB. The Royal Charter directs the Ministry of Finance to support GLCs in the form of subsidies for “social functions,” sovereign guarantees, on-lending, and additional financing, as well as facilitating bilateral and multilateral negotiations and considering “policy feedback provided by DHI.” DHI, in turn, provides dividends to the Ministry of Finance at an amount agreed annually and consults with the Ministry of Finance about “investments, divestments and the issuance of securities.” The Board of Directors of DHI are appointed by RGoB representatives, with the chairperson appointed by His Majesty the King.

**DHI’s investments encompass a broad range of sectors and forms of ownership.** To avoid competing with the private sector, DHI is expected to focus on ventures with long gestation periods and/or low returns and strategic investments with high risk, while divesting shares in companies in which the private sector can assume a greater role. However, between 2009 and 2015, DHI’s assets more than tripled, growing from Nu 51 billion to Nu 154 billion. Currently, DHI has shares in 20 different companies operating in the manufacturing, energy, natural resources, financial services, communication, aviation, trading, and real estate sectors (Figure 5). Of

3. This section draws from the following sources: DHI 2017; Lam-sang 2016; and DHI 2011.



Figure 5: Government-Linked Companies with DHI Equity  
 Source: DHI Annual Report 2016.

the 20 GLCs, 11 are fully owned by DHI, three are controlled by DHI, and DHI holds stakes below 51 percent in the remaining six.

**DHI has introduced reforms to improve the performance of GLCs.** For the GLCs it oversees, DHI is mandated to appoint board members and CEOs based on merit; provide a common platform for technologies, procurement, and human resource development; and extend capital through borrowing and issuance of debt, equity, or other securities. DHI has instituted system-based management in GLCs and provided associated training. Senior

management of GLCs are now competitively selected and thereafter put on short-term, performance-based contracts, with employees eligible to an additional 15 percent allowance above civil service pay subject to meeting individual and group targets. The Bank of Bhutan and the Bhutan Power Corporation have reportedly reaped substantial benefits from these changes, with profits of the former rising from Nu 183 million in 2007 to Nu 865 million in 2014 and profits of the latter rising from Nu 455 million in 2007 to Nu 1.3 billion in 2015. Overall, DHI's profits have risen from Nu 4.8 billion in 2008 to Nu 10.8 billion in 2015.

## 1.3 ENTERPRISE SECTOR PROFILE

**Bhutan’s private sector is dominated by micro-enterprises and dependent upon intermediaries to reach external markets.** Bhutan’s private sector consists overwhelmingly of microenterprises with a sole proprietor and focuses on services such as tourism (Subsection 1.3.1). While the service sector has rapidly generated new firms, the economy is creating relatively few new manufacturing firms or corporations (Subsection 1.3.2). Bhutanese firms are productive relative to those in comparator countries, but this performance is strongly driven by non-tradable sectors (Subsection 1.3.3). While few Bhutanese firms export directly, a comparatively high proportion of firms export indirectly by using middlemen (Subsection 1.3.4).

### 1.3.1 FIRM CHARACTERISTICS

**Most of Bhutan’s 28,000 existing businesses are small and engage in service activities.**<sup>4</sup> Data from the 2015 WBES provides for a snapshot of firms in Bhutan (Figure 6). Nonagricultural businesses are concentrated in services such as tourism (29 percent) and construction, retail, wholesale, and other activities (62 percent) and are mostly located in Thimphu and Paro. A large majority of firms are micro (75 percent) or small (16 percent) and overwhelmingly consist of a sole proprietor (92 percent), with a mere 2 percent of firms operating under

4. Bhutan maintains differing licensing schemes to provide smaller firms with simplified registration processes and better financial incentives. However, as licensing and other industrial statistics are managed in isolation by different line departments at MoEA (see Annex 2), information on firms is poorly consolidated and firm status is not monitored beyond initial entry. As a result, a lack of accurate data undermines Bhutan’s ability to monitor the private sector.

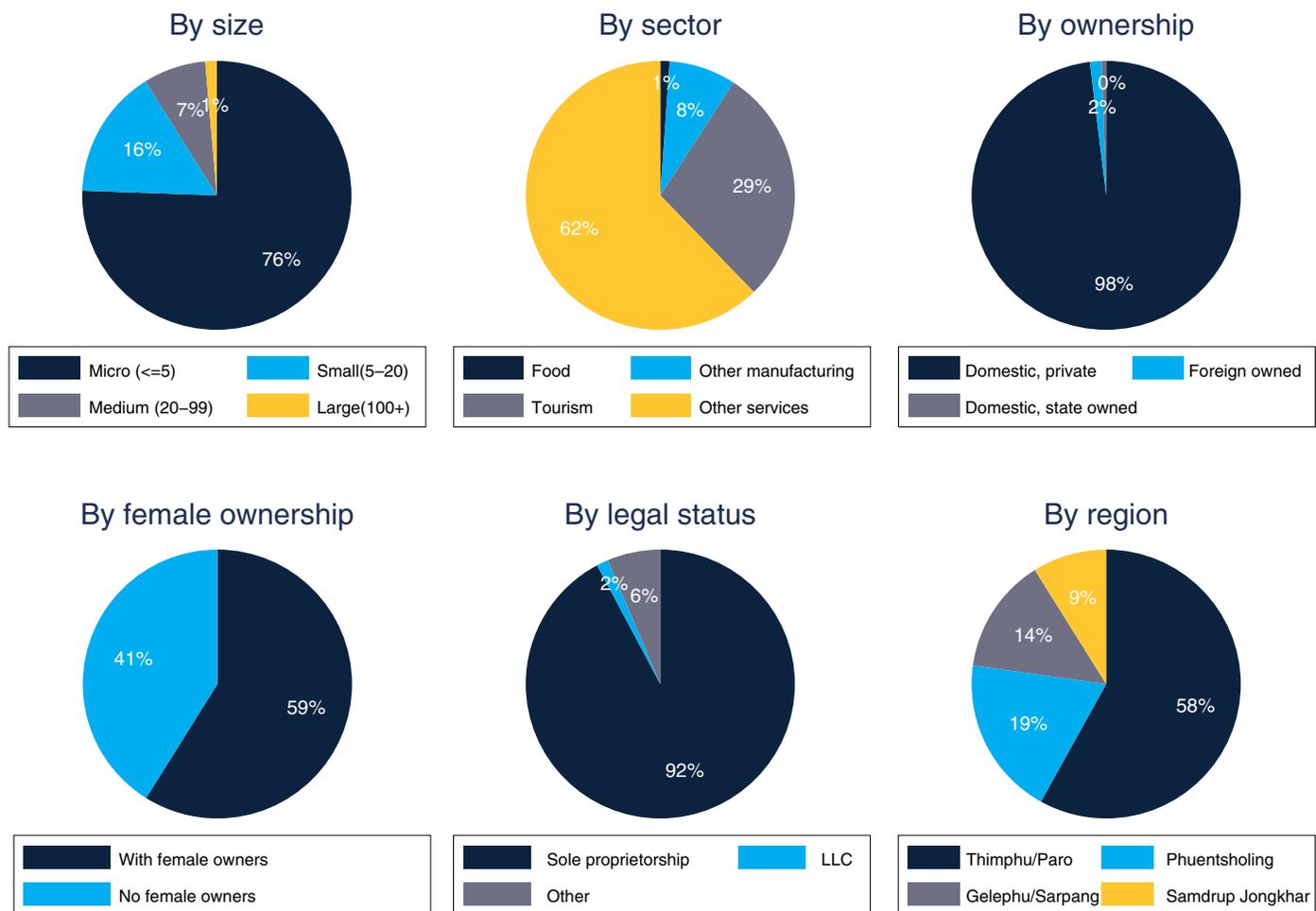


Figure 6: Characteristics of Private-Sector Firms

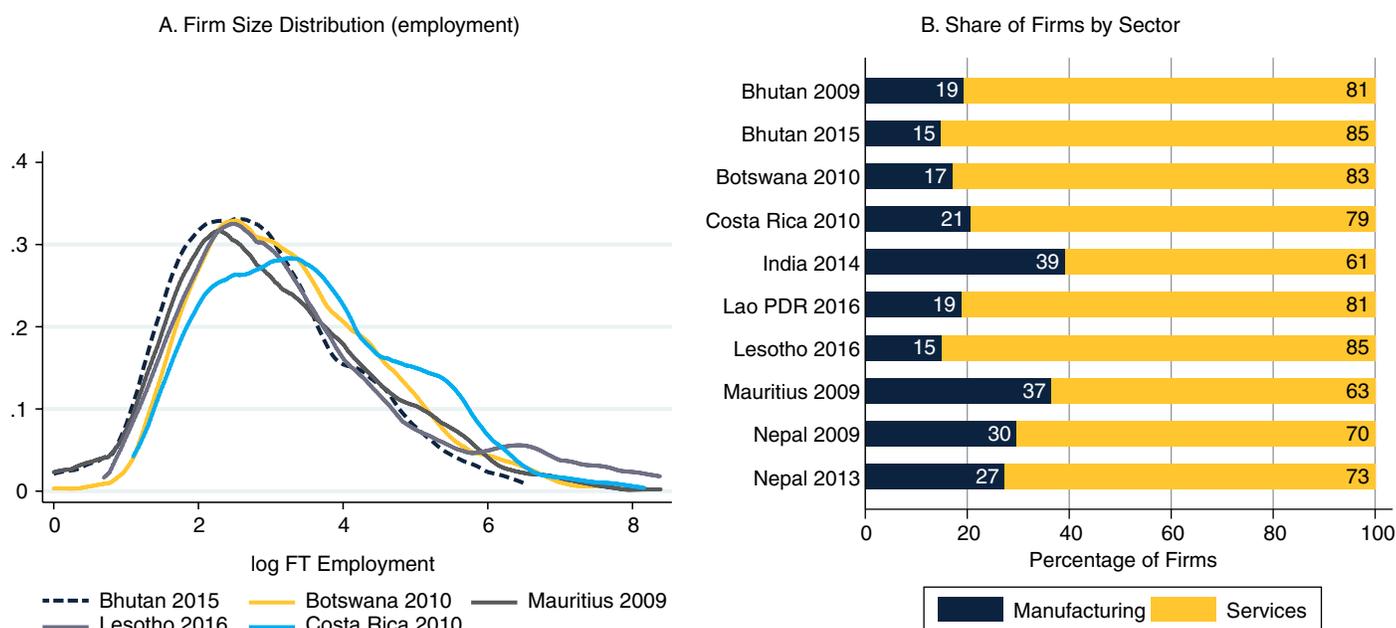


Figure 7: Size and Sectoral Distribution of Firms of Small Geographically Isolated Economies

Note: Employment is measured as number of equivalent full-time workers.

a limited liability regime. Few firms have foreign ownership (2 percent). Around 40 percent of firms have some female ownership, which is much higher than the South Asian average (18 percent). The small size and service-orientation of Bhutanese firms is distinctive, even among small geographically isolated economies (Figure 7).

### 1.3.2 DYNAMICS

**Small service-sector firms are being created rapidly, although Bhutan lags its peers in the creation of corporations.** Bhutan has a higher share of newly created (“young”) firms than other small geographically isolated countries (Table 3).<sup>5</sup> WBES data indicate that the rate of increase rose between 2009 and 2015, which is consistent with the increase in business registrations reported by Bhutan’s National Statistics Bureau. The growth in new businesses has been driven by services, with no change in manufacturing and a decline in entry in construction (Figure 8). New businesses are overwhelmingly sole proprietorships and the average entry of

TABLE 3: SHARE OF NEW AND YOUNG FIRMS

	Young (1–4 Years)	Avg. Size at Entry	Median Size at Entry
Bhutan 2009	19.0%	11.7	5
Bhutan 2015	24.6%	10.7	5
Botswana 2010	5.0%	16.9	6
Costa Rica 2010	5.8%	11.4	5
India 2014	10.4%	24.4	12
Lao PDR 2016	5.3%	9.4	5
Lesotho 2016	0.4%	34	6
Mauritius 2009	31.8%	9.8	4
Nepal 2013	5.2%	7.9	5

LLCs between 2009 and 2014 was low relative to other countries, even after accounting for Bhutan’s population and income. For firms that survived from 2012 to 2015, more than 60 percent added jobs, a higher share than all comparator countries (Figure 8-B).<sup>6</sup> While smaller firms grow faster, large firms created almost half of new jobs between 2012 and 2014.

5. While the WBES is cross-sectional and has limited information on business dynamics, information on firm characteristics at entry enables the construction of two measures: (i) entry by limited liability companies through the entrepreneurship database, and (ii) entry of licensed businesses as recorded by MoEA.

6. As young firms grow faster in general (Li and Rama 2015), this may be because Bhutanese firms are younger on average than firms in peer countries.

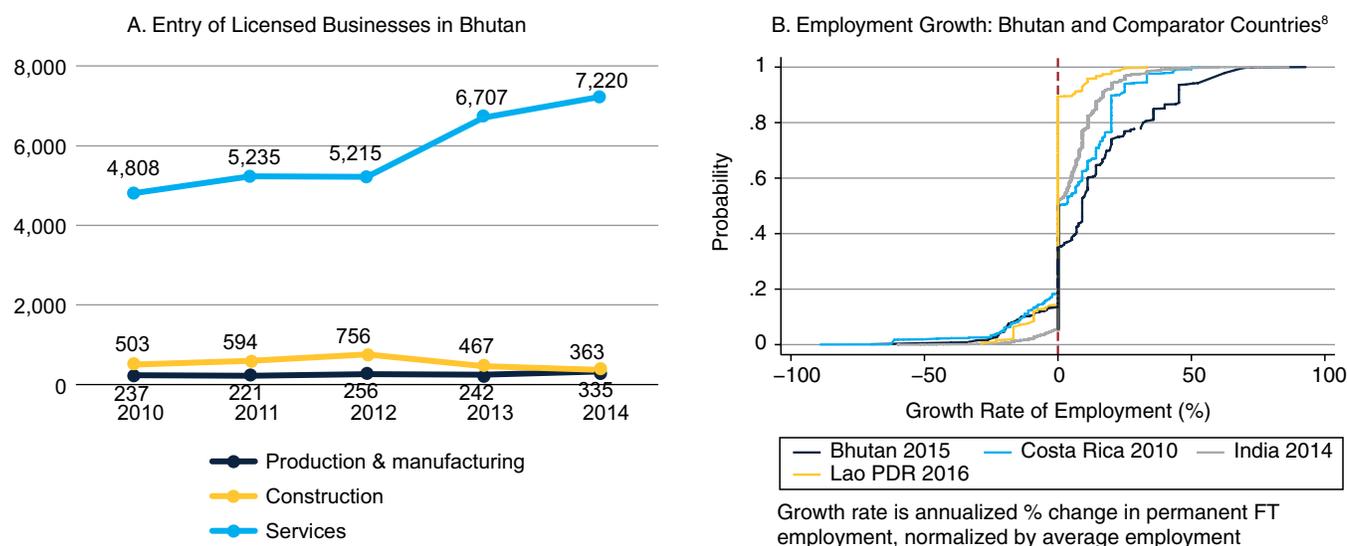


Figure 8: Business Entry and Employment Growth

Source: Bhutan National Bureau of Statistics, *Statistical Yearbook* (2015) (new licenses recorded by MoEA).

TABLE 4: GROWTH OF FIRMS, 2012–14

	Avg. Employ. Growth 2012–14	Avg. Sales Growth 2012–14	Contr. to Emp. Growth 2012–14*
Micro (<=5)	2.12	2.88	11%
Small (5–20)	13.15	14.99	14%
Medium (20–99)	10.44	8.39	15%
Large (100+)	3.76	2.71	46%
Food	5.63	13.16	1%
Other Mfg.	0.98	7.74	8%
Tourism	2.78	4.12	27%
Other Services	6.92	5.79	64%
<b>All firms</b>	<b>4.99</b>	<b>5.50</b>	

\*Growth is calculated as the annualized growth rate of FT permanent employment, normalized by average employment. Source: World Bank, MoHLR (2016a). Aggregate employment growth is only calculated for businesses that *existed* and *survived* between 2012 and 2015.

### 1.3.3 LABOR PRODUCTIVITY

**Bhutanese firms are relatively productive (Figure 9).**<sup>7</sup> The median value added per worker in Bhutan accords with the country's income level and is significantly higher than that observed elsewhere in the region. Between 2009 and 2015, estimated median productivity almost doubled, rising from US\$5,700 per worker to more

than US\$10,000 per worker. Moreover, not only is the median business in Bhutan more productive: businesses in the top quartile of the distribution in Bhutan exhibit relatively higher labor productivity than their regional peers.

#### **Manufacturing firms, however, are relatively unproductive compared to service sector firms.**

The median labor productivity of manufacturing firms in 2015, at US\$1,500 per worker, is lower than all other peer countries except for Nepal. Between 2009 and 2015, the median labor productivity in Bhutan's manufacturing sector decreased by around 50 percent. In contrast, the median firm in the services sector has doubled labor productivity (Figure 10).<sup>9</sup> In relative terms, the productivity gaps between manufacturing and service sectors in Bhutan are larger than in all comparator countries.<sup>10</sup>

8. To account for firm size, growth is calculated as the annualized growth rate of full-time permanent employment, normalized by average employment. Since employment information from two years ago is only available for permanent full-time employees, this growth rate ignores temporary employment.

9. Differences in labor productivity across countries and over time should be interpreted with caution as they may reflect changes in the sample or in industrial composition. Nevertheless, quartile regressions on the full sample and panel firms in Bhutan show that the increase in median productivity between 2009 and 2015 is statistically significant, driven by services.

10. Such large productivity gaps may indicate barriers to entry, inefficient labor or financial markets, and/or difficulties in transferring skills across sectors.

7. See Annex 3.1 for an explanation of the methodology.

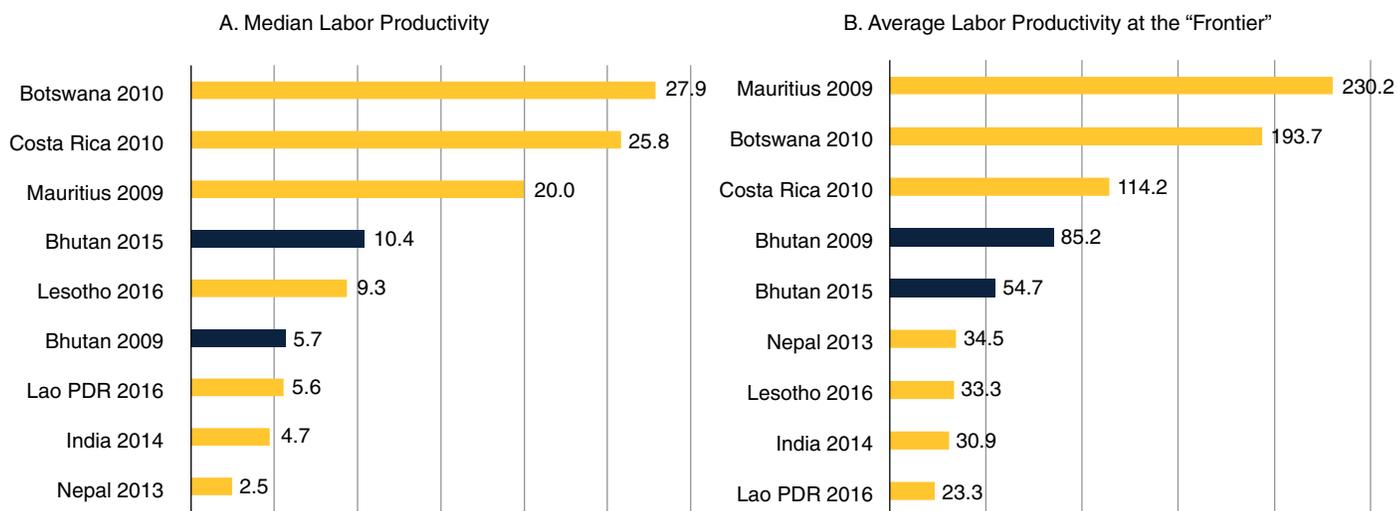


Figure 9: Labor Productivity (value added per worker)

Note: "Frontier" is defined as between 75th and 99th percentiles. Labor productivity is measured as value added per equivalent FT worker, in thousand US\$, 2010 prices. Prices are deflated using the CPI.

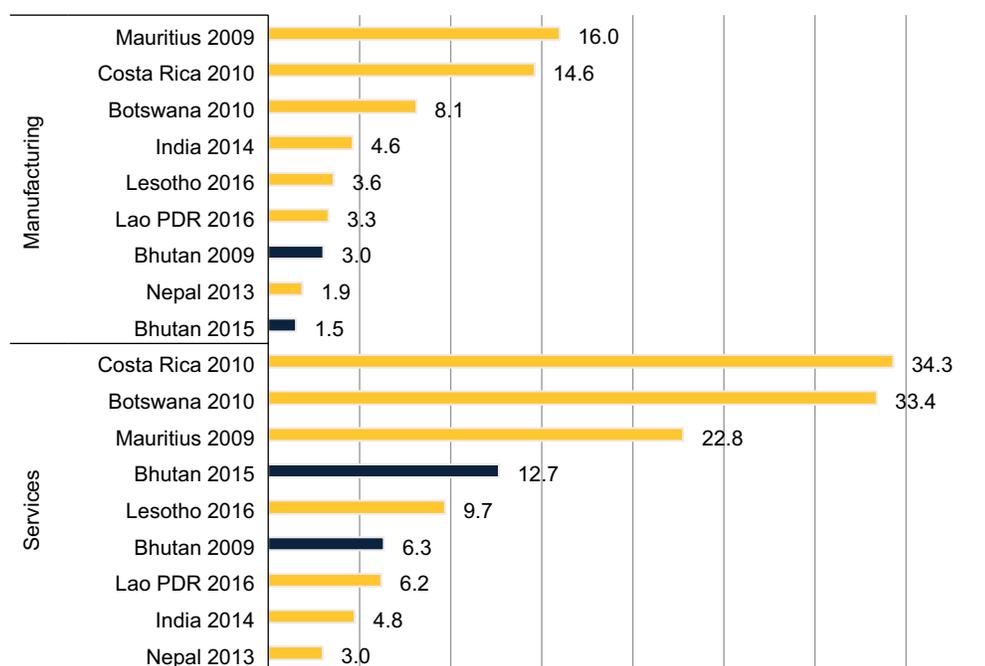


Figure 10: Median Labor Productivity by Sector (value added per worker)

Note: "Services" refer to construction, wholesale and retail, hotel and restaurants, transport, and other service activities (ISIC Rev. 3 sectors 45–99).

**Non-tradable service activities experienced the highest gain in value added per worker, which was likely driven by domestic consumption.** Within the manufacturing and service sectors, large variations exist in both the levels and growth of labor productivity across

different activities (Table 16; Annex 3.1). Across services, construction, wholesale, and retail are by far the most productive and have grown the fastest since 2009. Tourism-related activities, including travel agency services and land transport, have also grown significantly.

The entire tourism industry, however, remains less productive than other non-tradable service activities. High labor productivity of non-tradable industries might reflect changes in demand rather than improvements in efficiency alone.<sup>11</sup>

### 1.3.4 EXPORT ORIENTATION

**Although very few Bhutanese firms export directly, the share of indirect exporters is comparatively high.** In 2015, only 3.4 percent of Bhutanese firms directly exported goods or services, which is lower than

all other comparator countries except Lao PDR (Table 5). The proportion of firms directly exporting in 2015 was less than half the level observed in 2009 due to a reduction in export-orientation among manufacturing firms.<sup>12</sup> As with most other countries, manufacturing exporters are larger on average (Table 6), while exporting firms in manufacturing are more productive and more capital-intensive. Interestingly, 15 percent of Bhutanese firms indirectly export,<sup>13</sup> which is higher than most comparator countries. As noted in the 2012 Diagnostic Trade and Integration Study (Bhutan MoEA 2012), exports of goods

TABLE 5: FIRM'S LINKAGES TO EXTERNAL MARKETS

	Exports Directly	Exports Directly (Mfg.)	Exports Directly (Services)	Exports Indirectly	Imports Inputs (Mfg.)	Has Quality Certification
Bhutan 2009	7.8%	33.5%	1.2%	1.3%	74.7%	6.0%
Bhutan 2015	3.4%	10.3%	2.1%	14.5%	53.7%	4.4%
Botswana 2010	7.0%	12.2%	6.1%	4.6%	85.7%	22.3%
Costa Rica 2010	9.3%	27.4%	4.6%	7.6%	79.4%	15.6%
India 2014	7.8%	13.3%	4.1%	3.1%	17.8%	28.1%
Lao PDR 2016	2.9%	9.8%	1.2%	5.0%	14.7%	1.6%
Lesotho 2016	9.8%	31.4%	6.5%	12.8%	71.8%	2.5%
Mauritius 2009	9.0%	19.0%	3.4%	7.0%	65.3%	11.6%
Nepal 2013	4.3%	5.7%	3.1%	4.1%	51.5%	8.4%

TABLE 6: AVERAGE FIRM PERFORMANCE, BY EXPORT STATUS

	Manufacturing		Services	
	Nonexporter	Exporter	Nonexporter	Exporter
Employment	12.8	90.5	7.2	66.5
Value Added per Worker (\$US)	2,307	8,393	9,711	7,888
Capital per Worker (\$US)	3,434	17,194		

*Note:* Due to small sample size of exporters, these estimates are imprecise and should be interpreted with caution.

11. Inflows associated with hydropower projects increased domestic demand for goods and services, which would increase prices in the non-tradable service sector more than in tradable sectors. Data prior to 2015 indicate that prices for most service activities increased faster than for manufacturing goods (see Figure 28 and Figure 29 in Annex 3.2). Similarly, tax return data in 2013 suggest that ROI is highest in trade (112 percent) and other services sectors (44 percent), whereas it is low in manufacturing (16 percent).

12. The share of exporters declined by 50 percent among small, medium, and large firms, suggesting sample composition alone is not driving this decline. While the decline in the share of exporting firms in manufacturing might be driven by changes in sample composition between 2009 and 2015, the low share of manufacturing firms that export is consistent with low labor productivity in the sector.

13. The WBES defines indirect exporters as those who sell goods to an agent who exports the product without modifications. Direct exports are the sale of goods to an immediate recipient abroad.

such as potatoes, apples, mandarins, and cardamoms are controlled by Indian middlemen. Such arrangements reflect the difficulty of overcoming fixed costs for exporting from Bhutan, but also suggest that there exists an unmet demand that firms can exploit once they improve efficiency along their value chains.

## 1.4 PROFILES OF KEY SECTORS

**Bhutan's economic performance is linked to the success of a small number of sectors.**<sup>14</sup> Hydropower currently generates more foreign exchange and public revenue than any other segment, although more could potentially be done to encourage positive spillovers to other sectors (Subsection 1.4.1). Tourism has also developed into a key source of foreign exchange, but the changing composition and spending patterns of tourists are threatening the sustainability of the industry (Subsection 1.4.2). In contrast to hydropower and tourism, ICT and agribusiness are emerging sectors with strong growth potential. ICT, currently concentrated in the Thimphu Techpark, can potentially leverage Bhutan's abundant supply of electricity, English-speaking population, and civil stability to attract investments (Subsection 1.4.3). Agriculture in Bhutan has historically exhibited low productivity, although exports of niche products are increasing and new marketing initiatives can potentially exact a premium for Bhutanese products and boost incomes of rural households (Subsection 1.4.5).

14. Due to Bhutan's natural advantages in mineral deposits and cheap power, mining has been identified as one of the five jewels of the economy by the RGoB (ACC 2016). However, the sector remains significantly underdeveloped. The mining sector contributes significantly to exports but its contribution to GDP and employment is negligible (3% and 1%, respectively, in 2015, Bhutan National Bureau of Statistics 2016). Currently, the most immediate impediment to the sector's development is a weak governance framework, exacerbating environmental concerns endemic to mining activities (ACC 2016). This lack of clear policies, knowledge, and distribution of property rights (land leases) causes significant uncertainty, potentially discouraging investments in mining and mineral processing given the capital-intensive nature of such investments. Beyond the regulatory framework, Bhutan will need to develop a highly skilled labor force to engage in higher value-added activities, to offset the geographical disadvantages that raise the cost of both exports and imported inputs for the sector.

### 1.4.1 HYDROPOWER<sup>15</sup>

**While India has historically provided technical and financial assistance to develop Bhutan's hydropower industry, recent projects have leveraged joint ventures and public-private partnerships.**

Bhutan has the potential to generate an estimated 23,760 megawatts (MW) of hydroelectric power, but at peak times consumes only 300 MW (Premkumar 2016). With economic and population growth creating a shortage of electricity in India, the RGoB and the Government of India (GoI) agreed in 1974 to jointly construct Bhutan's first major hydroelectric plant, Chukha, which was commissioned in 1988. In 1994 and 1996, the GoI agreed to finance the construction of two additional plants: Kuri-chu, commissioned in 2002, and Tala, commissioned in 2007. More recently, two smaller plants—Basochhu I and II, commissioned in 2001 and 2005—were jointly financed by the Austrian government. Bhutan's first PPP-financed plant—Dagachhu, of which India's Tata Power has a 26 percent equity stake—was commissioned in 2015 and features a 25-year sales agreement with India's Tata Power Trading Company (ADB 2014).

**In 2006, Bhutan and India agreed to jointly develop ten additional projects, although it is unclear whether the targeted capacity will be attained.**

In 2006, GoI and RGoB agreed to an ambitious plan to develop an additional 10,000 MW of hydropower by 2020. The first three projects—Punatsangchhu I and II and Mangdechhu—are due to be commissioned in the next two years. The financing of an additional four projects—to be operated as joint ventures by the Druk Green Power Cooperation and Indian public sector companies—was approved by the GoI in 2014 (SANDRP 2016). While construction has commenced on one of these projects, media reports have speculated that—given slow progress in planning for the other six projects—Bhutan may only achieve 3,000 MW in generation capacity by 2020 (Premkumar 2016). Currently, the country has an installed hydropower capacity of 1,606 MW, although this will increase by 3,658 MW with the completion of the five plants under construction.

15. This section draws from the following sources: Bhutan, MoWHS 2012 and Premkumar 2016.

TABLE 7: MAJOR HYDROELECTRIC PROJECTS IN BHUTAN

Project	MW	Comm.	Orig. Cost (Mil. USD)	Final Cost (Mil. USD)	Funding Source	Project Model	Grant/ Loan		Status
							Ratio	Loan Interest	
Chukha	336	1988	\$13	\$38	GoI (1974)	IG	60:40:00	5	Completed
Kurichhu	60	2002	\$50	\$88	GoI (1994)	IG	60:40:00	10.75	Completed
Basochhu I	24	2001	\$23	\$22	Austria	JV	—	6	Completed
Basochhu II	40	2005	\$22	\$28	Austria	JV	—	6	Completed
Tala	1,020	2007	\$217	\$630	GoI (1996)	IG	60:40:00	9	Completed
Dagachhu	126	2015	\$127	\$201	Various	PPP	—	9	Completed
Punatsangchhu I	1,200	2019*	\$528	\$1,458*	GoI (2007)	IG	40:60	10	Construction
Punatsangchhu II	1,020	2018*	\$586	\$1,154*	GoI (2010)	IG	30:70	10	Construction
Mangdechhu	720	2018*	\$449	\$698*	GoI (2010)	IG	30:70	10	Construction
Kholongchhu	600	2019*	\$628	—	GoI (2014)	JV	30:70	—	Construction
Nikacchu	118	2019*	\$198	—	Various	PPP	—	—	Construction
Wangchhu	570	2019*	\$994	—	GoI (2014)	JV	—	—	Planning
Bunakha	180	2020*	\$455	—	GoI (2014)	JV	—	—	Planning
Chamkharchhu	770	2020*	N/A	—	GoI (2014)	JV	—	—	Planning
Sunkosh Res.	2,560	2020*	\$1,495	—	GoI (TBD)	IG	—	—	Planning
Kuri-Gongri	2,640	2020*	\$3,083	—	GoI (TBD)	IG	—	—	Planning
Amochhu	540	2020*	N/A	—	GoI (TBD)	IG	—	—	Planning
Komachhu	336	2030*	\$474	—	TBD	PPP	—	—	Planning
Rotpashong	1,230	2030*	\$1,686	—	TBD	PPP	—	—	Planning
BinduKhola	13	2020*	N/A	—	TBD	TBD	—	—	Planning
Sunkosh LB	35	2020*	N/A	—	GoI (TBD)	IG	—	—	Planning

\*Denotes estimate.

Source: Premkumar 2016; ADB 2014.

**The export of hydroelectricity to India has provided Bhutan with an unparalleled infusion of public revenue and foreign exchange.** Currently, around 70 percent of Bhutan’s installed hydropower capacity is exported to India (ADB 2014). In 2015, hydroelectricity comprised 34 percent of exports and, as of 2014, contributed 40 percent of public revenue. Economic growth has boomed as a result, while the construction activity associated with both hydroelectric facilities and public investments has driven poverty reduction (World Bank 2014, Bhutan MoF and World Bank Group 2016).

**The growth of Bhutan’s hydropower sector has, however, not come without financial, economic, and environmental costs and risks.** Costs related to hydropower now constitute approximately two-thirds of

Bhutan’s external debt, which stood at 99 percent of GDP at the end of 2015 (Bhutan MoF and World Bank Group 2016). The dominance of hydropower exports as a source of foreign exchange also raises the specter of “Dutch Disease”—that is, the competitiveness of other industries is undermined by the increased competition for resources (such as labor and materials) with the hydropower sector. Currently, imports for hydropower construction constitute half of the country’s current account deficit, which stood at 26 percent in December 2016 (Bhutan, MoF and World Bank Group 2016). Moreover, the inherent volatility in hydropower generation—which is likely to increase as climate change affects winter snowfalls and the flow of glacier-fed rivers—could result in large fluctuations in government revenue and expenditure if not properly managed.

## 1.4.2 TOURISM

**Policies relating to tourism have sought to generate revenue while minimizing cultural and environmental impacts.** Since it opened its borders to international visitors in 1974, Bhutan has maintained a unique focus on “high-value, low-impact” tourism. For all foreign tourists originating from countries other than India, Bangladesh, and the Maldives (the so-called “regional market”), Bhutan applies the minimum daily package policy (MDPP). The policy requires tourists to travel on prepaid, fully guided, all-inclusive package tours and to stay in accommodations that are at least of a “3-star” standard.<sup>16</sup> It also requires that a sustainable development fee (SDF) (currently \$65 per person per day)<sup>17</sup> be paid to RGoB. The MDPP is \$250 per day during the “high season” and \$200 per day at other times of the year.<sup>18</sup> As of 2015, the sector generated an estimated \$280 million in revenues or more than 20 percent of non-hydro export income.

**The volume and profile of tourists has changed in recent years, resulting in shifts in stay and spending patterns.** Between 2009 and 2014, the number of tourists visiting Bhutan rose dramatically from 23,500 to more than 130,000. The growth was driven not by the high spending North American market that has historically dominated arrivals, but in large part by tourists from China and India,<sup>19</sup> the latter of which now accounts for more than half of all foreign visitor arrivals. As western tourists stay longer and spend more per day than Asian visitors, these changes have reduced average revenues per tourist.

16. Accommodations above this standard generally attract a premium above the MDPP.

17. Persons traveling alone must pay a surcharge of \$40 per day, while those traveling in groups of two or more people must pay a surcharge of \$30 per day. Discounts are applied to children, full-time students, and those visiting Bhutan for more than eight nights.

18. The high season runs from March through May and from September through November.

19. The number of tourists from Canada and the United States has declined over the past five years. Arrivals from China almost doubled between 2013 and 2015, and arrivals from regional markets, which are not subject to the MDPP, grew by 66 percent in the year ending September 2015. Royalty paying visitors grew from 7,000 in 2001 to 68,000 in 2014.

**Flows are temporally and geographically concentrated and dominated by older demographic groups.** Currently, 87 percent of bed nights occupied by tourists occur in Paro, Thimphu, Punakha, or Bumthang, while the country’s other 16 districts each account for less than one percent of occupied bed nights. Visits to Bhutan occur much less frequently during summer and winter, with more than 70 percent of occupied bed nights generated over a five-month period. Historically, most tourists have been over 55 years of age, and this characteristic has not changed with the increase in tourist volumes. Currently, persons under 45 years of age comprise only 27 percent of tourists visiting Bhutan.

**The concentration of tourist flows reduces the value proposition of tourism for the country and for the tourists themselves.** The concentration of increasing volumes of tourist traffic in a short season and within a limited geographic area negatively impacts Bhutan’s environment and religious and cultural heritage and, in the process, adversely impacts the value proposition for higher spending visitors.<sup>20</sup> The seasonality of flows reduces the consistency of revenues and decreases the volume of employment associated with the tourist industry, while the geographic concentration of flows deprives the poorest areas of the country of the economic benefits of tourism and results in an extremely limited tourism product, which provides little incentive for visitors to make subsequent trips to Bhutan.

**Satisfaction of visitors with Bhutan’s tourism services is low, and very few tourists make return visits to the country.** Only 17 percent of non-regional respondents to the 2014 Bhutan Visitor Survey strongly agreed that “*Bhutan offers good value for money*” and, in most Asian and Western European markets, satisfaction was less than 10 percent. Of the visitors reporting the least satisfaction, the greatest number were on packages with three-star hotel accommodations and food offerings. Likewise, while visitors were generally satisfied with the quality of their tour guides, they expressed lower levels

20. According to tour operators, site managers, religious bodies, and government officials, the rapid growth of the low-spending regional market is creating significant challenges in terms of visitor safety and effective management of cultural heritage and religious sites.

of satisfaction with the quality of food and accommodations. Reports from key informants indicate that many tourists become “Dzonged out” and express a desire for immersive cultural experiences, current offerings of which are very limited.

**The concentration of flows is caused by factors that can potentially be adjusted by policy reforms, investments, and changes in operator behavior.** The seasonal pattern of tourism in Bhutan runs counter to travel patterns in major source markets and is not caused by climate or other structural factors. Promotion by tour operators is minimal during the “lean season,” which may be partially due to the change in the MDPP during these periods.<sup>21</sup> The geographic concentration of tourist flows along the country’s “Western Circuit” is driven both by path dependence and by a lack of access, the latter of which is being addressed by investments in road and air links. The demographic concentration of tourist flows appears to be driven by the lack of products and itineraries attractive to a broader variety of markets, such as families and youth (e.g., adventure tourism, immersive experiences, and so on).

**The management of Bhutan’s tourist industry is characterized by an apex body and three private-sector organizations.** The Tourism Council of Bhutan (TCB), a semi-autonomous government agency that reports to the prime minister, is the “Apex Tourism Body” and is responsible for setting and implementing all tourism-related government activities. However, a variety of other ministries and agencies set policies and make investments that directly impact the tourism sector, and there is a lack of intragovernmental communication and cohesion. The private sector is represented by three large but relatively young associations of tour operators, hotels and restaurants, and guides. However, these associations function primarily as lobbying entities and do not

21. “Tour operators selling packages at or near the minimum daily price have . . . significantly reduced margins to work with (\$135 per visitor per day vs. \$185),” thereby rendering “these lower package prices . . . significantly less profitable than high season bookings.”

undertake functions such as member education, certification, data collection, market research, marketing, strategic planning, and dispute resolution.

### 1.4.3 INFORMATION AND COMMUNICATIONS TECHNOLOGY

**The Thimphu Techpark has served as the main vehicle for creating an externally focused ICT sector in Bhutan.** Bhutan, which was without television until 1999 and is renowned as a rustic, remote, and largely unconnected Shangri-La, strikes many as an unlikely candidate for a tech hub. Accordingly, the Thimphu TechPark, a 50,000 square foot facility that opened in May 2012 as a partnership between the government and the private sector, has been controversial (Thimphu TechPark 2017). Backers of the park argued that Bhutan’s civil stability, its cheap and abundant electricity—a key business constraint elsewhere in South Asia—and its well-educated, tech-savvy, and English-speaking young workforce would present an attractive proposition for investors (United Nations Department of Economic and Social Affairs 2016). Skeptics argued that, with Bhutan’s tiny domestic market and reputation for Luddism, the notion of a Bhutanese ICT industry was pure fantasy (Bhutan Broadcasting Service 2013; M. Dorji 2013).

**The Techpark struggled to attract clients—and investors—in its initial years.** Major multinational companies that had previously expressed interest backed out, while local companies complained that the park did not suit their needs and rebuffed invitations to relocate (T. Dorji 2016). By January 2013, the first and second floors of the facility were still vacant (Bhutan Broadcasting Service 2013), and, with the park’s chief operating officer noting that the park was facing “cash flow challenges” due to a lack of rental income, the project was derided as a “white elephant” (M. Dorji 2013). In October 2014, Singapore’s Assetz Property Group—which had partnered with Druk Holdings and Investments to develop, build, finance, own, and operate the park and had held 74 percent of Thimphu TechPark Pvt. Ltd.—exited the arrangement, leaving RGoB’s commercial arm as the sole shareholder.

**The Techpark is now growing, attracting corporations from around the world.** Two U.S.-registered companies—ScanCafe, which specializes in digitizing and restoring vintage images, and Shaun Communications, which specializes in call center operations—were the first to move into the first floor. Attracted by Bhutan’s stable business environment, low degree of corruption, cheap electricity, reportedly high levels of labor productivity and worker retention, and tax holidays, four other international ICT firms—MultiRational from Australia, SELISE from Switzerland, Southtech from Bangladesh, and Zoop from Canada—have also moved into the park. Currently, the Techpark employs more than 700 people (Thimphu TechPark 2017). ScanCafe, which opened its park facility in 2012 with only 20 staff now employs more than 300 and expects to continue growing.

**Despite its recent new investments, Bhutan’s nascent ICT sector is facing growing pains.** Shaun Communications could not recruit enough qualified staff for its call center operations and, after incurring large losses on training (T. Dorji 2016), decided to close. The remaining international firms expressed concern that they may yet face similar fates. Stringent immigration regulations—which contradict the more lenient but unapplied FDI regulations—preclude the recruitment of foreign expatriates to temporarily fill critical skill shortages. Several firms also expressed concern over deficits in “soft skills”—such as punctuality and professionalism—among local employees and noted that this had negatively affected the firm’s reputation with international clients. Firms also noted that, even with subsidies, the cost of Internet access is twice as high as in neighboring countries and that regulations on payment transfers complicate multinational operations. Others questioned the government’s commitment to growing the nascent industry, given the lack of an FDI promotion strategy or efforts to build awareness of the park.

#### 1.4.4 AGRIBUSINESS

**While the agriculture sector is underperforming, exports of several high-value horticultural crops are growing.** Agriculture employs 70 percent of the

private-sector workforce, but the sector contributed just 18 percent to GDP in 2014. Yields per hectare have been declining at a compounded annual rate of 1.84 percent over the last 27 years, which contrasts sharply with increases of between 0.25 percent to 0.50 percent per year observed for the rest of the world (Wik, Pingali, and Brocai 2008). Most producers grow cereal crops—maize and rice, particularly (Table 8)—for subsistence. However, due to the expansion of feeder roads that give producers better access to markets in India, exports of several high-value horticultural crops—and the proportion of firms cultivating such crops—have recently increased (Bhutan MoAF 2011).<sup>22</sup> From 2011 to 2014, exports of oranges increased by 66 percent, apples by 35 percent, potatoes by 175 percent, and areca nuts by 225 percent.<sup>23</sup> Horticultural production is nonetheless highly concentrated, with 2008 data indicating that 10 percent of farmers account for 73 percent of sales (Christensen, Fileccia, and Gulliver 2012).

TABLE 8: AGRICULTURAL PRODUCTS IN BHUTAN

Commodity	Production (mt)	Value (\$)
Rice (paddy)	77,314	47,752,765
Maize	66,779	27,497,235
Potatoes	52,959	19,470,221
Mandarin	38,184	32,007,176
Chili	7,312	9,247,529
Wheat	5,647	2,574,368
Apple	5,410	4,773,529
Millet	5,024	1,625,412
Areca nut	4,036	2,284,376
Mustard	3,578	4,735,588
Beans	3,459	2,085,574
Barley	2,050	841,103
Cardamom	942	14,320,284
Mushrooms	9	76,412

Source: Bhutan MoAF 2010.

22. New roads have enabled producers to bring products to the Indian market that cannot be grown there at specific times of year due to differences in climatic conditions.

23. Other exports include chilies, cardamom, and ginger, as well as several niche crops (mushrooms, honey, asparagus, hazelnuts, black pepper, and Sichuan pepper).

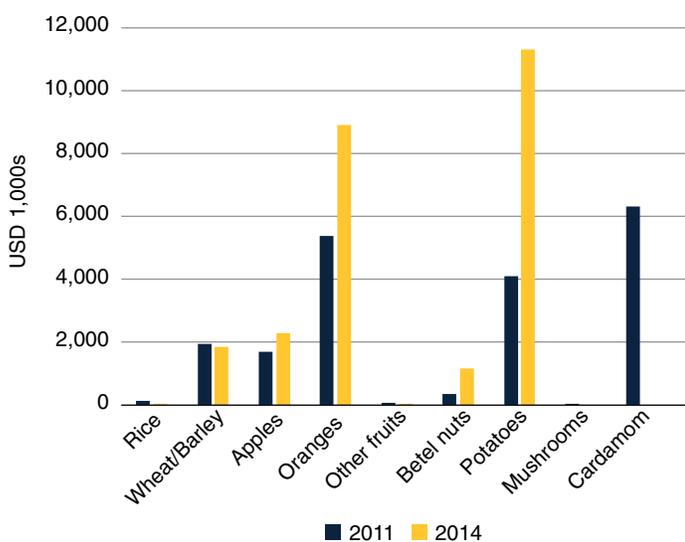


Figure 11: Bhutan's Agricultural Exports, 2011–14  
 Source: Bhutan MoAF 2016.

**Agribusinesses in Bhutan are primarily microenterprises operating as sole proprietorships.** Agribusinesses, which are geographically concentrated in the Thimphu/Paro region, are smaller than businesses in other sectors and more likely to be sole proprietorships. Of the agribusinesses sampled by the 2015 WBES, 91 percent are microenterprises, compared to 68 percent of other firms. Likewise, almost all agribusinesses sampled are sole proprietorships. Agribusinesses export less than firms in other sectors, although exporting is closely correlated with firm size.<sup>24</sup> Moreover, even exporting firms tend to be poorly networked with external markets. Most farmers and traders sell to Bangladeshi or Indian merchants operating within Bhutan or at border markets, rather than at the end market of the destination countries. This limits firms' exposure to innovation in product types, trade finance, product quality and other requirements of end markets, marketing, and distribution. Per WBES data, virtually no agribusiness firms have received foreign investment.

24. For example, medium-sized agribusinesses are 16 percentage points more likely to export at least 1 percent of their sales compared to smaller firms.

**The activities of state-supported entities, created to address perceived market failures, risk distorting factor and product markets and discouraging private investment in agribusiness.** The RGoB has established several state-owned enterprises or quasi state-owned enterprises to replace rural private sector initiatives perceived to be lagging. For instance, 16 Farm Shops in eastern Bhutan sell subsidized inputs and staple goods to and purchase primary agricultural products from the poor living in remote rural areas. Commercial vendors, however, complain that Farm Shops undercut their prices, forcing them out of business. Similarly, Bhutan Agro Industries Limited, a state-owned company established in 1993, develops, distributes, and markets value-added (processed) agricultural goods and, in so doing, potentially crowds out private investment in food processing.<sup>25</sup> Several mega-farms and demonstration farms also compete with private businesses by selling their products in the same markets.

**Existing agricultural subsidies risk diminishing the choices open to farmers and discourage innovation and diversification.** Vegetable farmers and rice farmers are currently given prepackaged sets of inputs, which effectively dictate production choices as similar support is not available for other commodities. In addition to reducing incentives for diversification or innovation, such subsidies deter investment by private-sector support services, such as seed companies, fertilizer importers, and distributors. In addition, the subsidy has created an expectation among farmers that the government will continue to provide these items at little or no cost. Accordingly, the RGoB is concerned that if it withdraws the subsidies, production will decrease precipitously.

**Efforts to better market Bhutanese products abroad are underdeveloped.** In October 2014, Bhutan's Department of Trade partnered with UNDP and Future Brand to develop a visual identity that would "add a premium to the goods and services that are produced and

25. Other than Druk Brewery, no similarly large, private food processor has emerged in Bhutan.

originate in Bhutan” (Future Brand 2015a). If properly developed, Brand Bhutan can enable Bhutanese exporters to access a quality premium in high-value markets. However, the Ministry of Economic Affairs (MoEA) has yet to formally launch Brand Bhutan. Moreover, there is a need for MoEA to create a framework for the strategy’s

management that will: (i) establish standards for products bearing the Brand Bhutan identity and associated labels; (ii) outline procedures for the private sector to use the brand; (iii) establish and publish sanctions and penalties for misuse of the brand; and (iv) create systems for controlling the quality of products sold under the brand.



Workers of Bhutan Power Company replace an old pole, Upper Motithang, Thimphu, July 2015.

## CHAPTER 2

# CONSTRAINTS ON PRIVATE-SECTOR DEVELOPMENT

### Summary

Recent reforms have addressed several factors that previously impeded private-sector development, but Bhutan's overall economic competitiveness lags other countries in the region due to constraints on access to inputs and to product markets.

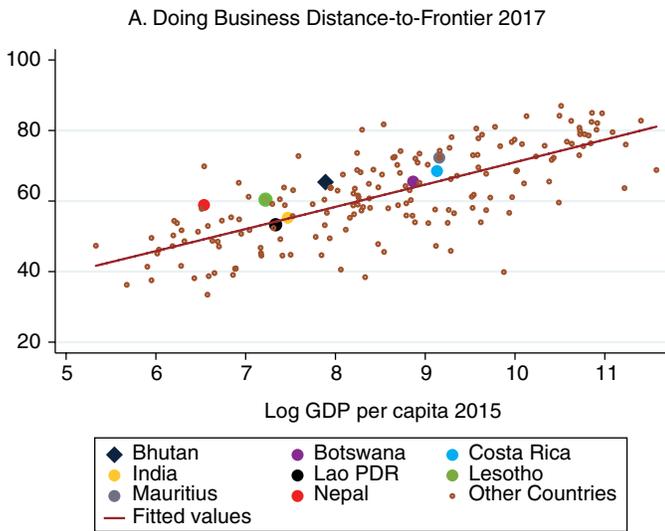
Access to Inputs. Limited access to finance—due to a lack of competition and credit information, a deficient insolvency regime, limited collateralizability, and widespread financial illiteracy—is a major constraint for micro and small firms. The limited supply of skilled labor—resulting from low overall levels of education, competition for talent with the public sector, and restrictions on hiring foreign workers—reduces the productivity of larger firms.

Access to Markets. Despite an open trade policy and recent investments, the access of Bhutanese firms to external markets is inhibited by infrastructure gaps, an underdeveloped logistics sector, inefficient transit corridors, and restrictions on foreign investment. In several sectors, perceptions of unfair competition with state enterprises and a lack of private-public dialogue dampens investment incentives. Finally, while Bhutan's institutional quality is one of the best in the region, deficiencies in accounting standards and corporate governance exacerbate regulatory uncertainty and discourage risk taking.

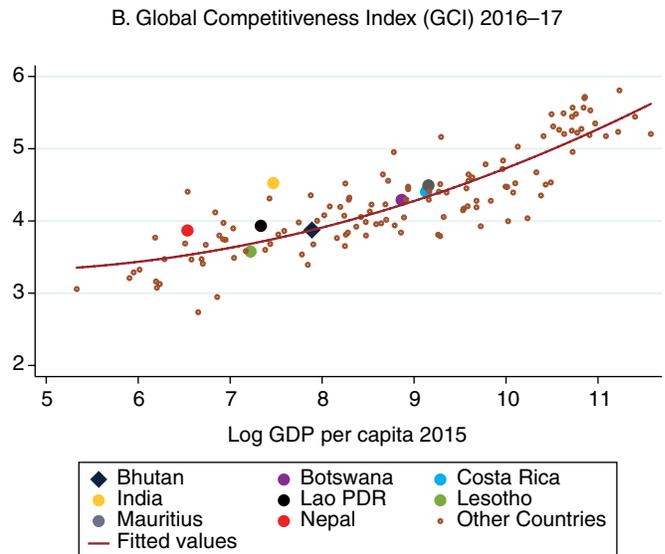
## 2.1 INTRODUCTION

**Over the last decade, reforms have improved Bhutan's investment climate.** Key reforms—such as the new Licensing Policy approved by the Cabinet; digitization efforts to simplify the process of registering properties; and ongoing revisions of FDI regulations—have improved the regulatory environment. The RGoB has also implemented reforms in several areas to improve access to finance. Forthcoming or proposed reforms include improving usage of movable assets as collateral, revision of the Bankruptcy Act to strengthen legal rights for creditors and borrowers, and improvements to the Credit Information Bureau (CIB).

**Bhutan's competitiveness is nonetheless constrained by financial underdevelopment, skills shortages, limited access to markets, and**

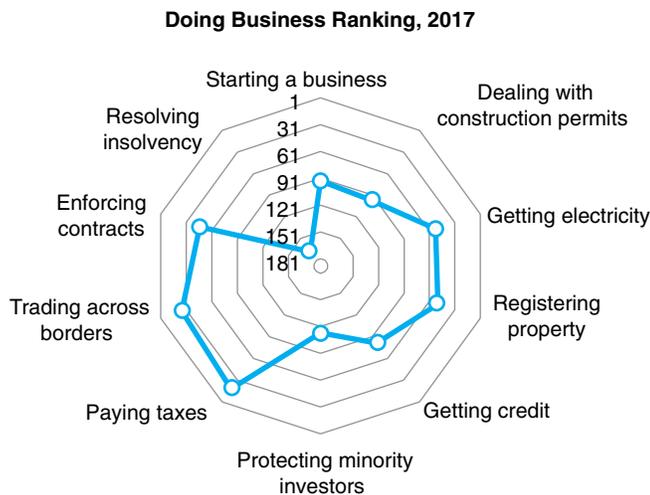


Source: World Development Indicators and World Bank 2016d. Distance to Frontier (DTF) benchmarks economies with respect to regulatory practice, showing the absolute distance to the best performance in each indicator.



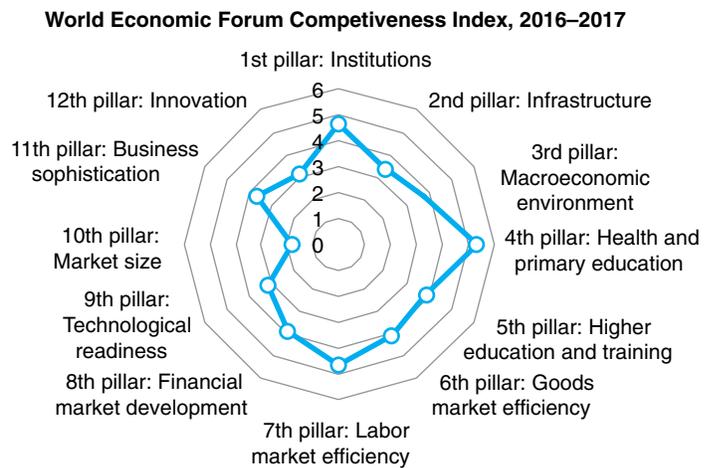
Source: World Development Indicators and Schwab 2016.

C. Components of Doing Business 2017



Source: Doing Business 2017 (World Bank 2016d).

D. Components of GCI 2016-17



Source: Schwab 2016.

Figure 12: Business Environment and Competitiveness Ranking

**an underdeveloped competition policy.**<sup>26</sup> Bhutan ranked 73th out of 192 countries in 2017 in the overall

26. Many of the shortcomings identified by Doing Business and the Global Competitiveness Index align with those identified by previous assessments of the constraints to private-sector growth in Bhutan. The World Bank's 2010 Investment Climate Assessment (World Bank 2010), for example, identifies regulatory complexity and access to finance, transportation, and a skilled domestic labor force as Bhutan's main challenges. Similarly, the Asian Development Bank (ADB 2013) notes that the key impediments include: (i) inadequate and poor quality infrastructure, particularly in transport and connectivity in rural areas; (ii) lack of access to finance by MSMEs; and (iii) limited and unequal access to quality education and labor market mismatches.

ease of doing business (World Bank 2016d), which is higher than all other South Asian economies (Figure 12-A). However, Doing Business data also indicate that Bhutan has much room for improvement in access to credit, construction permits, bankruptcy procedures, and the protection of minority investors (Figure 12-C). The WEF Global Competitiveness Index, meanwhile, reports that Bhutan lags most comparator countries and is below the level predicted by its income level (Figure 12-B). In addition to the deep constraints of a small domestic market and adverse geography, Bhutan's ranking in the

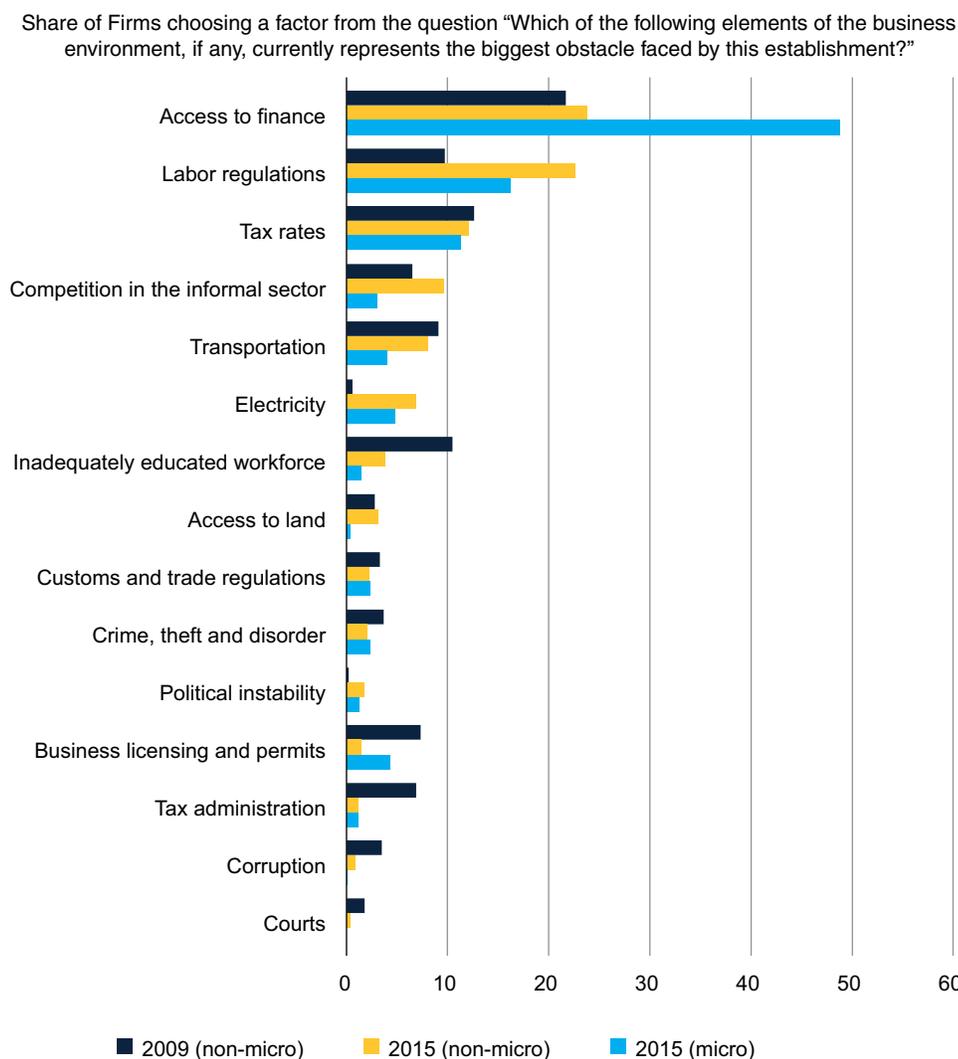


Figure 13: Perception of Investment Climate Constraints, 2009 and 2015

Global Competitiveness Index is lowered by the country’s limited financial development and a shortage of high-skilled workers (Figure 12-D).

**Bhutanese managers perceive access to finance, labor regulations, and taxation as the biggest constraints to firm growth.**<sup>27</sup> By a large margin, Bhutanese managers surveyed by the WBES 2015 cite access to finance, labor regulations, and tax rates as the greatest constraints presented by the country’s economic, institutional, and regulatory framework to the growth of their

business (Figure 13). Firms were much less likely to identify institutional factors such as political instability, corruption, and courts as factors inhibiting the growth of the firm. This represents a contrast with other South Asian countries. For instance, the top obstacles cited by Indian and Nepalese businesses in 2014 and 2013 were corruption and political instability, respectively, while the second most important obstacle for both countries was electricity.<sup>28</sup>

**To assess the severity and sources of different business constraints, this chapter supplements firm perceptions with data on firm performance, cross-country benchmarking indicators, and**

27. Despite the shortcomings of relying on subjective information, factors that firms perceive as inhibiting productivity and growth provide useful information as perception matters for investment decisions. Gennaioli, Ma, and Shleifer (2016), for example, find that investment plans and actual investments are well explained by business expectations.

28. See: <https://www.enterprisesurveys.org/data/exploreeconomies/>

**qualitative information.** Section 2.2 examines access to finance, which Bhutanese firms surveyed by the 2015 WBES were most likely to identify as their primary constraint. Section 2.3 examines access to labor, which encompasses labor regulation (the second-most frequently cited constraint in the WBES) and innovation and high-end skills (which the Global Competitiveness Index suggests are major constraints on competitiveness). Section 2.4 examines access to external markets, which encompasses logistics, transportation infrastructure, trade policies, and border processing. Section 2.5 examines competition policy, which World Economic Forum (WEF) data and anecdotal evidence suggest hinders the performance of Bhutanese firms. Section 2.6 examines taxation, which is the third most frequently cited constraint in the 2015 WBES.

## 2.2 ACCESS TO FINANCE

**Insufficient access to finance constrains Bhutan's private sector.** Recent reforms have laid the foundations for the development of Bhutan's financial sector. However, the growth of firms—and the growth of microenterprises, in particular—continues to be impeded by inadequate access to credit (Subsection 2.2.1). Access to finance is restricted both by supply-side factors (such as a lack of financial competition, insufficient credit information, and an unpredictable restructuring and insolvency regime) and by demand-side factors (such as an inability to collateralize assets and a lack of financial literacy) (Subsection 2.2.2).

### 2.2.1 SEVERITY OF CONSTRAINT

**Despite recent reforms, the supply of credit is problematic.** According to Doing Business, Bhutan ranked 82nd out of 183 countries on the ease of accessing credit in 2017, up from 177th in 2010. This improvement reflects the success of reforms such as the establishment of the Credit Information Bureau (CIB) in 2010, the creation of three new commercial banks in 2010, and the inception of a minimum reference rate for lending in August 2016.<sup>29</sup> Nonetheless, the supply of credit to Bhutan's

productive sectors remains low. While credit to the private sector as a share of GDP increased rapidly between 2006 and 2010, it has been constant since 2010 and is dominated by housing and personal loans (Figure 14 A and B). Although lending to agriculture and trade and commerce sectors has increased,<sup>30</sup> the share of credit to industry has barely changed in the last three years.

### **Managers—particularly of microenterprises—identify access to finance as a major constraint.**

In both the 2009 and 2015 WBES, access to finance was most frequently cited by managers as the constraint that most seriously inhibited firm productivity and investment,<sup>31</sup> a result that is consistent with the Establishment Survey Report 2016 by the Ministry of Labor and Human Resources (Bhutan, MoLHR).<sup>32</sup> The constraint is not uniform across firms, however (Figure 15). Whereas the access to finance for larger firms in Bhutan is comparable to that elsewhere in South Asia, microenterprises are—after accounting for sector and region—40 percent more likely than larger firms to cite access to finance as their biggest obstacle.<sup>33</sup> Microenterprises are often forced to tap alternate sources of financing—such as internal funds or retained earnings—or to forgo investments.<sup>34</sup> While close

---

sectors. In 2015, for example, Bhutan's interest spread was 9.8 compared to the South Asian average of 5.1. Similarly, the lending interest rate has stayed at around 14 percent in the last 10 years, higher than most peer countries.

30. As of 2015, agriculture represented only 5 percent of aggregate credit. Lending to the trade and commerce sector has, however, increased from 12.7 percent in 2013 to 19.1 percent in 2015, which reflected the sector's evident increase in labor productivity and profitability.

31. Over the two periods, the share of (non-micro) firms holding this view has not changed significantly.

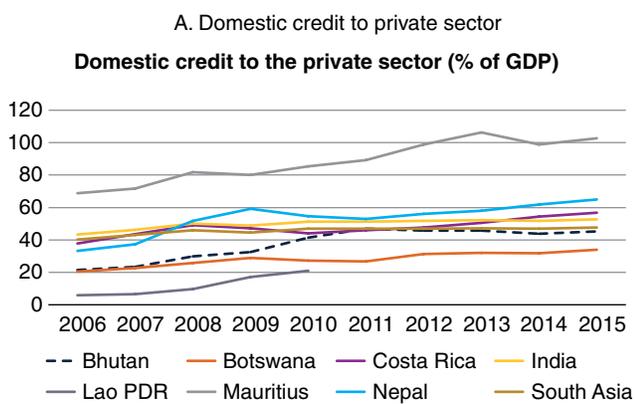
32. Firms indicate that expectations about output demand is the most important driver for hiring, while lack of credit is the most important obstacle to growth (Table 21 in Annex 3.3).

33. Non-micro Bhutanese firms are less likely than similar firms in South Asia to consider access to finance as a major or severe constraint and are more likely to have a bank loan or line of credit (47 percent versus 27 percent) and to use banks to finance investments (Table 9). Microenterprises also use financial products less frequently, despite reporting higher average levels of productivity (Figure 16-B).

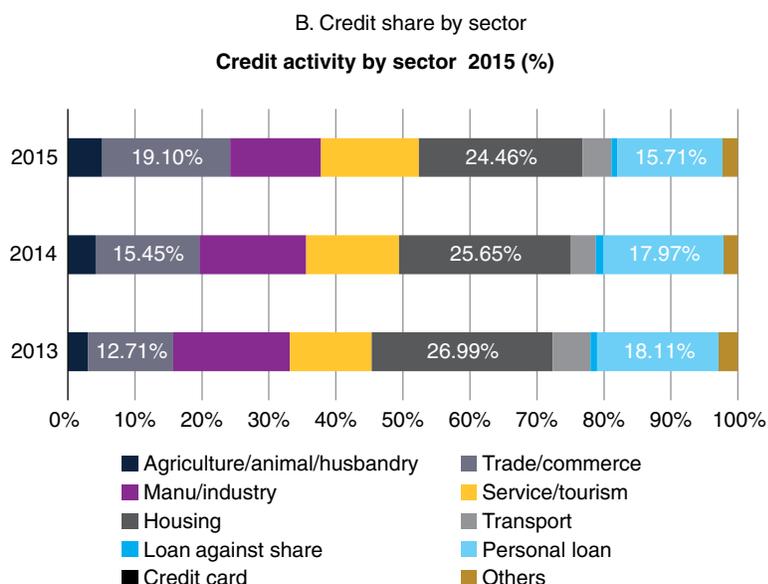
34. Among microenterprises that invested, only 9 percent had bank financing compared to 25, 48, and 60 percent of small, medium, and large firms, respectively. Internal funds and retained earnings represent the main source of financing for microenterprises, both for fixed assets and for working capital (89 and 91 percent, respectively). Among larger firms in Bhutan and South Asia generally, three-quarters of firms depend on internal financing to fund investments.

---

29. Prior to 2016, regulations in Bhutan imposed interest rate caps and restricted interest spreads based on banks' individual cost structure. These regulations limited price competition, curtailed product differentiation, and restrained the extension of credit to high-risk



Source: World Development Indicators.



Source: RMA 2015.

Figure 14: Aggregate Credit

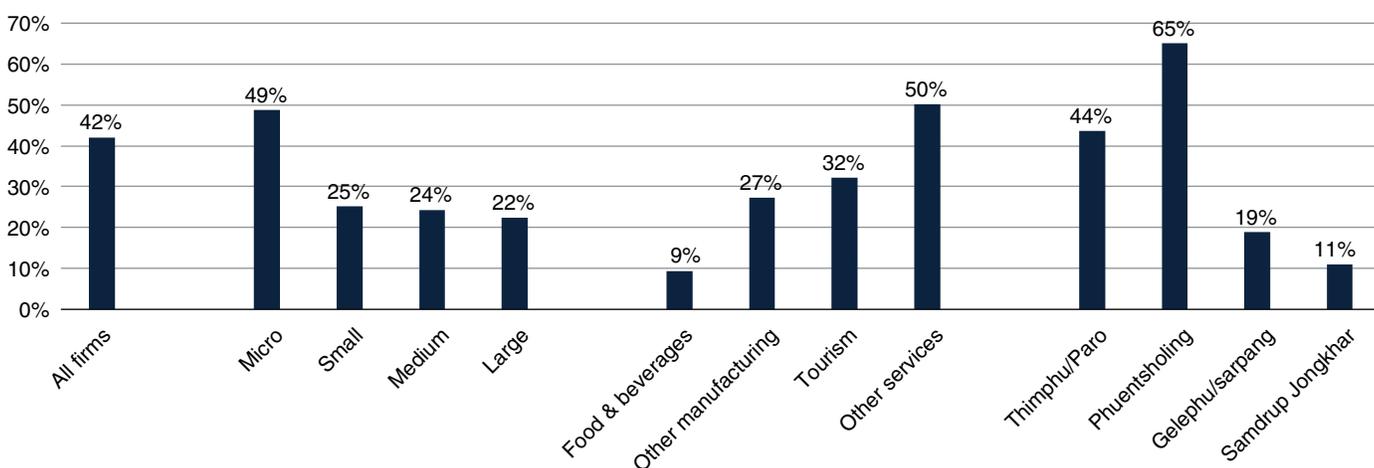


Figure 15: Share of Firms Indicating Access to Finance Is Biggest Obstacle

to half of larger firms invested in fixed assets, only 6 percent of microenterprises did so. Among microenterprises that did not invest, almost half attributed this to the high cost of finance or a lack of internal funding. In contrast, 14, 17 and 7 percent of small, medium, and large firms, respectively, chose not to invest due to a lack of financing.

**Constraints on access to finance reduce labor productivity and employment growth.** Evidence suggests that a lack of access to finance reduces labor productivity in manufacturing. While the median manufacturing firm in Bhutan has a capital stock of only US\$3,500 per

equivalent full-time worker, the counterpart median firm in India has twice as much capital, while the counterpart in Costa Rica has six times as much. For manufacturing firms for which data on assets is available, capital intensity is the most important predictor of labor productivity. Econometric analysis of various firm characteristics also indicates that firms for which access to finance is a constraint have lower employment growth rates (Annex 3.3).<sup>35</sup>

35. Foreign firms also grow faster. To the extent that foreign firms are often less credit constrained, this result supports the hypothesis that access to finance matters for employment growth.

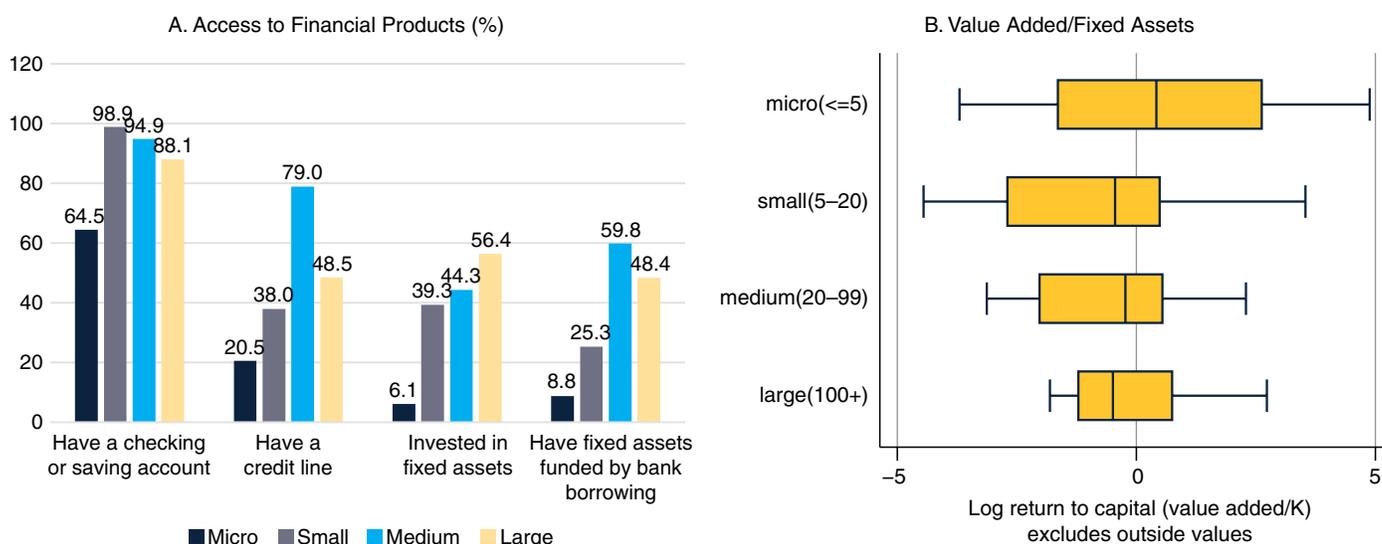


Figure 16: Financing Needs and Financial Access by Firm Size  
*Note:* Available for manufacturing firms only.

## 2.2.2 SOURCES OF CONSTRAINT

**Access to finance is limited both by factors that discourage lenders from supplying financial products and by factors that discourage potential borrowers from demanding finance.** Potential lenders are discouraged from supplying financial products and services by the dominance of public banking institutions; a lack of innovation in financial products; limited credit information; and a complex, unpredictable, and ineffective restructuring and insolvency regime (Subsection 2.2.2.1). Potential borrowers are discouraged from accessing financial products by constraints on the extent to which productive assets can be collateralized and a lack of financial literacy (Subsection 2.2.2.2).

Potential lenders are discouraged from supplying financial products and services by the dominance of public banking institutions; a lack of innovation in financial products; limited credit information; and a complex, unpredictable, and ineffective restructuring and insolvency regime (Subsection 2.2.2.1). Potential borrowers are discouraged from accessing financial products by constraints on the extent to which productive assets can be collateralized and a lack of financial literacy (Subsection 2.2.2.2).

### 2.2.2.1 Supply Side

**Access to finance is restricted by high prices and the limited scope of products offered by the banking sector.** Bhutan's three largest banks—Bank of Bhutan (BoB), Bhutan National Bank (BNB), and Bhutan Development Bank Ltd. (BDBL), which collectively account for 87 percent of bank assets—are all public entities. Bhutan's two privately controlled banks have low and declining market shares, suggesting that they are relatively uncompetitive (Murgatroyd 2016).<sup>36</sup> Moreover,

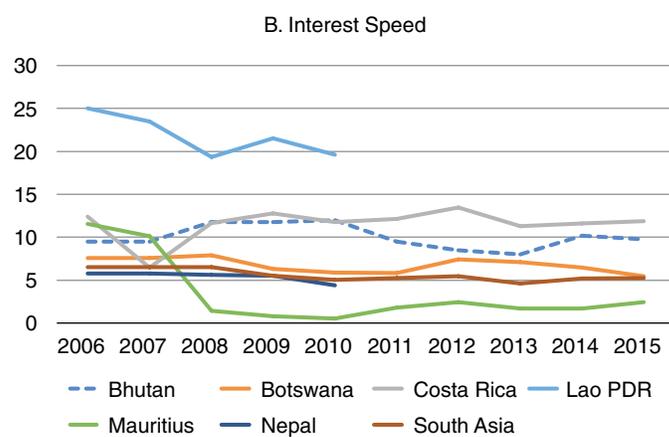
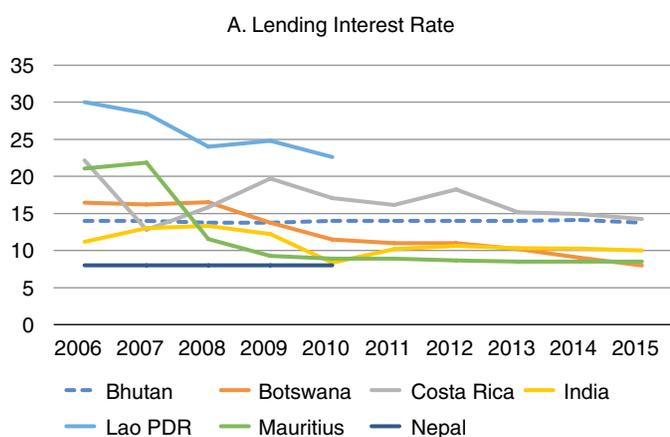
36. The share of total assets held by the two private banks dropped from 13.6 percent in 2013 to 12.8 percent in 2016 (Murgatroyd 2016, 20).

while the BDBL is the most important provider of credit to the country's farmers, it lacks a commercial banking license and so is unable to finance agricultural exports. The lack of financial competition results in limited product development, high interest rates (Figure 17), and a general reluctance among institutions other than BDBL to lend to risky sectors (*ibid.*).

**A weak insolvency scheme reduces the transparency, cost-effectiveness, and simplicity of insolvency procedures and increases credit risk.**

Bhutan's existing insolvency regime—governed primarily by the Bankruptcy Act 1999 and some provisions in the Companies Act—is outdated, lacks key provisions, and is governed by multiple statutes. Banks are consequently more risk-averse and lend less than they would under a developed insolvency regime. In particular, financial institutions tend to focus more on safe loans—for instance, on firms whose collateral in fixed assets could be more easily foreclosed on—rather than undertaking potentially profitable investments. Such deficiencies explain the gaps between firms' returns on investments and their ability to receive bank credit.

**Access of small and rural enterprises to finance is limited by shallow credit information and a lack of mobile banking and/or microfinance institutions (MFIs).** Bhutan's Doing Business score of depth of credit



Source: World Development Indicators.

Source: World Development Indicators.

Figure 17: Lending Interest Rate and Interest Spread

TABLE 9: COMPARISON OF BHUTAN'S FINANCIAL SECTOR INDICATORS WITH THOSE OF PEER COUNTRIES

Country	Strength of Legal Rights (0: weak; 12: strong), 2016	Depth of Credit Info. (0: low; 8: high), 2016	Public Credit Registry Coverage (% adults), 2016	Private Credit Bureau Coverage (% adults), 2016	Have Bank Account (% age 15+), 2014	Have Debit Card (% age 15+), 2014	Have Credit Card (% age 15+), 2014
Bhutan	4	6	26.0	0.0	33.7	17.2	0.3
Botswana	5	6	53.5	0.0	49.2	35.1	9.9
Costa Rica	10	7	100.0	30.5	64.6	53.6	14.5
India	6	7	21.4	0.0	52.8	22.1	4.2
Lao PDR	6	5	0.0	10.9	..	..	..
Mauritius	6	7	0.0	83.3	82.2	62.0	17.3
Nepal	6	0	1.8	0.0	33.8	6.7	0.4
South Asia		3.875	14.0	4.2			

Source: Doing Business 2016 and FINDEX 2014.

information and its credit registry's coverage compares favorably with the South Asian average (Table 9). However, the CIB currently only collects information from banks, which limits the system's utility.<sup>37</sup> Farmers are at a particular disadvantage, as fewer than one in five have access to bank credit (Murgatroyd 2016, 12). While mobile banking has potential to extend credit to small enterprises and other clients that cannot be served by traditional banks,

37. Plans exist to expand the CIB database coverage to incorporate information from utility companies—the two local telecom providers and the Bhutan Power Corporation—and to include loans made by MFIs (including REDCL), as well as information from insurance companies.

and while Bhutan's high level of mobile phone penetration would facilitate the expansion of mobile banking,<sup>38</sup> such services do not currently exist in Bhutan. The MFI sector is similarly underdeveloped. Currently, only three NGOs (Renew, Tarayana, and Loden) provide loans to

38. As of July 2015, Bhutan was estimated to have 91 mobile phone subscribers per 100 inhabitants (US, CIA 2017). According to Murgatroyd (2016), Bhutan's "two mobile cellular service providers are well placed to reach customers with affordable financial services given their existing customer base, marketing capabilities, physical distribution infrastructure, and experience with high-volume, low-value transactions like the sale of airtime" (11). B-Mobile—a local cellular provider—has already partnered with some local banks to issue e-money cards.

small enterprises and cooperatives in Bhutan (Murgatroyd 2016). Priority lending to rural enterprises, administered by BDBL and the Rural Enterprise Development Corporation Limited (REDCL), may be inadvertently undermining the development of such sources of commercial finance due to the provision of loans for unproductive uses and the resulting high rates of default.<sup>39</sup>

### 2.2.2.2 Demand Side

**Restrictive requirements limit the ability of potential borrowers to collateralize assets.** One of the key complaints from Bhutan’s private sector is the excessive amount of collateral required to obtain credit.

39. The Business Opportunity and Information Centre (BOiC), which approved Nu 273 million in funding for cottage and small industries over 20 months of operation, was closed in May 2016. The Bhutan Development Bank Ltd. (BDBL) provides collateral free low-interest loans to cottage and small industries through revolving fund I (RF-I). The new Rural Enterprise Development Corporation Ltd. provides micro-lending to rural enterprises through revolving fund II (RF-II). T. Dorji (2016) notes that, “RF-II has a ceiling of Nu 100,000 per activity at the interest rate of 4 percent and is meant for non-formal rural activities like dairy, poultry and piggyery, among others.” Per a directive from the prime minister, RF-I is to target schemes proposed by women entrepreneurs and recent graduates and those located in rural areas (T. Dorji 2016).

The average collateral requirement, as measured by collateral-to-principal ratios, has declined from 283 percent in 2009 to 178 percent in 2015, but remains high (Figure 18-A). In addition to the high levels of collateral required, prevailing practices only allow for the collateralization of fixed assets. Firms find it difficult to collateralize moveable assets such as vehicles and inventory, and agricultural producers face similar problems in collateralizing crops, crop transactions, and warehouse receipts.

**Limited financial awareness and financial management skills reduce use of financial products and services.** As Bhutan’s financial system has only recently been liberalized, the population has had limited exposure to modern financial products and services. The proportion of the population with access to a bank account or credit or debit card is low compared to peer countries (Table 9). Among entrepreneurs and firm managers, financial literacy and the use of financial products and services also are very low. In 2015, only 35 percent of firms surveyed prepared externally audited financial statements, which is 10 percentage points lower than the regional average (Figure 18). Only 27 percent of

TABLE 10: ACCESS TO FINANCE IN BHUTAN (WBES 2015)

Access to Finance Indicators	Non-Micro	Micro-Firms	South Asia (Non-Micro)
Firms with Checking or Saving Account	93.3	63.3	77.6
Firms with Loan/Line of Credit	46.5	19.8	27
Firms with Annual Financial Statement Reviewed by External Auditors	35.8	7	46.3
Loans Requiring Collateral	94.5	96.3	81.1
Value of Collateral Needed for Loan (% of loan amount)	352	226	236
Firms That Do Not Need a Loan	57.7	58	44.7
Firms Whose Recent Loan Application Was Rejected	8.3	32.6	14.4
Firms Using Banks to Finance Investments	32.2	0	21.8
Investments Financed Internally	75.1	86.1	73.9
Investments Financed by Banks	18.9	13.4	14.4
Investments Financed by Supplier Credit	0.9	0	1
Investments Financed by Equity or Stock Sales	3.4	5.6	6.9
Firms Using Banks to Finance Working Capital	42	9.4	25
Working Capital Financed by Banks	25.9	5.8	12.4
Working Capital Financed by Supplier Credit	1.1	0	4.3
Firms Identifying Access to Finance as a Major Constraint	16.4	44.2	26.5

Source: Author’s calculations from the WBES and <https://www.enterprisesurveys.org/>.

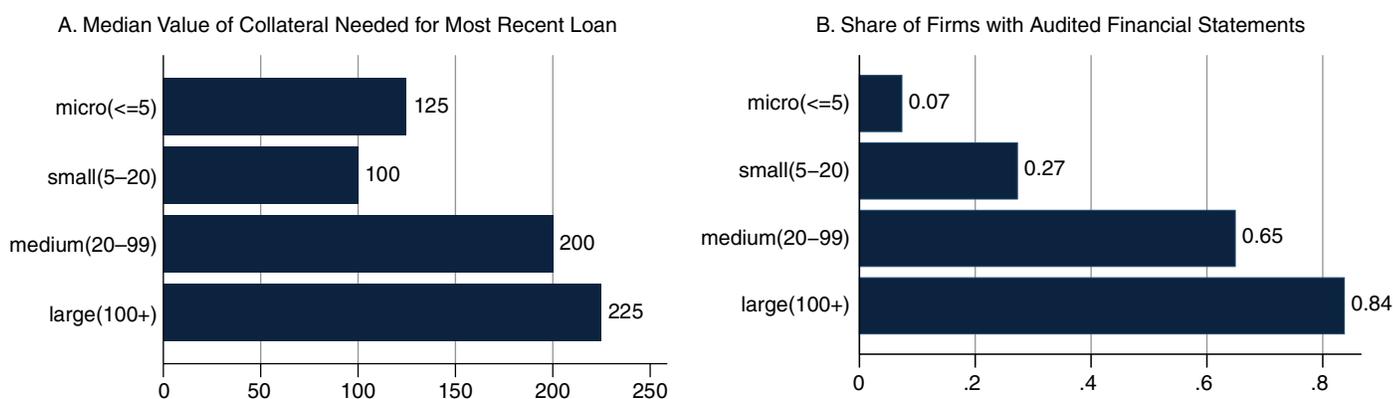


Figure 18: Demand-Side Factors Inhibiting Access to Finance

small firms and 7 percent of microenterprises prepared audited financial statements (Figure 18), which potentially explains the observed financing gaps.

## 2.3 ACCESS TO SKILLS

**Access to skilled labor constrains the growth of Bhutan’s private sector.** After access to finance, labor regulations are the business constraint most frequently cited by Bhutanese managers (Subsection 2.3.1). While Bhutan’s *de jure* labor regulations compare favorably with those of other countries in the region, the access of private-sector firms to labor—particularly skilled labor—is inhibited by three major factors: (i) low levels of education among the population; (ii) competition with the public sector; and (iii) regulations limiting the employment of skilled foreign workers (Subsection 2.3.2).

### 2.3.1 SEVERITY OF CONSTRAINT

**Despite frequent complaints by managers about labor regulation, Bhutan’s domestic labor market policies align with international norms.**<sup>40</sup> Bhutan’s Labor and Employment Act places few restrictions on the hiring and firing of workers. For example, there are no limits on fixed-term contracts and few restrictions on terminating employees for economic reasons. Regulations on work hours, annual leave, and occupational health and safety are in accordance with international standards, while labor taxes are comparatively

40. Assessments of labor regulations in this section draw heavily from World Bank 2016a.

low. Furthermore, the country’s minimum wage is reasonable given the average wage.<sup>41</sup> Overall, the policy regime seems to strike a good balance between over- and under-regulation, and Bhutan performs relatively well on the World Economic Forum’s Global Competitiveness Report 2017 assessment of labor market efficiency, ranking 27th out of 140 countries.

**Restrictive immigration rules and high salary costs are problematic for larger firms.** Microenterprises are less likely than larger firms to complain about labor regulations (Figure 19), which may be due to larger firms hiring more foreign workers.<sup>42</sup> Conditional on size, sector, and regional composition, firms with foreign workers are 22 percent more likely to consider labor regulations as the most important obstacle. Across all firms surveyed, salary costs, immigration rules, and workers’ education are the most likely to be cited as particularly problematic (Table 12, Annex 3.5). However, there is variation between firms in the extent to which they are affected by different forms of labor constraints, with restrictive immigration rules particularly problematic for medium and large firms (49 and 54 percent, respectively).

**Bhutan’s worker education and managerial experience is comparatively low, which reduces firm**

41. The ratio of minimum wage to value added per worker in Bhutan is 0.2, lower than that in all other countries with a minimum wage policy in South Asia (Table 13).

42. Once the presence of foreign workers is taken into account, there are no significant differences in perception about labor regulations across firm sizes.

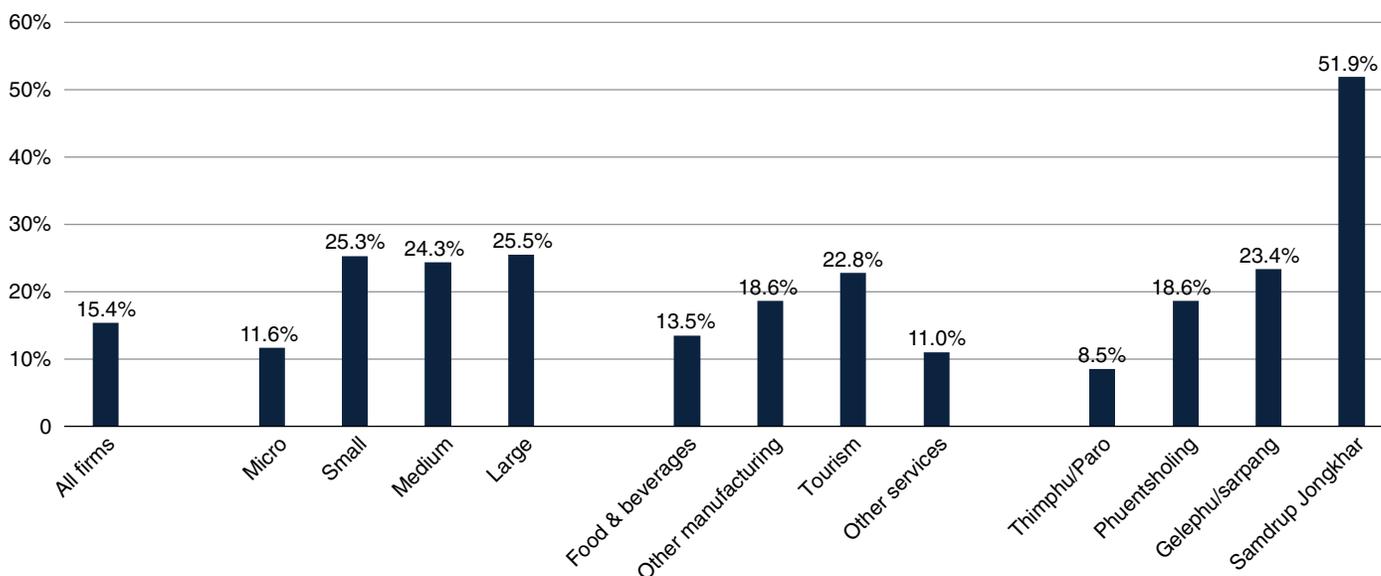


Figure 19: Share of Firms Citing Labor Regulations as Biggest Obstacle

**productivity.** Levels of worker education and manager experience in Bhutan’s private sector lag those of other small service-driven economies such as Botswana and Mauritius (Table 19; Annex 3.4). Furthermore, managers of Bhutanese firms in 2015 have less experience than managers in 2009. Given that the education of firm owners and workers is one of the most important determinants of labor productivity,<sup>43</sup> Bhutanese firms are likely to benefit from attracting better educated workers and more skilled managers.

## 2.3.2 SOURCES OF CONSTRAINT

**Skills shortages are caused by a generally low level of education, by recruitment of skilled workers into the public sector, and by restrictions on the employment of foreign workers.** Over the past decade, Bhutan has increased educational enrollment. However, due to historically low levels of schooling, the pool of well-educated workers in Bhutan remains relatively small (Subsection 2.3.2.1). Moreover, secondary and tertiary graduates in Bhutan are overwhelmingly attracted to the public sector, making it difficult for private-sector firms to recruit such workers (Subsection 2.3.2.2). Due to immigration restrictions, firms cannot overcome skill shortages by employing foreign labor (Subsection 2.3.2.3), lowering productivity.

43. Table 17 (Annex 3.3) reports results from firm-level regressions that formally analyze the determinants of labor productivity.

### 2.3.2.1 Domestic Supply of Skills

**Despite the recent rapid improvement in school enrollment rates, a majority of Bhutan’s workforce lacks formal education.** Bhutan recently achieved near-universal enrollment in primary education and has dramatically increased secondary and tertiary enrollment rates. While these recent changes are impressive, they also underscore the low levels of educational attainment among the older population. As of 2014, more than 60 percent of Bhutan’s labor force—and 49 percent of nonagricultural private sector workers—lacked formal education, and only 7 percent—and 8 percent of nonagricultural private sector workers—had completed tertiary education (World Bank, MoHLR 2016a). While the supply of skills in the economy is increasing due to higher educational attainment, it is also being reduced by declines in labor force participation as women increasingly opt out of employment.<sup>44</sup>

**Specialized and soft skills are particularly scarce across the Bhutan labor force.** WBES data show that nearly 40 percent of firm managers believe their employees’ job-specific skills fall below that required for the firm’s scope of work (World Bank, MoHLR 2016a). The dearth of computer and soft skills—such as leadership,

44. Female labor force participation rose from 38 percent in 2001 to 67 percent in 2011, but fell to just 56 percent in 2015 (Bhutan, MoLHR 2015a).

teamwork, and professionalism—appears to particularly concern managers. For instance, 60 percent of employers believe that their employees’ computer skills are inadequate, while 40 percent of managers at nonagricultural private-sector firms report that their employees lack necessary skills in problem solving, critical thinking, and/or leadership. Managers at a quarter of firms expressed concern about the teamwork of their workers.

**The scarcity of skills in Bhutan constrains the competitiveness of manufacturing.** In both manufacturing and services, prevailing wages paid by firms in Bhutan appear to be highly competitive compared with those paid by firms in other peer countries (Figure 20). Median wages in manufacturing in fact declined between 2009 and 2015. However, the productivity of manufacturing—as measured by the ratio of value added to the cost of labor—fell even further over the same period. As worker skills are a key determinant of productivity in manufacturing, the very low level of productivity underscores the economic cost imposed by the shortage of skills for manufacturing firms.

### 2.3.2.2 Domestic Demand for Skills

**Bhutan’s small stock of skilled workers are overwhelmingly employed in the public sector.** The public sector employs a similar number of workers as does

the nonagriculture private sector. This is in line with international averages.<sup>45</sup> However, what is remarkable about public-sector employment in Bhutan is the extent to which it is dominated by skilled employees and, as a result, consumes the country’s relatively small supply of skills. Of those workers with tertiary education, more than 66 percent are employed by the public sector, and 51 percent work in the general government (that is, not in a state-owned enterprise) (World Bank, MoHLR 2016a). While more than 60 percent of Bhutan’s general labor force lacks a formal education, only 22 percent of public sector workers do so. Likewise, workers with tertiary education make up 21 percent of the public-sector workforce, but only 7 percent of the general workforce.

**The disproportionate number of skilled workers in the public sector reflects the preference of educated Bhutanese for public-sector employment.** Whereas the unemployment rate for those without formal education is just 0.2 percent, 12.3 percent of those with tertiary

45. Globally, an average of 18.9 percent of all workers are employed in the public sector and 13.8 percent in the government. Overall public-sector employment in Bhutan is on a par with the international average, although general government employment (which excludes state-owned enterprises) is somewhat higher. However, this figure is high for a small, landlocked country such as Bhutan that has a relatively underdeveloped private sector (World Bank, MoHLR 2016a).

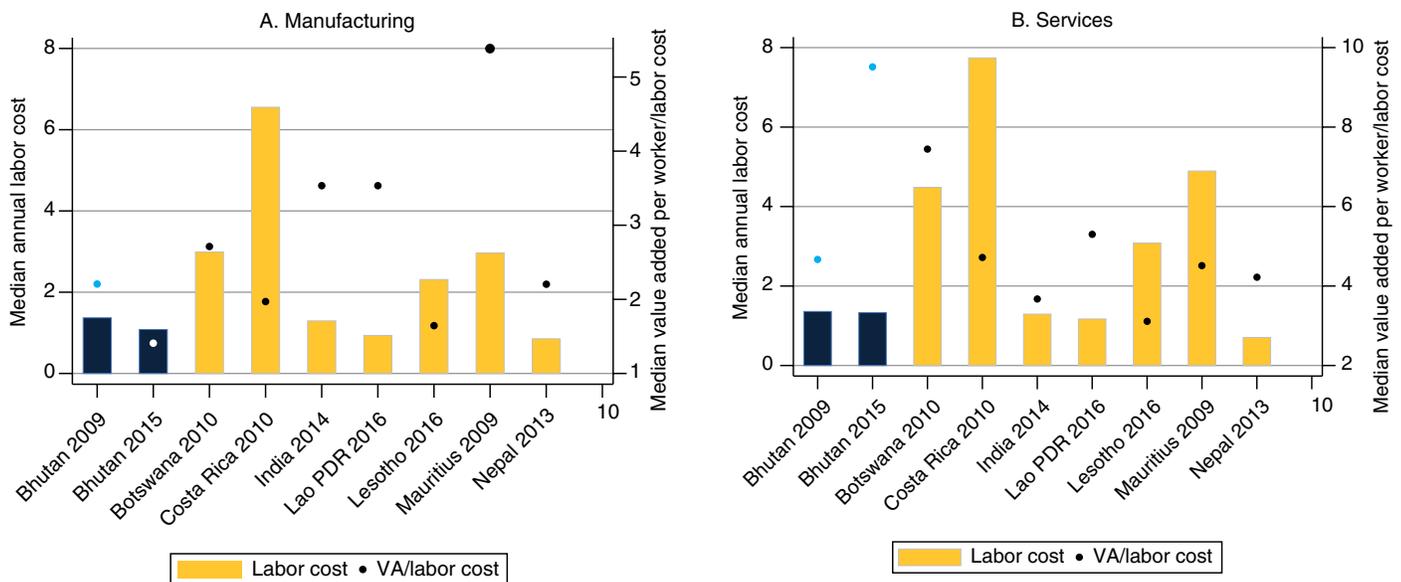


Figure 20: Relative Cost and Productivity of Labor

Note: Annual labor cost is measured in thousands of \$US per worker, in 2010 prices. Value added is similarly measured in 2010 \$US. A higher ratio of value added/labor cost, indicates a more competitive labor force.

education are unemployed (World Bank, MoHLR 2016a). Surveys of the unemployed indicate that they are waiting for public-sector opportunities to become available. According to the 2014 Labor Force Survey, 71 percent of unemployed or otherwise inactive respondents with a higher-secondary education and 87 percent of those with a tertiary education preferred a position in the public sector.

**Public-sector jobs offer more generous benefits, as well as greater job security.** While public-sector workers receive wages similar to those doing comparable work in the private sector, overall compensation packages—which include pensions, subsidized housing, and provident fund payments—are more generous in the public sector (Figure 21; World Bank, MoLHR 2016a).<sup>46</sup> As a result, competition from the public sector makes it very difficult for private firms to recruit and retain skilled

labor at reasonable wage rates. WBES data indicate that among firms who tried to hire in 2014, 57 percent encountered hiring difficulties, of which most related to applicants expecting higher wages (59 percent) and preferring public-sector jobs (25 percent). Among managers of large firms, 42 percent indicate that competition from the public sector is the main reason that they are unable to retain workers (World Bank, MoLHR 2016a).

### 2.3.2.3 Employment of Foreign Workers

**While Bhutan has flexible labor regulations, it is difficult for firms to recruit expatriate workers.** Current regulations on the employment of non-Bhutanese workers, outlined in the Handbook on Recruitment and Employment of Foreign Workers, restrict occupation of employment and country of origin, other than India; impose a cap on the total number of foreign workers in Bhutan; and restrict firms from terminating the contracts of local employees (Bhutan, MoLHR 2015b). While foreign investment regulations prescribe greater flexibility for foreign firms, such policies appear not to have been applied. Investors, rather, indicate that they are subject to the standard regulations and thereby limited in recruiting skilled foreign labor (see Subsection 1.4.3).

46. For instance, the 2014 Labor Force Survey establishes that while over 90 percent of public-sector workers receive key fringe benefits to which all workers are entitled to by law, only 25 to 65 percent of private-sector workers receive any particular benefit (World Bank, MoHLR 2016a). There is a particular discrepancy in the generosity of pensions, with Bhutan’s public-sector pensions exhibiting the highest level relative to wages in all South Asian countries except Sri Lanka (ibid.).

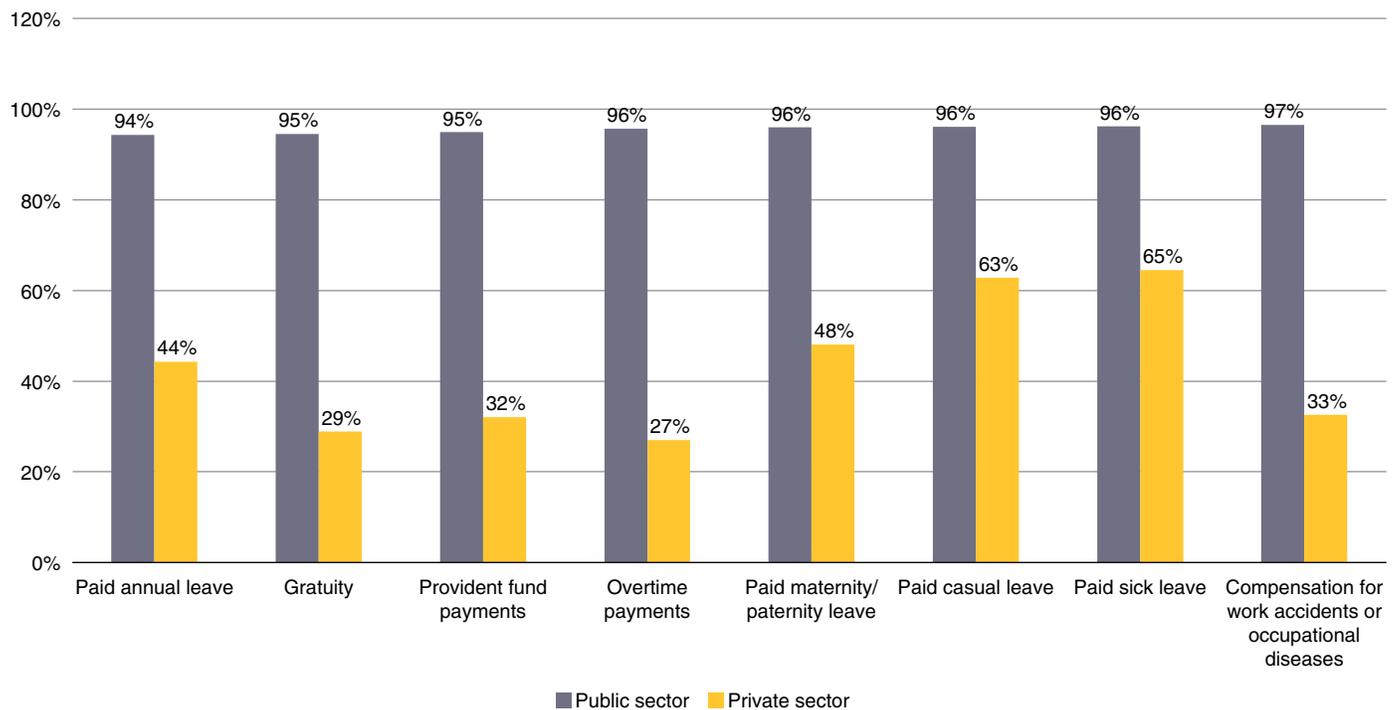


Figure 21: Competition for Labor with Public Sector

Source: World Bank, MoLHR 2016a.

**Current policies inhibit firms from using expatriate workers to fill skills gaps.** As of April 2016, 48,122 foreign workers were employed in Bhutan, comprising 19.8 percent of the workforce (Bhutan, MoLHR 2015c). The vast majority of foreign workers are less skilled, as indicated by their lower qualifications and wage levels (World Bank, MoHLR 2016a). Almost all foreign workers are Indian, with only 323 non-Indian foreign workers as of April 2016. As such, the cap imposed on foreign workers appears to crowd out skilled foreign labor and inhibit firms from filling skill shortages.

## 2.4 ACCESS TO EXTERNAL MARKETS

**Access to external markets—caused by transport and logistics deficiencies and low levels of foreign investment—inhibits the development of the private sector.** Bhutanese businesses do not rank access to external markets as a primary obstacle, although this reflects the low proportion of firms that attempt to export. Doing Business and the Logistics Performance Index (LPI) report that Bhutanese firms face high costs to access external markets (Subsection 2.4.1). While tariff barriers are low and customs facilities efficient, the cost

of cross-border transport is increased by deficiencies in infrastructure quality and logistics performance, while limited flows of foreign investment also reduce access to markets (Subsection 2.4.2).

### 2.4.1 SEVERITY OF CONSTRAINT

**Few firms rank transport, customs, and trade regulation as a key constraint, although this reflects the low number of firms on the cusp of exporting.** Only 5 percent of all firms perceive customs procedures and trade regulations as a top constraint, and less than 3 percent of firms consider transportation to be a top obstacle (Figure 22). However, perceptions differ significantly between exporters and non-exporters. Direct and indirect exporters are 10 percent more likely than non-exporters to cite transportation as their biggest constraint. Of firms that export directly, 10 percent consider custom and trade regulations to be the top constraint, compared to only 1 percent of those firms that do not export directly.<sup>47</sup>

47. A key challenge in accessing foreign markets is the high fixed costs associated with exporting, which favor larger firms. These fixed costs are especially binding for Bhutanese firms given the country's constraints of geographical and economies of scale. Because of the fixed costs of exporting, exporters tend to be larger firms.

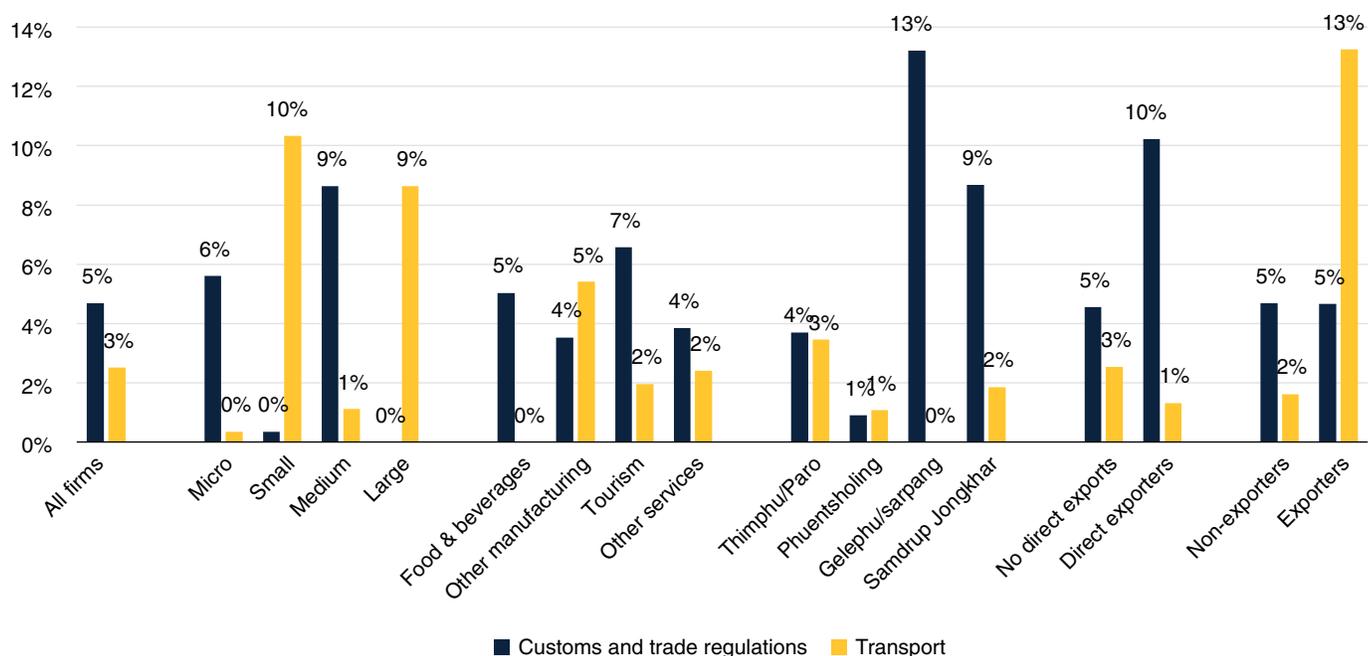


Figure 22: Share of Firms Citing Customs and Trade Regulations or Transport as Biggest Obstacle

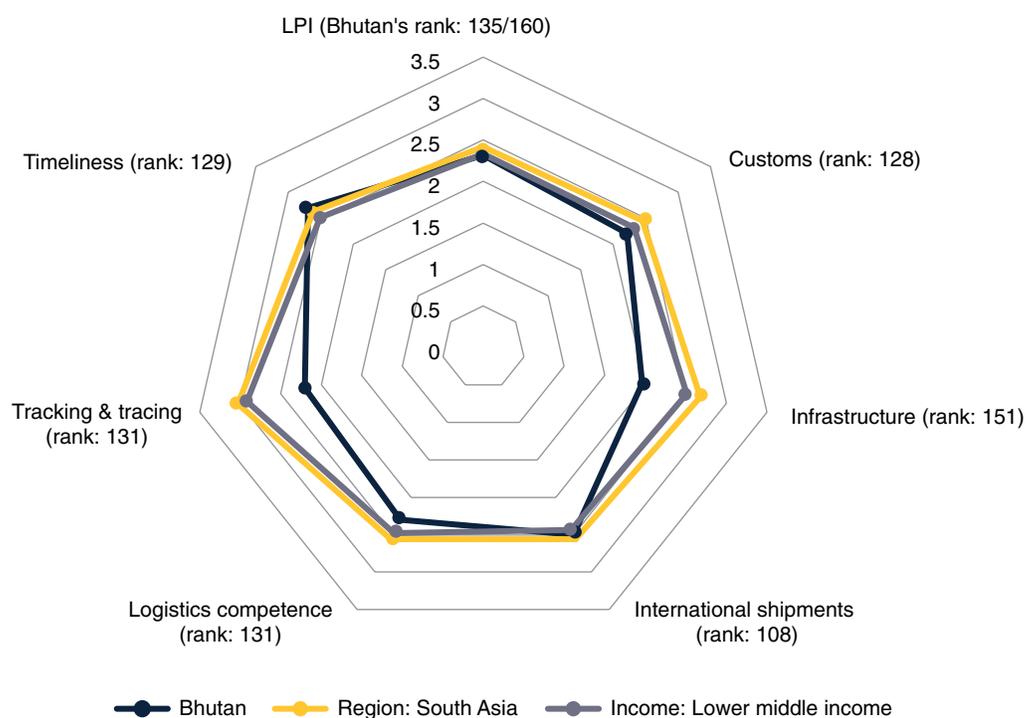


Figure 23: Logistic Performance Index 2016  
Source: World Bank Logistic Performance Index 2016.

### The high costs faced by importers and exporters in Bhutan are reflected in the country's low—and falling—LPI ranking.

Bhutan's overall LPI score fell between 2012 and 2016 from 2.52 to 2.32 (with 5 being the most efficient), and Bhutan ranked 135th out of all 160 economies in 2016.<sup>48</sup> Bhutan underperforms both the regional average and lower-middle income countries in most indicators, but particularly in infrastructure, logistic competence, and the ability to track and trace consignments (Figure 23). Bhutan's logistical performance resembles that of other landlocked countries in the region, including Afghanistan, which ranked 150th in 2016, and Nepal, which ranked 124th.

## 2.4.2 SOURCES OF CONSTRAINT

**Access to external markets is inhibited by gaps in domestic infrastructure, deficiencies in transit corridors, and impediments to foreign investment.**

48. Due to the methodology of the LPI, rankings for landlocked countries and small island states may reflect access problems outside the country assessed. As such, the low rating of a landlocked country might not adequately reflect its trade facilitation efforts.

The ability of Bhutanese producers to access external markets is hindered by gaps in domestic infrastructure, by the underdeveloped state of Bhutan's transport and logistics industry, and by limitations on air travel and Internet connectivity (Subsection 2.4.2.1). While Bhutan enjoys tariff-free access to key trading partners and has developed sound customs procedures, inefficiencies at the Port of Kolkata hinder the access of Bhutanese producers to third-country markets (Subsection 2.4.2.2). Finally, inflows of foreign investment—which can enable access to external markets and technologies—are hampered by sectoral restrictions, skills shortages, and the *ad hoc* nature of incentives (Subsection 2.4.2.3). The limited use of quality certification also inhibits market access, particularly to high-value markets (Subsection 2.4.2.4).

### 2.4.2.1 Transport, Logistical, and Internet Infrastructure

**Despite recent public investments, Bhutan has poor domestic connectivity.** Bhutan's road network has recently been expanded. Since 1997, for instance, the government has built more than 6,920 kilometers of motorable roads (Bhutan National Bureau of Statistics

2015). However, the southern east/west axis of the country still suffers from limited connectivity, forcing traders and travelers to transit the Indian state of Assam. The high overall transport costs are reflected in Doing Business, which reports that exports cost US\$287 per container in Bhutan,<sup>49</sup> compared to US\$158 in India.<sup>50</sup>

**Bhutan's transport and logistics industry is underdeveloped.** According to the Diagnostics Trade and Integration Study 2012 MoEA, 2012), Bhutan's key weaknesses include a lack of logistics infrastructure, professional handling services, and economies of scale. These problems are exacerbated by: (i) relatively high land prices for transport related infrastructure; (ii) few opportunities for logistics training and driver training; and (iii) the small size of most consignments carried by Bhutanese traders, which in turn limits the ability of freight forwarders' services to achieve economies of scale. The lack of specialized freight services particularly impedes the transport of perishable goods (such as agricultural and horticultural products), which is one of the few industries with existing demand for exports.

**Despite recent investments, the cost of air transport to and within Bhutan is extremely high due to limited competition and high operational costs.**<sup>51</sup>

Bhutan has invested in upgrading its three domestic airports in Gelephu, Bumthang, and Yongphulla, although the cost of air travel remains high. The current market for air travel in Bhutan includes two main carriers, Bhutan Airlines and Druk Air, and a third that operates only limited charter flights, Buddha Air. The entry of Bhutan Airlines, a private carrier, has increased choices for consumers, but further entry into the market is limited by

49. This reflects transport from a warehouse in the largest business city to the most widely used seaport, airport, or land border and captures the time for (and cost of) the actual transport; any traffic delays and road police checks, as well as time spent on loading or unloading at the warehouse or border.

50. Bhutan's poor connectivity is echoed by the World Economic Forum's (WEF) Executive Opinion Survey in 2017, which reports that the "inadequate supply of infrastructure" is the second most problematic factor for doing business in the country. The WEF's Competitiveness Index 2017 also ranks Bhutan among the lowest in the world in quality of port infrastructure (136/140) and availability of airline seats (137/140).

51. This section draws heavily on the air transport sector assessment by the ADB (2016).

the small market size and high operational costs caused by limitation to visual landings at all airports. Combined, these barriers limit competition and make flights into Bhutan some of the most expensive in the world.

**The logistics sector is inhibited by the requirement that Bhutanese trucks entering India return empty.**

Indian trucker syndicates unofficially impede Bhutanese plated trucks from picking up goods on their return from India. Thus, while Indian truckers readily cross into Bhutan, Bhutanese truckers are forced to focus exclusively on domestic transport. As a result, Bhutanese transporters carry only a fraction of cross-border freight (Subba 2017), limiting the economic viability of the logistics sector and reducing the incentives for private investment.

**Bhutan's Internet connectivity lags neighboring countries.**

According to the quarterly State of the Internet Connectivity Report prepared by Akamai Technologies (Akamai 2017), Bhutan's average Internet connectivity speed is 3.4 Mbps. This matches Nepal and exceeds Pakistan (2.3), but is slower than Bangladesh (4.2), India (6.5), Indonesia (7.2), Vietnam (9.5), and Thailand (16.0).<sup>52</sup> Key informants in the Thimphu TechPark noted that, even with subsidies, the cost of Internet access is twice as high as in neighboring countries. Indeed, the (unsubsidized) monthly Internet lease line tariff provided by Bhutan Telecom (at up to 30 Mbps or more) is currently 252,626 BTN (Bhutan Telecom Ltd. 2017), or more than US\$3,000, whereas monthly prices for broadband services (at speeds of at least 60 Mbps) in Dhaka, Bangladesh, and Bangalore, India, are US\$24.46 and US\$18.39, respectively (Numbeo 2017).

#### 2.4.2.2 Border Costs

**Bhutan has maintained low trade barriers to offset its high trade costs.**

Bhutanese producers enjoy unfettered access to India and duty-free and quota-free access to Europe and the U.S. Bhutan has been part of the South Asia Free Trade Agreement since 2004 and, as a result, has low overall applied and most favored nation (MFN) tariff lines with current trading partners. The

52. Fastmetrics (2017) reports that Bhutan's average Internet speed is 2.4 Mbps, compared to 2.7 Mbps in Bangladesh and 2.8 Mbps in India.

2009 Market Access Overall Trade Restrictiveness Index (MA-OTRI) (Kee et al. 2009), which captures the policy distortions imposed on Bhutan’s export bundle, reports that Bhutan’s level of access is second only to Nepal in South Asia. Bhutan also maintains near-zero tariffs on imports, especially for manufacturing goods (Bhutan, MoEA 2012).

**Phuentsholing Port is generally efficient, although uncertainty is created by uneven implementation.**

In 2017, Bhutan ranks 26 out of 190 in the Doing Business’s Trading Across Borders indicator, based on procedures at the Phuentsholing-Jaigaon border crossing.<sup>53</sup> For both imports and exports, Bhutanese borders are some of the fastest and least expensive in the region. In 2017, the typical cost to import and export is US\$109 and US\$160 per container, which is less than one-fifth of the average

cost in India and far lower than in Costa Rica or Mauritius (Figure 24-A; Figure 24-B). However, firm-level data suggest Bhutan has a higher median processing time as well as a high level of variation compared to other landlocked countries such as Lao and Lesotho. Anecdotal evidence further suggests increased congestion and inefficiencies at Phuentsholing.

**Access to third-country markets is hampered by inefficiencies at the Port of Kolkata.**

Most Bhutanese freight uses three main transit corridors: (i) Phuentsholing-Kolkata; (ii) Phuentsholing-Burimari; and (iii) Phuentsholing-Birgunji. Of these, the Kolkata corridor carries the most regular and largest volume of freight flows as it is used for the transit of third-country goods. The performance of this corridor is, however, hampered by lengthy clearance procedures and frequent strikes at the Port of Kolkata (Bhutan, MoEA 2012). Accordingly, the RGoB has been seeking to increase the use of alternative transit routes—especially through the border post at Changrabandha (India) and Burimari

53. The methodology for scoring the “trading across borders” performance changed in 2015, rendering the ranking not comparable over time.

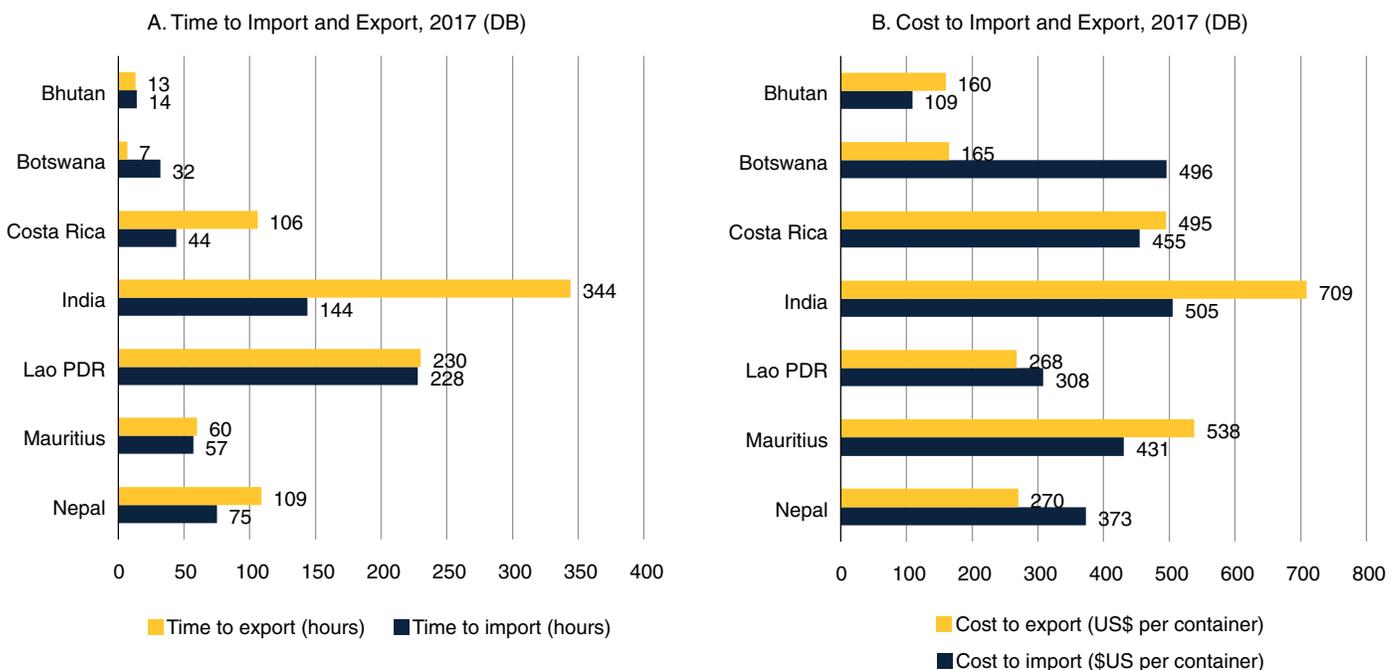


Figure 24: Time and Cost to Import and Export

Source: Doing Business 2017. Costs of exporting and importing are estimated as the total of cost for border compliance and documentary compliance. Border compliance includes the time and cost for obtaining, preparing, and submitting documents during port or border handling, customs clearance, and inspection procedures. Documentary compliance includes the time cost for obtaining, preparing, processing, presenting, and submitting documents.

(Bangladesh)—and to develop new entry and exit points that connect more directly to the planned new industrial estates along the border with India.

#### 2.4.2.3 Foreign Direct Investment

**Despite gradual liberalization since 2010, entry barriers remain high for foreign investors.** FDI is important for Bhutan’s economic development as a source of capital, innovation, management expertise, and in enabling access to external markets. However, equity restrictions exist and differ for various non-priority sectors. The 2010 FDI policy has used a “negative list” approach toward entry barriers, which helps improve predictability for foreign investors. However, some equity restrictions require revision to ensure desirable investments are not inhibited. One example is the hotel sector. A minimum investment threshold exists to attract high-value, low-impact tourism, but alternative incentives to encourage home-stay tours in rural destinations might be more effective.

**Foreign investment in agribusiness is discouraged by difficulties in registering property.** Given the land intensiveness of agribusiness and the collateral requirements for obtaining credit in Bhutan, the ease of registering property is important for prospective foreign investors. According to Doing Business, it takes on average 77 days to transfer a property title between Bhutanese nationals and likely takes much longer for transfers involving foreign investors. Such administrative barriers discourage foreign agribusiness firms from establishing operations in Bhutan.

#### 2.4.2.4 Quality Certification

**Quality certification in Bhutan is low by international standards.** Currently, less than 5 percent of Bhutanese firms have any internationally recognized quality qualification. This is significantly lower than in other countries. The low prevalence of quality certification might reflect low demand given that only a small share of firms export products. Nevertheless, a lack of firm-level investments in quality standards contrasts with the country’s ambition to build Brand Bhutan. The underuse of quality certification might stem from both a failure to understand the benefits of certification and the high

cost of obtaining them, given Bhutan’s underdeveloped quality infrastructure and limited supply of certification services.

## 2.5 MARKET COMPETITION

### **Competition is reduced by oversized public investments and deficiencies in public procurement.**

Competition is less than satisfactory in many sectors (Subsection 2.5.1). The oversized role of state-owned enterprises and their level of access to policy makers potentially discourages private investment (Subsection 2.5.2). While Bhutan’s public procurement framework performs well by international standards, it may be further refined to promote competition.

### 2.5.1 SEVERITY OF CONSTRAINT

**Sectors of Bhutan’s economy suffer from low levels of competition.** While existing data do not permit the estimation of concentration by business sector, evidence suggests that the economy lacks healthy competition in some areas. Bhutan ranks 102 out of 140 countries in “intensity of local competition” on the 2016–2017 Global Competitiveness Index (Schwab 2016). According to Bhutan’s 2015 *Statistical Yearbook* (Bhutan National Bureau of Statistics 2015), the manufacturing sector is dominated by a small number of operators, two of which—Bhutan Ferro Alloys Ltd. and Bhutan Carbide and Chemicals Ltd.—belong to the same conglomerate, the Tashi Group. In the service sector, stagnating wage levels in the face of large labor productivity growth indicates the presence of monopsony power.

**Public procurement, which is large relative to the economy and can impact competitiveness, performs well.**<sup>54</sup> Public procurement accounted for 60 to 70 percent of Bhutan’s government budget, or around 35 percent of GDP in 2012–13 (CSCP undated), compared to an average of 19 percent across South Asia

54. As the largest buyer in the country, the government can influence private-sector capacity and competition in a major way through its procurement policy. One example includes recent efforts by the government to roll out ICT infrastructure for online business registration and tax administration, which represents an opportunity to establish an environment in which services to the IT sector can compete and develop.

(Djankov et al. 2016). The large size of Bhutan's public procurement creates the potential for the sector to impact the private sector. However, a recent World Bank assessment concludes that the public procurement system is satisfactory (World Bank 2017a). Bhutan also scores well in the World Bank's 2017 Public Procurement Benchmarking on aspects related to the efficiency of administrative procedures (World Bank 2016f).

## 2.5.2 SOURCES OF CONSTRAINT

**Large state-owned enterprises, unequal access to policy makers, and public procurement policies inhibit private-sector development.** In the absence of a robust competition policy, various interventions appear to inadvertently inhibit private-sector development (Subsection 2.5.2.1). The mandated role of DHI in providing feedback to the Ministry of Finance creates a *de jure* conflict of interest that may discourage private investment (Subsection 2.5.2.2). Finally, Bhutan's public procurement framework also may be inadvertently inhibiting the development of private sector firms (Subsection 2.5.2.3).

### 2.5.2.1 Competition Policy

**Bhutan's competition policies are still rudimentary.** In 2015, the Gross National Happiness Commission began reviewing a draft National Competition Policy, but currently no laws address anticompetitive practices, monopolies, and cartels. The Consumer Protection Act, enacted in 2012, sets out the rights and responsibilities of consumers and is administered by the Office of Consumer Protection. The passage of the Act appears to have provided a slight boost to competition, but awareness of the Act seems low and firms indicate that the playing field is still unfair (Bertelsmann Stiftung 2016).

**State interventions in some sectors have raised concerns about crowding out of private investments.** State-owned enterprises (SOEs) have achieved economies of scale in various strategic industries, including those in which private firms operate. However, key informants suggest that, in sectors such as small-scale mining, woodcraft, and construction, where potential profitability is relatively high, private investments have been deterred by SOEs. The establishment of Farm Shops by the Department of Agricultural Marketing and

Cooperatives has also drawn complaints by local shop owners of unfair price competition (World Bank 2017a).

**Various sectoral regulations also inhibit competition.** In the tourism sector, the current tariff policy effectively guarantees a price floor and minimum profitability for tour operators. Consequently, tour operators have few incentives to compete and diversify their products. Anecdotal evidence suggests that many tour operators offer identical packages on their websites.

### 2.5.2.2 Policy Feedback

**Conflicts of interest discourage private investment in sectors in which SOEs operate.** With the 2007 state ownership policy, Bhutan has sought to improve the efficiency and effectiveness of SOEs through better governance by separating policy oversight from shareholder oversight. However, DHI's role in advising Ministry of Finance policies creates *prima facie* conflicts of interest in industries in which GLCs compete with private firms. The mere appearance of such conflicts of interest may also discourage private investment. In addition, GLCs may exercise a competitive advantage over private firms in the respective sector that over time may result in higher prices and lower quality for consumers.

### 2.5.2.3 Public Procurement

**The current public procurement framework is limited in its potential to develop firm capabilities.** The absence of a policy covering market analysis to inform the creation of an effective procurement strategy for contracts and the lack of a clear policy on bidder debriefs could contribute to higher bidding costs, rebidding costs, or the selection of the wrong bidder, as well as disincentives to participation for potential bidders (World Bank 2017b). The public procurement framework has provisions for preferential treatment by types of firms (domestic firms and Cottage and Small Industry [CSI] sectors), which has been the typical tool for governments to encourage specific groups. However, conversations with private-sector representatives suggest that bidding evaluation criteria are not formulated in a way that incentivizes businesses to improve their capabilities. For example, no provision ensures that the quality of a firm's human resources matches the requirements of a job.

## 2.6 TAXATION

**The high proportion of firms that cite taxation as a major business constraint reflects the predominance of poor accounting practices.** Taxation was the third-most cited constraint by Bhutanese firms in 2015. However, the proportion of Bhutanese firms noting taxation as a constraint is below the South Asian average, and the overall tax burden in Bhutan is similar to comparator countries (Subsection 2.6.1). Rather than actual tax rates or procedures, the perception of burdensome taxes reflects poor accounting practices, which in turn necessitate discretionary judgments by officials to determine tax burdens (Subsection 2.6.2).

### 2.6.1 SEVERITY OF CONSTRAINT

**The proportion of firms citing taxation as a major constraint is high, although less than in other countries.** High tax rates were considered a major business obstacle by 15 percent of Bhutanese firms. However, firms around the world routinely complain about high tax rates. For instance, 26 percent and 30 percent of businesses in South Asia and in all countries, respectively, identify tax rates as a major or severe constraint.

**While profit tax rates in Bhutan are higher than in many countries in the region, the overall tax burden in Bhutan is low.** Bhutan's tax regime imposes a 30 percent tax on net profit, but does not tax labor or other contributions.<sup>55</sup> The overall burden of taxation in Bhutan is lower than that in India and across South Asia countries (Figure 25-A). For a typical LLC, the time to pay taxes has also dropped over the past 10 years. In 2017, the time to pay taxes was 85 hours per year, which is one-third of the average time required for firms across South Asia (Figure 25-B). WBES data further suggest that firms faced fewer tax

55. The legislative framework for Bhutan's tax system is provided by the Income Tax Act 2001 as well as by the Sales Tax, Customs, and Excise Tax of 2000 and its corresponding rules. For businesses, the principal taxes include a business income tax (BIT) or corporate income tax (CIT), a personal income tax, a property transfer tax, and the sales tax for selected domestic goods and services. CIT is a corporate tax, levied at the rate of 30 percent on net profit, on those entities registered as a company under the 2001 Companies Act. BIT is similarly levied at 30 percent on unincorporated businesses operating with a license or permit issued by relevant government authorities. The category includes sole proprietorships and partnerships with sizes ranging from micro to large businesses (DRC 2016). See Annex 3.6 for more detail.

inspections in 2015 than in 2009 and fewer inspections than in comparator countries such as Costa Rica and India. Tax inspections are also applied more consistently. In Bhutan, most firms have only one tax inspection per year, whereas in Costa Rica and India firms may experience between one and six tax inspections per year (Figure 25-C).

### 2.6.2 SOURCES OF CONSTRAINT

**Poor accounting practices—common among micro and small firms—result in a lack of transparency in taxation assessments.** Many micro and small firms report that taxation is a significant burden on their operations, yet such firms are also most likely to be eligible for tax exemptions.<sup>56</sup> Moreover, where firms lack detailed accounts, tax officials apply discretionary judgment to calculate tax payments.<sup>57</sup> As such, a lack of financial management may adversely affect firms' tax burden. Bhutanese firms are less likely than their regional peers to prepare externally audited financial statements, with microenterprises extremely unlikely to do so. Tax data collected by Department of Revenue and Customs (DRC) indicate that, in 2015, only 8.6 percent of all BIT registered payers submitted books of account. Firms with audited statements are 6 percent less likely to perceive tax rates as the top constraint, even after accounting for firm size, sector, and location (Figure 25-D).

**Poor accounting practices reflect the recent adoption of official accounting standards and failures to build firm capacities.** The lack of accounting standards limits transparency and inhibits firms' access to capital markets. Until 2012, Bhutan did not have official accounting standards and businesses generally follow the Generally Accepted Accounting Principles (GAAP) and, in some cases, the Indian Accounting Standards (<http://business.bhutan.bt/10933-2/>). Consequently, accounting principles and methods practiced lacked uniformity, and disclosures of financial reports were inadequate (AASBB 2015).

56. The DRC estimates that, as of 2015, 11,571 businesses were tax exempt, accounting for 45 percent of all BIT units (DRC 2016).

57. The DRC maintains two methods to collect BIT. Taxes are computed based on tax rules when the taxpaying entity maintains and submits books of accounts during the time of filing taxes. However, for firms without bookkeeping, the DRC uses an estimated assessment method, usually based on any information available to the department, taxpayers, or third parties. The DRC itself recognizes that this method of tax assessment and collection are highly criticized (DRC 2016).

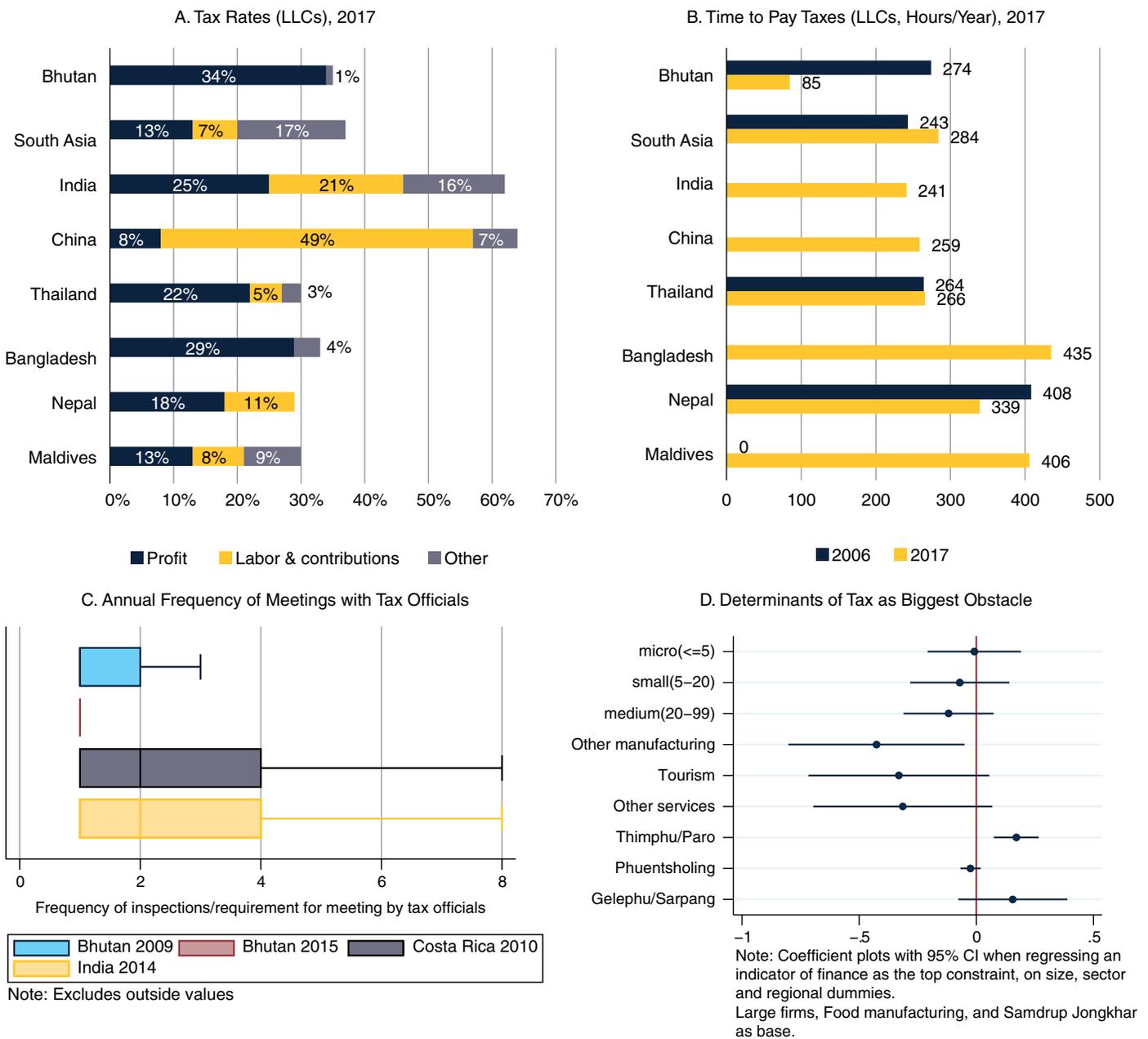


Figure 25: Tax Rates and Tax Administration

Source: Tax rates and time to pay taxes come from the Doing Business database. Frequency of tax official visits is estimated from WBES 2015.

## CHAPTER 3

# THE WAY FORWARD

### Summary

Improving the competitiveness of Bhutan’s private sector will require a mixture of both crosscutting and sector-specific reforms:

Crosscutting Reforms. Reforms that reduce uncertainty for lenders and risk for creditors, enhance asset collateralizability, and increase financial awareness can increase firms’ access to finance. The access of firms to skilled labor can be improved by relaxing barriers to skilled migration, providing vocational training, and addressing the attractiveness of private-sector compensation. Greater access to external markets can be achieved by improving border processing, upgrading infrastructure, and promoting FDI. Competition can be enhanced by rationalizing the role of state-owned enterprises, instituting a competition policy and public-private dialogue, and adjusting public procurement. The perceived burden of taxation can be reduced through revisions to licensing and incorporation procedures and by improving accounting standards.

Sector-Specific Reforms: To increase the benefits of tourism, policies should be revised to reflect the changing nature of flows and the changing preferences of tourists. The development of the ICT sector can be facilitated through improving Internet connectivity and by developing sector-specific channels to attract foreign expertise and investment. To develop agribusiness, the RGoB should rationalize the current program of subsidies and other interventions, develop supporting infrastructure, and fully implement the Brand Bhutan strategy. Finally, to enhance the economic spillovers of hydropower investments, the participation of local firms and workers in project construction should be increased.

## 3.1 INTRODUCTION

**The achievement of sustained economic growth will rest on the development of product lines which can leverage the country’s institutional assets while not being constrained by its natural endowments.** Bhutan’s natural endowments—its small size, mountainous topography, and landlocked location—hinder the ability of manufacturing firms to achieve increases in productivity through exploiting economies of scale. On the other hand, the country’s institutional characteristics—good governance, low corruption, civil stability, an English-speaking workforce, and cheap and reliable electricity—reduce risks ordinarily associated with private investment. In addition, Bhutan’s

commitment to GNH principles can help the country's products command a premium among environmentally conscious consumers in high-value markets. Thus, while Bhutan's potential to develop profitable industries centered on the export of basic goods is limited, industries focused on the export of services—such as tourism and ICT—and of premium niche products have substantial potential.

**The ability of the private sector to take advantage of Bhutan's latent potential in tradable services and premium niche products is currently inhibited by various input and product market imperfections.**

Bhutan's private-sector development is constrained both by crosscutting factors and policies affecting specific key industries. The growth of firms across the economy is stunted by a limited supply of and demand for financial products; by immigration restrictions and public-sector compensation policies that reduce the supply of skilled labor; by transport and logistics deficiencies that inhibit access to external markets; by unfair competition from public-sector entities; and by accounting practices that unnecessarily increase the burden of taxation. The growth of Bhutan's tourism industry is specifically inhibited by deficiencies in the quality and scope of accommodation, food, and tour services; the growth of the ICT industry is inhibited by a failure to capitalize on regional pools of skilled labor, by connectivity costs, and a lack of promotion; while the growth of agribusiness is inhibited by counterproductive public investments, inadequate trade infrastructure, and shortcomings in branding and marketing. Finally, the impact of Bhutan's hydropower industry on the wider economy is inhibited by the limited integration of local firms and workers in project construction activities.

**A reform program that combines crosscutting and sector-specific measures will promote broad-based economic development.** With a robust institutional framework, Bhutan has an advantage over many of its peers in the region and beyond in being able to enhance private-sector development by making relatively minor adjustments to policy and public investments. However, to fully achieve Bhutan's economic potential, the RGoB will need to undertake reforms that are both crosscutting and sector specific. Crosscutting reforms should address the limited access to finance experienced by microenterprises

in various sectors; difficulties experienced by firms in hiring skilled labor; factors inhibiting the integration of producers with external markets; activities of government-linked entities that discourage competition; and regulations that discourage licensing, incorporation, and tax compliance (Section 3.2). Sector-specific reforms, on the other hand, should update policies affecting the tourism sector to reflect the changing pattern of tourist flows and the changing preferences of tourists; address factors that undermine the viability of investments in the ICT sector; promote investments that enable access to high-value markets for agribusiness products; and maximize the positive economic spillovers of hydropower investments (Section 3.3).

## 3.2 CROSSCUTTING REFORM RECOMMENDATIONS

**A prioritized yet multifaceted reform program will facilitate private-sector development.** Analysis of the perceptions of firm managers and complementary data sources indicates that the growth of Bhutan's private sector is inhibited by multiple factors, including insufficient access to finance; limited access to skilled labor; restricted access to external markets; and factors restricting competition. To alleviate these constraints and promote the development of the private sector, certain reforms should be prioritized. Specifically:

- » **Access to Finance:** To improve the access of firms to finance, the RGoB should address deficiencies in the supply of and demand for financial products by reforming the credit information system, credit registry, restructuring and insolvency regime, and banking regulations and by providing financial literacy training (Subsection 3.2.1).
- » **Access to Skilled Labor:** To enable private-sector firms to access essential skills, the RGoB should provide vocational training to the adult population; adjust public-sector compensation and recruitment policies to improve the relative attractiveness of private-sector employment; and relax restrictions on the recruitment of skilled expatriates (Subsection 3.2.2).
- » **Access to External Markets:** To address Bhutan's poor integration with foreign investors and markets, the RGoB should support the upgrading

of firms' marketing capabilities; reduce the costs that border processing, infrastructure gaps, and the logistical sector impose on trade; and take additional measures to attract FDI (Subsection 3.2.3).

» **Competition:** To enhance competition, the RGoB should review SOE activities to ensure that private-sector development is not being curtailed; introduce a new competition policy and establish a mechanism for public-private dialogue; and revise public procurement processes to provide incentives for firms to acquire new capabilities (Subsection 3.2.4).

» **Taxation:** To reduce the burden of regulation and increase compliance with tax policies, the RGoB should revise licensing and incorporation procedures, provide training on taxation and accounting standards, harmonize databases, and improve coordination between agencies (Subsection 3.2.5).

### 3.2.1 ACCESS TO FINANCE

**Further reforms are needed to enhance the supply of and demand for financial products.** To increase the supply of finance, the RGoB should reduce uncertainty for lenders; reduce creditor risk; and adjust regulations to increase financial competition (Subsection 3.2.1.1). To increase the demand for finance, the RGoB should enhance potential borrowers' ability to use assets as collateral and bolster financial literacy (Subsection 3.2.1.2).

#### 3.2.1.1 Supply Side

**Improving the Movable Property and Immovable Property Security Act (MIPA), the credit information systems, and insolvency procedures should increase the supply of finance.** The RGoB should prioritize reforms that broaden and deepen the MIPA and expand the CIB, as well as the passage of the new Insolvency Bill. Other actions that the RGoB may undertake include increasing interbank competition by reforming the role of the BDBL and promoting the expansion of nonbank financial institutions by easing requirements for microfinance institutions and reducing the risks of e-banking.

#### *Deepen and Broaden Credit Information Systems*

**Deepening and broadening credit information systems will reduce uncertainty associated with**

**lending and increase the supply of finance.** Plans exist to expand coverage of the CIB to include loans made by MFIs (including REDCL), as well as information from insurance companies. Bhutan's two utility regulators have issued directives to utility providers to provide information to the CIB. The CIB system has been upgraded to accept and incorporate this new information into the credit reports for all users. To further this process, an outreach exercise is needed to show the banks how these new information sources can be integrated into their credit assessment processes to enable better lending decisions and increase the supply of credit. Finally, to ensure its commercial sustainability, the CIB should develop a strategic business plan, undertake a pricing review, and adopt corporate governance structures.

#### *Approve and Implement New Insolvency Bill*

**A new restructuring and insolvency regime will provide better protections for creditors and borrowers and facilitate efficient debt recovery.** A new Insolvency Bill has been drafted by the RGoB to replace the current Bankruptcy Act and certain sections of the Companies Act. The new Insolvency Bill introduces a new restructuring and insolvency system aligned with best practices that will improve both the reorganization and the liquidation of distressed companies and small businesses. The Bill has been approved by the Cabinet and rapid passage through Parliament will be an important step to better pricing creditor risk; preserving jobs and supply chains; promoting entrepreneurship; and improving economic efficiency by reallocating productive assets from insolvent to solvent firms. The RGoB should further review and amend the Land Act to further reduce the costs and uncertainty for creditors seeking to recover outstanding debts through the judicial process; explore the feasibility of establishing a commercial court; and build the capacity of insolvency professionals (Murgatroyd 2016, 41).

#### *Increase Financial Competition*

**Reforms of the role of the BDBL can increase interbank competition and expand the scope of financial products available.** To increase the supply of credit to agriculture, the RMA should expand BDBL's license to enable it to provide export financing for agricultural

clients (Murgatroyd 2016), such as by providing letters of credit and factoring and handling foreign exchange transactions. To further enhance the availability of credit to farmers, the RGoB should direct BDBL to prioritize group lending to the 37 agricultural cooperatives, all of whom currently have bank accounts and are currently undergoing financial literacy training to bolster credit-worthiness (ibid.). To further increase the scope for price competition, the RGoB should also require SOEs to regularly obtain competitive bids from multiple banks and consider distributing funds more widely across the financial system (ibid.).

**The easing of licensing and reporting requirements for MFIs can expand the access of small and/or remote enterprises to credit.** To facilitate the growth of MFIs, it is essential that the RMA finalize regulations for deposit taking MFIs and ease the licensing and operation of nondeposit taking MFIs by reducing the required minimum paid-in capital and simplifying and standardizing reporting requirements with the Civil Society Organizations (CSO) Act (ibid.). To improve the sustainability and enhance the growth of the microfinance sector, the RMA should require that information on all MFI, REDCL and BDBL loans, regardless of size, be reported to the CIB and that avenues are explored to establish a partial credit guarantee fund (ibid.).

**Regulatory reforms that focus on reducing risks for customers can encourage the growth of e-banking.** To resolve outstanding issues concerning the security of and responsibility for mobile transactions, the Bhutan Information, Communications and Media Act 2006 (BICMA) should be amended to enable the issuance of e-money. In addition, the Ministry of Information and Communications (MoIC) should amend the e-Governance Master Plan to address outstanding regulatory gaps pertaining to privacy, data protection, and service provider and user responsibilities. To further facilitate the growth of mobile banking, the RMA should adopt e-money regulations that accommodate bank- and nonbank systems; create a gateway for e-money interoperability among banks and mobile operators; and incorporate a framework for combatting financial terrorism into the country's anti-money laundering regime (ibid.).

### 3.2.1.2 Demand Side

**An increase in the realized demand for finance can be achieved by expanding the scope of collateralizable assets.** To this end, the RGoB should prioritize proposed amendments to the MIPA and enhance the Central Registry for Secured Transactions (CRST), while pursuing reforms that will enable the use of crops, crop transactions, and land as collateral. The demand for finance may be further increased through efforts to address financial illiteracy and to develop cultures of financial responsibility and inclusion within the private sector.

#### *Expand Scope of Collateralizable Assets*

**An expansion in the scope of movable assets that can be used as collateral can be achieved by Parliament approving amendments to the MIPA and through an upgrading of the CRST.** Proposed amendments to the MIPA that will enable all moveable assets (such as accounts receivable, inventory, factoring, etc.) to be registered in the CRST and subsequently used as collateral are currently before Parliament. These should be approved. Thereafter, the RMA should draft regulations to ensure that collateral requirements are favorable to movable asset-based financing in accordance with Basel-II recommendations. To render the CRST easier to use, the database's search functionality should be enhanced. The RMA should also establish an appropriate corporate governance structure for the CRST and provide training to financial institutions on the development of new lending products against movable assets.

**The volume of agricultural finance may be increased by empowering farmers to use crops and crop transactions as capital.** A substantial volume of Bhutan's produce is currently exported and a network of warehouse facilities exists to collect crops prior to export. Adoption of legislation and accompanying regulations to enable the use of warehouse receipts as collateral could potentially increase the volume of agricultural credit (ibid.). The development of crop insurance mechanisms, a commodities exchange, and the adoption of accompanying regulations to permit the use of associated instruments as credit may also serve as instruments for increasing the access of farmers to credit over the medium term (ibid.).

**Reforms of the management of property records will facilitate the use of land as collateral.** Electronic input and search capabilities should be integrated into the National Land Commission electronic property and land registration system and real estate valuation services should be developed. The National Land Commission should undertake measures to link the Thromde Land Section's property records with the corresponding property titles and land information from the land commission's registries by upgrading the current platform for urban and rural titles and connecting it with the geo-spatial information contained in the Arc GIS database. Finally, the unified system should be linked to municipalities to ensure that citizens and businesses can take full advantage of the upgraded system.

#### *Increase Financial Literacy*

**A multifaceted financial literacy program can increase the use of financial products among different segments of the population.** To inform the design of tools to increase financial literacy among entrepreneurs and other segments of the population, the RGoB and its development partners should comprehensively survey financial literacy and identify a focal agency. Options for financial literacy initiatives include focusing training on financial managers and entrepreneurs; expanding MFI village-based financial literacy initiatives; upgrading bookkeeping modules provided to members of agricultural cooperatives to enable the production of annual balance sheets and income statements that may be used to support loan applications; incorporating modules on financial literacy into the high school education system; and creating incentives to provide financial consulting services to firms and entrepreneurs (ibid.). The efficacy of entrepreneurship training programs in increasing financial literacy and usage should be evaluated to identify adjustments that may improve such programs.

**The efficiency of priority lending programs can be enhanced through better defining targets and developing a more rigorous monitoring and evaluation framework.** To bridge financing gaps for MSMEs and the agriculture sector, the RGoB has introduced various concessional lending programs, some of which are coupled with entrepreneurship training. Priority credit

lines provided for CSIs and rural enterprises, now managed by BDBL and REDCL, have suffered from slow disbursement due to capacity and geographical constraints. However, implementation is also affected by unclear policy objectives and inconsistencies in eligibility conditions. Similarly, past programs, such as the Entrepreneurship Development Program (EDP), were considered ineffective at improving lender viability. Both types of programs suffer from poor targeting resulting from a lack of understanding of the demand for finance by CSI and rural enterprises. Going forward, rigorous results tracking is needed to assess effectiveness and provide evidence to improve programmatic design (see Box 1).

### 3.2.2 ACCESS TO SKILLED LABOR

**Alleviating skill shortages will be essential to bolstering economic growth, particularly in the tradable services sector.** While Bhutan has made significant strides in increasing school enrollment over the past decade, such improvements address the prevailing skill shortage only gradually. Thus, to limit the negative economic impact of skill shortages, the RGoB should act to ensure a greater availability of skills over the short term by developing channels for skilled migration while also investing in building the skills of the adult population (Subsection 3.2.2.1). To increase the access of private-sector firms to skilled graduates, the RGoB should also take actions to improve the relative attractiveness of private-sector compensation packages (Subsection 3.2.2.2).

#### 3.2.2.1 Skill Gaps

**Skill shortages may be alleviated by rationalizing rules for hiring foreign workers and by providing vocational training.** Durably resolving skill shortages requires an upskilling of the domestic workforce, which is gradually being achieved through increases in school enrollment. However, the failure to resolve skill shortages in the short term may critically handicap emerging industries of strategic economic significance, such as ICT and tourism. To gain a foothold in these sectors, the RGoB should reform labor and immigration regulations to enable the recruitment of skilled foreign workers and should develop vocational training programs and scholarships for executive education.

## Box 1: Evidence from Entrepreneurship Training in South Africa

While economic research has established the importance of entrepreneurial skill as a determinant of productivity, the impacts of business training programs on the profits of small firms in developing countries have been disappointing. The results of a recent experimental study are notable, therefore, not only because they demonstrate that training programs—if sufficiently intensive—can increase profits, but also because they indicate that achieving such impacts requires matching different types of training to firms with different characteristics.

The study focused on 852 small firms in Cape Town, South Africa. Entrepreneurs leading a randomly selected subsample of these firms were provided with 10 weeks of intensive training on either marketing or finance delivered by a local business development and training organization. The study used a novel electronic survey tool to measure key outcomes, such as firm behaviors, sales, costs, and profits, at six months and then again at 12 months after the training.

The study finds that, over the course of a year, both programs created significant statistical and qualitative increases in firm profits of between 41 and 61 percent. However, only modest impacts were detected six months after the training. The authors surmise from

this that “business training requires an incubation period of several months for firms to apply and test their new knowledge before improvements in firm outcomes are realized.

Interestingly, the study finds differences in the effects of the two training programs. Entrepreneurs receiving marketing training became better at receiving feedback from business partners and customers and increased profits by focusing on increasing sales, investing in stock and materials, and hiring more employees. Entrepreneurs receiving finance training, on the other hand, increased profits by reducing costs and better managing firm finances, resulting in significantly higher levels of firm efficiency.

The two types of training had varying effects on the entrepreneurs involved. Those with less exposure to different business contexts benefited significantly more from the marketing training, while those with broad exposure did not appear to benefit from that training. On the other hand, finance training benefited more established firms, but newer firms benefited little.

*Source:* Anderson, Chandy, and Zia 2016.

### *Rationalize Restrictions on Migrant Labor*

**The rationalization of rules on hiring foreign workers will enable firms to fill skill shortages.** Addressing the skills shortage in the near term will necessitate reforms to remove barriers to the recruitment of skilled foreign labor. The RGoB may consider the creation of a separate channel for skilled temporary migration (similar to the H-1B program in the United States) to both enable control over the volume of immigration (a goal which is achieved by current policy) and to ensure that flows of unskilled migration do not crowd out flows of skilled migration (which is not achieved by current policy). Complementary reforms that might be considered include the elimination of the negative list of occupations in which foreign employment is precluded; the standardization of approval requirements across all countries of origin; and the introduction of decentralized approval procedures. By easing the extent to which firms may use foreign workers to fill prevailing skill shortages, such reforms can increase the productivity of Bhutanese firms and thereby improve employment prospects of Bhutanese workers.

### *Upskill the Domestic Labor Force*

**Increased vocational training and a focus on building technical and soft skills of the labor force**

**can improve firm-level productivity and increase wages.** The RGoB and its development partners should increase the provision and quality thereof of vocational training to the adult population. Based on employers’ perception on skill deficits, the content of training should focus on core technical skills such as computer literacy and soft skills such as leadership and teamwork (World Bank 2016a). To ensure the effectiveness of these initiatives, it is important that impacts on skill attainment and employment outcomes are rigorously evaluated and that variations in programmatic design and implementation are continuously tested to enable ongoing improvements (Box 1).

**Scholarships for intensive business education can improve the capacity of private-sector executives to develop the soft skills of their workers.**<sup>58</sup> In many sectors, managerial capacity and firm-level training are a key determinant of the level of soft skills within a firm. To

58. Entrepreneurship training is not discussed given mixed evidence about its effectiveness. A variety of programs exist to provide incentives for capacity upgrading, such as the Entrepreneurship Development Program and matching grants provided for the CSI sector. The RGoB needs to rigorously monitor and evaluate these initiatives and experiment with targeted training.

assist managers in building the skills required to instill cultures of teamwork and professionalism, the RGoB should develop a scholarship program that enables well-qualified managers, business executives, and young business professionals to pursue intensive executive education abroad. Currently, a total of 921 students are undergoing tertiary education on scholarship, of which 242 students graduated in 2016 (Bhutan MoLHR 2015a). However, very few of these are in business. Creating an avenue by which Bhutanese business professionals can gain an international standard executive education will, in addition to helping build cultures of managerial excellence among Bhutanese firms, further the development of linkages with export markets.

### 3.2.2.2 Attractiveness of Private-Sector Work

#### **Adjustments to public-sector compensation packages and recruitment procedures will enable private-sector firms to attract talented graduates.**

Currently, private-sector firms in Bhutan struggle to attract talented graduates, who are enticed by more lucrative jobs in the public sector. Ensuring that the private sector can attract the best and brightest workers will require measures to address the relative attractiveness of private-sector jobs. Specific actions include moderating increases in public-sector wages, bolstering social protection for private-sector workers, and ensuring the equality access between public- and private-sector workers to fringe benefits. In addition, the RGoB might consider adjusting how public-sector workers are recruited by placing a greater emphasis on private-sector work experience.

#### *Realign Public- and Private-Sector Compensation*

#### **Moderation of public-sector wage increases and the development of ‘flexicurity’ policies for private-sector workers will improve the relative attractiveness of private-sector jobs.**

Jobs in Bhutan’s public sector generally offer better total compensation and are more secure. While Bhutan’s employment protection legislation provides flexibility to employers, it also creates a degree of risk for workers that—absent a robust social protection system—reduces the attractiveness of private-sector jobs. Improving the competitiveness of the private sector will require the RGoB to take measures to address this imbalance. First, the RGoB should moderate future

increases of public-sector wages to less than or equal to those of the private sector, thereby enabling the private sector to become increasingly competitive in base pay (World Bank 2016a). Second, the RGoB should develop income support measures for unemployed private-sector workers and active labor market programs—such as retraining and job search assistance—to ameliorate the negative impacts of shocks and vulnerabilities associated with private sector employment (ibid.). By adopting these twin policies of moderating public-sector wage increases and developing a “flexicurity” system, the attractiveness of private-sector employment for skilled workers should improve over time.

#### **An alignment of pension systems, provision of mandated benefits by private-sector employers, and a reduction in benefits for public-sector workers will address the imbalance in total compensation.**

The generous pensions paid to public-sector workers account for a substantial portion of the differential in total compensation. To improve the attractiveness of private-sector jobs without creating a tax wedge, the RGoB may promote voluntary participation in a defined contribution scheme by matching contributions made by private-sector workers (World Bank 2016a). In conjunction, the generosity of the defined benefit scheme offered by the public sector should be parametrically adjusted to reduce the risk of future deficits. Even though the equality of employment benefits is mandated by law (ibid.), a relatively small proportion of Bhutan’s private-sector workers have access to fringe benefits such as gratuities, provident fund payments, overtime, paid annual, sick, maternity/paternity, and casual leave, and compensation for work accidents. To redress this imbalance, the RGoB should undertake public awareness campaigns to apprise workers of their rights and employers of their responsibilities, while bolstering enforcement (ibid.). Finally, improving the relative attractiveness of private-sector employment may also necessitate reducing certain fringe benefits offered to public-sector workers but which are not legally mandated, such as subsidized housing (ibid.). The development of a national social protection system as described above could help provide political space for such reforms.

#### *Reform Public-Sector Recruitment*

#### **Changes to civil service recruitment practices can render private-sector employment a more**

**attractive option for graduates.** The Bhutanese civil service administers a rigorous examination to select the most qualified candidates for employment (World Bank 2016a). The examination emphasizes academic achievements, technical knowledge, analytical ability, and fluency in English and Dzongkha, among other criteria, but does not place any value on private-sector work experience (ibid.). Due to this failure to consider private-sector employment as a qualification for the civil service, those who seek a career in the civil service are encouraged to focus on preparing for the next exam rather than using the intervening period to gain work experience (ibid.). Reforming the civil service recruitment process to enable candidates to be rewarded for having gained private-sector work experience would immediately increase the attractiveness of private-sector employment for graduates and thereby the supply of skilled workers available to the sector, while also potentially increasing the quality of civil service recruits over time (ibid.).

### 3.2.3 ACCESS TO EXTERNAL MARKETS

**Achieving greater access to high-value export markets will require improved marketing, more efficient border processing and transportation infrastructure, and increased flows of FDI.** In order to enable Bhutanese firms greater access to external markets, the RGoB should support the upgrading of firms' marketing capabilities, such as e-commerce, quality certification, and branding (Subsection 3.2.3.1); address prevailing constraints on trade imposed by border processing, customs regulation, infrastructure gaps, and the underdevelopment of the logistics sector (Subsection 3.2.3.2); and remove barriers to FDI (Subsection 3.2.3.3).

#### 3.2.3.1 Marketing

**Support to improve the capabilities of Bhutanese firms to export can enable the realization of firms' ambition to reach higher value markets.** An unusually large share of Bhutanese firms relies on intermediaries for exports (Subsection 1.2.4), which is a symptom of a lack of experience in accessing foreign markets. Key informants at commercial banks suggest that many firms demonstrate a lack of marketing skills, a lack of understanding and use of trade finance and commercial

contracts, and an unfamiliarity with standards and quality certification. To increase the access of Bhutanese firms to new markets, the RGoB should promote the use of online business platforms to enable access to e-commerce, increase awareness of the importance of quality standards and certifications, reinforce the Brand Bhutan strategy, and develop a strategy to *leverage* duty-free and quota-free access to European, South Asian, and U.S. markets.

#### *Promote the Use of Online Business Platforms*

**The creation of online platforms to match local firms with export partners and other e-commerce initiatives can enable firms to overcome Bhutan's high transport costs.** Micro and small firms, which typically face a high fixed cost to export, have been shown to benefit from online platforms for commerce.<sup>59</sup> The Internet is a particularly important tool for firms in small countries, given the difficulties firms in such countries face in achieving economies of scale when serving only domestic markets.<sup>60</sup> Estonia provides an example of a small country that has embraced e-commerce as its key development strategy (see Box 2).

**Bhutan will need to strengthen its logistics infrastructure, including e-payment systems, and encourage pioneer investors to develop e-commerce.**<sup>61</sup> Except for online sales of air tickets and a small number of online shopping portals (e.g., <http://shop.bt/>), there is limited e-commerce in Bhutan. A key barrier to e-commerce in Bhutan has been the lack, until recently, of supporting infrastructure. There were no options for Bhutanese merchants to receive payments online prior to the launch of BoB's e-payment gateway in 2015. At present, few banks allow Internet transactions and the RGoB

59. Many exporting firms on eBay have fewer than 10 employees (Kelly et al. 2017). Research by eBay (2013) finds, for example, that Jordanian businesses using eBay Marketplace to export reached on average 28 different markets, whereas traditional Jordanian exporters only reached 3 markets on average (eBay 2013, 32).

60. For example, the share of sales to other EU countries in total eBay sales is negatively correlated with the size of GDP. In general, the benefits of e-commerce are highest for the smaller and less developed countries in the region (Kelly et al. 2017).

61. This discussion draws on an e-trade readiness assessment by UNCTAD (2017).

## Box 2: E-commerce Development in Estonia

Estonia is one of the world's leaders in e-commerce. In 2016, over 50 percent of the country's population were e-commerce users, spending around \$389 USD on average. With the industry growing at a rate of 40 percent per annum, the penetration and numbers are expected to continue to rise.

The Estonian government has been facilitating the growth of e-commerce since it regained its independence in 1991, when the government prioritized the development of ICT. Recently, the government created a first-of-its-kind e-residence program with the aim of further growing e-commerce. This program allows anyone in the world to create a business that will utilize and develop e-services in Estonia. As e-residents generally require local banking and accounting services, the establishment of e-businesses by e-residents generally results in broad economic spillovers.

The rise of e-commerce has had positive impacts on Estonia. Firstly, with 97 percent of banking transactions done using e-banking services and given the convenience associated with online shopping, it has made citizen's lives a lot easier. Secondly, Estonia is reaping the benefits of being recognized as the world's leader in e-commerce, with tens of thousands of new e-residents. Thirdly, e-commerce is driving the country's economic growth. Estonia's experience shows that in the digital age, being a small country is not an impediment to development.

*Source:* The Economist (2013).

will need to further develop payment solutions to enable firms to receive payments. To fill in the gaps in human capital, the RGoB needs to place a greater emphasis on ICT training in the education system. In the short term, the RGoB can also support the development of an online platform to match Bhutanese firms with potential export partners (as with Japan's Trade Tie-Up Promotion Program). The RGoB might also consider adopting elements of an initiative deployed by the Republic of Korea which supported the growth of rural e-commerce by developing a reliable nationwide distribution channel through its post office service (UNCTAD 2015).<sup>62</sup>

62. Korea's rural project could be benchmarked not just for the promotion of commerce abroad, but also in the context of RGoB's e-government initiatives. While the project has been created to bridge the digital divide between rural and urban areas, the e-commerce system is available to provide incentives to residents of rural areas to participate in the training programs that impart basic Internet skills. E-commerce channels developed by the Korean project have made great contributions to the income growth of rural areas and to the capacity required to utilize the e-government systems.

## *Improve the Quality Standards and Certifications Framework*

**A communication strategy to increase awareness of the importance of quality standards and certifications will help firms expand their market opportunities.** Effective adoption of quality standards will require an assessment of target export sectors and markets to prioritize investments in the national quality infrastructure. Currently, the share of Bhutanese firms meeting international standards is low, partly due to a lack of awareness on the demand side. As a first step, the government should invest in a communication strategy to explain and highlight the benefits of standards and quality certification in gaining access to new markets (ICA Costa Rica 2002). For example, Colombia's Quality and Environmental Management Program was key to increasing SME certification (World Bank 2007).

### 3.2.3.2 Border Performance, Infrastructure, and Logistics

**Reforms to border and customs procedures, investments in infrastructure, and support for the development of the logistics sector can help improve export performance.** Firm-level data and benchmarking of Bhutan's performance in trade logistics indicate that several connectivity constraints inhibit the country's export performance. In order to address these, the RGoB should: introduce risk-based inspections and improve coordination with other international border agencies by aligning customs legislation and practices with the Revised Kyoto Convention (RKC) standards; expand and improve the current transport and logistics infrastructure and diversify the transport corridors to reduce current dependency on India; phase in the Bangladesh, Bhutan, India, and Nepal Motor Vehicles Agreement (BBIN MVA); and support the development of private-public partnerships in infrastructure.

## *Introduce Risk-Based Inspections and Increase Border Coordination*

**Introducing risk-based inspections and clearances and strengthening coordination with India will allow for more efficient processing of shipments.** The risk-based management approach targets a balance between ensuring compliance and minimizing disruptions

and trade costs, as it allows customs to assign its resources to high-risk areas and to increase the efficiency of the clearance procedures for low-risk cargo (WCO 2011). One option is for the DRC to move from a semiautomated clearance process system to a fully automated system that allows creation of a database of information on risks. This would lead to a lower rate of physical inspections of cargo traffic and enable more efficient clearances for import and export based on traders' history, thus reducing congestion and inefficiencies at Phuentsholing (Bhutan, MoEA 2012).<sup>63</sup> More broadly, the RGoB should align customs legislation and practices with the RKC standards,<sup>64</sup> which entail making customs actions predictable and transparent, standardizing and simplifying procedures and documents, using risk management and audit-based controls, and coordinating interventions with other border agencies.<sup>65</sup>

**Improved border coordination and automation of customs procedures will reduce trade costs and facilitate customs clearance of Bhutanese products.** Traders in Bangladesh benefited from the introduction of an automated customs clearance system at Chittagong port, reducing a customs clearance process of 42 steps to just 5, reducing costs of doing business by 70 percent, and reducing custom processing time by 80 percent (World Bank 2009; DataSoft 2010).<sup>66</sup> In addition to creating a national single-window system, Bhutan could establish joint border facilities with India to reduce border queues and clearance times for products

that transit between Phuentsholing and Kolkata. International border-agency cooperation makes cross-border trade and logistics more efficient and less costly, as it simplifies document preparation, harmonizes physical inspections, reduces administration costs, and decreases staff needs (UNCTAD 2011).<sup>67</sup>

**The RGoB should provide adequate access to convertible currency and ensure that tax rebates for imports of semifinished goods manufactured in India are correctly implemented (Bhutan, MoEA 2012).** Inefficiencies in refunding taxes have a distortionary effect on market prices, competition, and economic growth. The RGoB could allow credit to be carried forward and offset against future tax liabilities, including income tax. This measure would avoid creating barriers for imports.

*Support the Development of Infrastructure and Logistics*

**By expanding existing transport and logistics infrastructure, Bhutan can reduce its dependency on existing transport corridors.** To reduce dependence on Kolkata, the MoEA should fast-track a bilateral transit agreement with Bangladesh and work with the private sector to identify and assess viable alternative corridors, such as Bangladesh's Chittatong and Mongla ports. The MoEA should encourage the development of industrial and logistic clusters along existing and planned corridors (Bhutan, MoEA 2012; Rahman and Rahman 2016).<sup>68</sup> The RGoB should focus on completing the southern east-west highway, which will reduce unnecessary delays and boost tourism (Galay 2014). The RGoB must also ensure that the newly planned dry port facilities near Phuentsholing are constructed on time given the current bottlenecks caused by the lack of appropriate customs facilities and multiplication of clearance sites. The viability of

63. For instance, Zambia introduced a risk management system in 2015 that determines the degree of intervention of consignments according to their risk profile, resulting in minimal intervention of at least 59 percent of cargo intervened between June and August 2015 (IFC 2016).

64. The RKC provides a harmonized blueprint for modern, simplified, and efficient customs procedures.

65. For example, after Japan signed the RKC in 2001, release times were reduced by the introduction of several customs procedures and techniques; in 2009, the average release time for sea cargoes with pre-arrival information was 60 percent shorter than for those without pre-arrival information (Yasui 2010).

66. Colombia introduced a national single-window system, Ventanilla Única de Comercio Exterior (VUCE) in 2005, which streamlined more than 135 different import procedures into one, reduced cargo inspection times from three days to one, and contributed to a 40 percent reduction in direct costs of exporters and importers (MinCIT 2014). In Costa Rica, the implementation of streamlined export permit procedures through a single-window system increased the number of exporters by 22.4 percent (World Bank 2016d, 80)

67. For example, Germany and Poland jointly operate the Ludwigsdorf border crossing (customs office, inspection area, parking lots, storage, and other facilities), located in German territory. Zambia and Zimbabwe cooperated on the implementation of the Chirundu Border Post, which reduced the time trucks spent at the border from four days to one (Zambia, MoCTI 2011).

68. For example, Kosovo reduced the time and cost of documentary and border compliance by implementing the Albania-Kosovo Transit Corridor and upgrading its automated customs system (World Bank 2016b, 37).

a railroad connection between Phuentsholing and the Indian railway network should also be analyzed as this would enhance the dry port's potential (Kunaka 2014).

**The elimination of cross-loading requirements and the provision of training for logistics professionals can bolster Bhutan's logistics sector while reducing trade costs.**

The RGoB should seek to phase in the Bangladesh, Bhutan, India, and Nepal Motor Vehicles Agreement, which enables vehicles to enter any of the four countries without transshipment of goods at the border from one country's trucks to another's (Mitra 2016; The Hans India 2017). The RGoB must negotiate provisions that ensure that bad practices, such as the unofficial ban of Bhutanese-plated trucks in Indian markets, are ended.<sup>69</sup> The RGoB should also phase in the introduction of the BBIM MVA with the planned completion of new road infrastructure (Galay 2014), so as not to collapse existing networks.<sup>70</sup> The MoEA should also design and offer a logistics training program that combines conceptual and practical notions (i.e., distribution channels, methods of payment, and logistics systems management) (Bhutan, MoEA 2012, 50). The MoLHR and MoEA should further make vocational training for drivers and other manual intensive handling labor a priority, as the BBIN MVA will introduce strong competition from Indian trucking companies.

**The development of a Viability Gap Fund can facilitate private-public partnerships to finance the construction and maintenance of road infrastructure.**

The Ministry of Finance (MoF) should encourage PPPs through its newly established Public Private Partnership Agency (P3A) and PPP policy (Bhutan, RGoB 2016). To date, only a few PPPs have been implemented in Bhutan: the Dagachhu Hydro Power Plant, the

Thimphu Parking, and the Thimphu Tech Park. New PPP projects in the transport, energy, urban infrastructure, tourism, healthcare, and education sectors have great potential (Ernst & Young 2014). For example, the National Highways Authority of India was established through a combination of public resources and standardized PPP concession schemes (India, PPIAF 2011). Some projects that may not be commercially viable for investors in the short term may be economically viable and of social interest in the long term. To finance these types of projects (i.e., construction of a low-volume road network to connect an isolated region), the MoF should develop appropriate procedures and guidelines to establish a Viability Gap Fund (VGF) targeting specific key constraints to PPP project development (Bhutan, RGoB 2016; ICA Nepal 2012, 8; ADB 2016, 14).<sup>71</sup>

**Continued investments in airport infrastructure and deregulation in the airline sector can help improve the potential for multimodal ground-to-air logistics.**<sup>72</sup>

Despite improvements of the road network, Bhutan's mountainous terrain continues to impose travel times and costs that discourage tourists from visiting locations beyond the western regions and renders the exports of goods such as perishable produce infeasible. Improving connectivity will require Bhutan to further increase the efficiency of its air transport. To achieve this, the RGoB may consider further investments in the regulatory capacity of the Bhutan Civil Aviation Authority (BCAA) and in the operational capacity of the Department of Air Transport (DOAT).

**3.2.3.3 Foreign Direct Investment**

**Bhutan should use specific strategies to attract investors to niche sectors that can leverage the country's unique institutional features.**

Bhutan has natural constraints in attracting private-sector investment due to its landlocked nature, small domestic market, and

69. The RGoB, with the Indian government, should address particularly the interference with the Bhutanese trucking and trading industries. Further, the RGoB should seek a reciprocal transport agreement enforced with the Indian trucking syndicate that allows backhauling by Bhutanese trucks from Assam and West Bengal.

70. For example, to facilitate cross-country trade and reduce border corruption, Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Macedonia, Moldova, Romania, and Serbia and Montenegro adopted the Trade and Transport Facilitation in Southeast Europe Program, which generated economies of scale in the production of marketable goods and services (WB IEG 2007).

71. For example, Mexico's National Infrastructure Fund (FONADIN) provides grants to make PPPs financially viable. It does not obtain any annual funding from the treasury, receives revenues from existing projects, and offers reimbursable and nonreimbursable support. From 2010 to 2012, each dollar of FONADIN subsidy generated \$7 of private investment (ADB 2016).

72. This section draws heavily on the air transport sector assessment by the ADB (2016).

long distance to global and regional markets. At the same time, Bhutan possesses unique advantages over its neighbors, including carbon neutrality, limited corruption, civil stability, low electricity prices, unique cultural values, and a high quality of life. An efficient FDI policy framework can help Bhutan navigate its disadvantages to better attract and retain FDI. While foreign investors interested in coming to Bhutan have received dedicated promotion services in some cases, Bhutan does not have a strategy to proactively target potential investors. RGoB should promote new FDI through a well-formulated promotion strategy, targeting niche markets in key sectors like medical, educational tourism, and niche agricultural products.<sup>73</sup> In the short term, the RGoB should present and promote investment opportunities directly to existing networks of investors. In the medium term, the RGoB can assess the need to create a stand-alone investment promotion unit with dedicated staff to conduct outreach.<sup>74</sup>

**To further increase inflows of the FDI, the RGoB should revise existing sectoral barriers to entry and relax *de facto* and *de jure* restrictions on registering property and employing high-skilled foreign labor.** Equity restrictions like the minimum investment threshold in the hotel sector inhibit desirable investments in the country. To attract high-value, low-impact tourism, the RGoB should introduce alternative incentives to encourage home-stay tours in rural destinations. In addition, immigration rules should be consistently enforced in accordance with the FDI policy. Moreover, the RGoB should avoid inflexible regulations on the foreign-to-local employment ratio given the extent to which foreign workers in new sectors are essential for knowledge spillovers. The RGoB should facilitate learning and training for high-skill sectors through the establishment of a

73. Bangladesh and the Indian state of Orissa have excellent experience in promoting agribusiness investment. Given their proximity, Bhutan should consider familiarizing themselves with their investment promotion efforts. The World Bank Group's Agribusiness Investor Targeting Toolkit (World Bank Group 2014) also provides a useful step-by-step guide in the design and conduct of outreach campaigns aimed at investors, along with many practical tools for project teams to use in developing outreach plans.

74. For example, New Zealand, a small and geographically isolated country, established New Zealand Trade and Enterprise to target investment into the government's priority growth sectors, to develop a global network of investors, and to attract and retain smart FDI in greenfield and brownfield projects (UNCTAD 2013).

dedicated investment promotion unit to match industry and educational providers.<sup>75</sup> Finally, the RGoB should reduce the time it takes to register a property to create a more positive environment for prospective investors, particularly in the agribusiness sector.

### 3.2.4 COMPETITION

**Rationalizing the role of state-owned enterprises, passing a robust competition policy, establishing mechanisms for public-private dialogue, and revising procurement rules will facilitate the growth of the private sector.** To reduce the adverse effect of SOEs on private investment, the RGoB should carefully evaluate the merits of intervention (Subsection 3.2.4.1). The RGoB should also introduce a new competition law and invest in the necessary enforcement capacity (Subsection 3.2.4.2). To address the perception of policy capture, the RGoB should create a robust private-public policy dialogue platform to provide equal access to policy makers (Subsection 3.2.4.3). Finally, revisions to public procurement policies and practices can help further promote private-sector development (Subsection 3.2.4.4).

#### 3.2.4.1 Role of State-Owned Enterprises

**Rationalization of the activities of state-owned enterprises will limit the extent to which efforts to overcome market failures inadvertently crowd out private-sector development.** DHI currently provides essential public goods and enables economies of scale in several sectors. PPP investments in the Thimphu Techpark, for instance, provided essential infrastructure to kick-start the first foreign investments in the ICT sector (Subsection 1.4.3). However, in activities such as small-scale mining and manufacturing, the RGoB should identify the market failures that DHI can help correct and scale back interventions that are not well justified. For example, if the concerns are to maintain strict environmental quality, resources could be reallocated to improve the capacity of the Department of Natural Resources to monitor and enforce environmental standards. In the ISP

75. For example, Costa Rica's IPA, CINDE, surveys foreign investors' skill demands and works with academia to design and implement training programs and to inform students of highly demanded career paths; since 2005, CINDE has trained more than 10,000 workers in high-value skills (UNCTAD 2014).

market, the government could evaluate whether allowing new private entrants would help bring down the cost of broadband Internet access.

#### 3.2.4.2 Competition Policy

**The creation of a new legal framework to prevent anticompetitive practices, monopolies, and cartels can help improve economic efficiency and the competitiveness of the private sector.** Bhutan has adopted a National Competition Policy that requires all relevant government agencies to carry out competition impact assessments of new and existing laws. However, the RGoB should also introduce a competition law and build enforcement capacity and understanding of the law (UNCTAD 2015). Kenya may provide a potential model. Kenya's Competition Authority, for example, raised awareness and understanding of its new competition law through a successful advocacy campaign; the compliance effects of the advocacy campaign avoided a 20 percent increase in the cost of certain private healthcare providers (World Bank 2016c).

#### 3.2.4.3 Policy Feedback

**Establishing a mechanism for public-private dialogue will reduce the perception of undue influence of SOEs or large private players.** In intervening in the economy, the government's objectives have principally aimed to correct market failures and support public goods creation. However, a lack of dialogue with the private sector has resulted in some failures to incorporate feedback from businesses about the on-the-ground impact of policies and created perceptions of inequalities in access to policy makers. To address these issues, Bhutan would benefit from establishing a formal private-public dialogue platform.<sup>76</sup> Bhutan has a difficult balancing act to maintain a healthy level of market competition while allowing firms to reach the economies of scale needed to compete successfully on international markets. Ensuring equal access to policy dialogue is a first critical step to maintain this balance. Introducing an online platform could

76. Usually, PPDs are mechanisms that go beyond coordination, in that they help building trust, sharing knowledge, making evidence-based decisions, and fostering transparency, to name a few benefits.

enhance coordination in the short term without requiring substantial budgetary outlays.<sup>77</sup>

#### 3.2.4.4 Public Procurement

**A national e-procurement implementation strategy can reduce costs and delays, maximize efficiency, increase transparency, and boost the participation of SMEs.** E-procurement can help reduce the cost of accessing public procurement opportunities, especially for smaller enterprises.<sup>78</sup> Bhutan has started building a comprehensive end-to-end e-GP system. However, the lack of a national e-GP implementation policy and strategy increases the risk that the e-GP system will not be delivered on time and on budget. It is recommended that a national e-GP implementation policy and strategy be prepared. The national policy should include stakeholder training and a phased, time-bound action plan to move to a 100 percent electronic system. In addition, this measure should be complemented with a properly defined market analysis policy and bidder debriefing in the public procurement network (World Bank 2017b). The RGoB should also make sure that the bidding evaluation criteria incentivizes businesses, especially SMEs, to improve their capabilities. To do so, the RGoB must include a firm's skill composition in the bidding criteria, and it should also divide larger contracts into smaller batches or establish incentives aimed at facilitating SME access, so as not to systematically exclude smaller businesses.<sup>79</sup>

### 3.2.5 TAXATION

**Revisions to licensing and incorporation procedures, the provision of training on taxation and accounting standards, and the harmonization of government databases can increase tax compliance and reduce regulatory burdens.** Bhutan

77. For example, Peru implemented a program of "Mesas Ejecutivas," which consists of weekly temporary public-private working groups focused on solving sector-specific bottlenecks; these "Mesas Ejecutivas" were implemented in sectors such as forestry, aquaculture, logistics, textiles, gastronomy, and high-impact entrepreneurship (Ministerio de la Producción del Peru 2016).

78. For example, 10 years after Chile introduced its ChileCompra portal, the share of contracts awarded to SMEs rose from 24 percent to 44 percent (World Bank 2016c).

79. For example, in Angola, Côte d'Ivoire, the Dominican Republic, India, and Morocco around 20 percent of the total value of government contracts is allocated to SMEs (World Bank 2016c).

has one of the highest levels of institutional quality in the South Asia region. However, suboptimal coordination among regulatory agencies reduces the quality of government-to-business services. Moreover, weaknesses in accounting standards, creditors' rights, and corporate governance have a negative impact on taxation revenues, transparency, access to capital, and risk taking. To promote the development of the private sector while increasing taxation revenues, the RGoB should take steps to increase the awareness of private sector actors of taxation policy and accounting standards (Subsection 3.2.5.1). Taxation revenues can be further increased and incentives for firm productivity enhanced through revision of licensing and incorporation procedures and increased data sharing between government agencies (Subsection 3.2.5.2).

### 3.2.5.1 Taxation

**The provision of targeted training and communications campaigns on taxes and accounting standards can improve compliance with tax regulation.**

Small businesses' biggest obstacle to paying taxes is unfamiliarity with accounting practices. This result resonates with the MoLHR's assessment that accounting and finance are the most important skill gap in the production sector (Bhutan, MoLHR 2016, 91). To successfully mainstream the adoption of accounting standards, the RGoB should carry out a communication campaign on tax compliance and offer adequate training programs for SMEs (Bhutan, MoEA 2012).<sup>80</sup> The widespread implementation of bookkeeping among firms would reduce subjective tax assessments and improve compliance with tax regulation.

### 3.2.5.2 Licensing and Incorporation

**Amendments to the Companies Act can ensure adequate oversight of firms' practices without restricting boards' flexibility in commercial decision making.** The Companies Act sets the rules on business ownership, incorporation, management, insolvency, and court challenges. Therefore, the amendment should address the current liquidation and reorganization framework gap. For example, India started working on

the overhaul of its Companies Act back in 2004, focusing on simplifying administrative requirements, creating transparent company structures, boosting competitiveness through accountability and corporate governance, and contributing to greater shared prosperity (World Bank 2016d, 69).

**By streamlining the existing licensing procedures for businesses holding multiple licenses, taxation revenues can be increased.** The MoEA and the DRC should work on streamlining the existing licensing procedures, as one business can hold up to 21 licenses, which makes it confusing to file tax returns and to keep track of existing businesses (Bhutan, RAA 2016, 33). The newly introduced government-to-business (G2B) online license portal is a good step in the right direction. However, the MoEA should identify and eliminate redundant licenses.<sup>81</sup>

**The increased use of ICT to harmonize government processes and facilitate data sharing among government agencies can improve the RGoB's ability to design policy and deliver efficient government-to-business services.** A key step is to complete the integration of the Revenue Administration Management Information System (RAMIS) with MoEA's electronic business registration system. As of 2016, RAMIS had been integrated with the Bank of Bhutan for online payments and with the Public Expenditure Management System (PEMS) for online filing of Tax Deducted at Source (TDS). To follow through with the e-Government Master Plan, the RGoB should integrate RAMIS with other relevant agencies and systems, move toward a unique business identification system through a centralized database (Bhutan, RAA 2016, 21) and add a license registration module to RAMIS that can be used on a real-time basis by the Regional Trade and Industry Offices (RTIO) and the Regional Revenue and Customs Offices (RRCO) (Bhutan, RAA 2016). Such a measure would generate trustworthy data on business status and

80. It has been shown that teaching "rule of thumb" accounting concepts to microentrepreneurs can be more effective than teaching a traditional approach to accounting (Xu and Zia 2012).

81. For example, Lao PDR made starting a business faster by implementing simplified procedures for obtaining a license and a registered company seal (World Bank 2016d). A randomized controlled trial in Guatemala found that letters containing deterrent messages calling nondeclaration of taxes either an intentional choice or a violation of social norms among the rest of the population that did pay taxes was effective in increasing payment rates (Kettle et al. 2016).

timely registration of licenses with the RRCOs (Bhutan, RAA 2016, 34). By effectively adopting an integrated approach to the existing and planned information systems, the RGoB would mitigate inefficiencies, minimize the risk of technology obsolescence, and improve interactions with businesses (Bhutan, MoIC 2014, 37).<sup>82</sup>

### 3.3 SECTOR-SPECIFIC REFORM RECOMMENDATIONS

**Addressing sector-specific constraints through targeted reforms will ensure the growth of Bhutan's leading industries.** The performance of the hydropower, tourism, ICT, and agribusiness sectors will have a major effect on the future of Bhutan's economy. While each sector is growing rapidly, they also all face industry-specific constraints that either threaten to inhibit future growth or curtail spillover benefits for the wider economy. To alleviate these constraints, certain reforms and investments should be prioritized. Specifically:

- » **Tourism:** Limited accessibility, high seasonality, lack of product development, ineffective marketing, and the dual tariff system are starting to negatively affect the sustainability of Bhutan's tourism industry. To address these issues, the RGoB should support the building of capacity by tourist service providers; provide incentives for operators to promote new packages during the lean season and outside the Western Circuit; and use social media and other innovative strategies to develop new markets (Subsection 3.3.1).
- » **ICT:** To promote the development of Bhutan's nascent ICT sector, the RGoB should invest in enhancing the speed, reliability, and cost-effectiveness of high-speed Internet connectivity; explore the feasibility of high-skilled migrant worker programs for the ICT sector; encourage the development of data

storage facilities; and undertake targeted FDI promotion (Subsection 3.3.2).

- » **Agribusiness:** To grow Bhutan's agribusiness sector, the RGoB should reform public investments to minimize adverse effects on the private sector; promote markets for high-value niche products by encouraging the development of export infrastructure; and fully implement the "Brand Bhutan" strategy (Subsection 3.3.3).
- » **Hydropower:** To ensure the benefits of hydropower generation for the rest of the economy, the RGoB should explore mechanisms to promote the involvement of local firms (Subsection 3.3.4).

The following sections provide further details on these sector-specific policy recommendations.

#### 3.3.1 TOURISM

**By addressing shortcomings in the quality and scope of tourist services, Bhutan can enhance the value of its tourism brand.**<sup>83</sup> Bhutan's tourism sector currently suffers from extreme seasonality, limited geographic reach, low quality services, and insufficient marketing. Bhutan could increase tourism revenue without incurring adverse impacts by utilizing existing excess capacity and broadening itineraries across the country. To diversify flows temporally, geographically, and demographically, the RGoB and tourist service providers should work together to promote lean season arrivals and develop alternative activities, while introducing a fee system for regional arrivals (Subsection 3.3.1.2). Finally, the RGoB and service providers should strengthen policy coordination and destination marketing by developing new structures for public-private dialogue and joint investments (Subsection 3.3.1.3).

82. For instance, Sri Lanka, a lower-middle-income country like Bhutan, provides more than 65 online services through basic phone calls and has developed an inclusive e-government strategy to cope with its literacy gap (UN 2014, 2016). The Philippines rolled out a one-stop shop, the Integrated Business Registration System, which integrates business registration, tax payments and payroll related payments, thus converting a 34-day, 16-step process to start a business into an 8-day, 6-step process (Philippines, NCCP 2015).

83. A properly planned and executed tourism policy, related strategy and coordinated actions could have major positive impacts on Bhutan's people and landscapes, by giving cultural and environmental assets greater economic value, stimulating private investment and job creation, helping to preserve the country's primary tourism assets, and providing rural residents with socioeconomic incentives to remain in or return to rural villages, which underpin Bhutanese culture and traditional ways of life.

### 3.3.1.1 Price and Quality

**Adjustment in incentives, technical assistance, and marketing support can address service shortcomings that undermine tourist satisfaction.** Potential measures that may be adopted include: (i) a review and revision of when and how hotels are paid by operators for bookings; (ii) a review and revision of the hotel rating system, so outdated hotels would be required to invest in renovating properties to maintain their three-star rating; (iii) improvement of access to financing and tax incentives for renovations; (iv) provision of technical assistance and incentives for use of locally produced furniture and décor; (v) streamlining of the work permitting process for foreign chefs; (vi) creation of a culinary school in Bhutan; (vii) creation and promotion of a consumer-driven online review and rating system for hotels, restaurants, and tour operators; and (viii) reduction or elimination of tariffs on imported wine and other spirits.

### 3.3.1.2 Diversification of Flows

**By providing incentives to operators, the temporal and geographic diversification of tourist flows can be diversified.** By geographically and temporally diversifying flows, the economic impact of tourism can be broadened across the population. Despite investments to improve access to central, eastern, and southern Bhutan, the potential offered by these regions is untapped. To promote tourism in the areas, the RGoB should consider establishing a public-private Rural Tourism Development Task Force, which will be responsible for drafting a strategy to expand and market travel beyond the Western Circuit. Through tax exemptions, technical assistance, challenge grants, airfare discounts or subsidies, and/or targeted market support, the RGoB should also create circuit development and marketing incentives to promote rural tourism focused primarily on eastern and southern Bhutan. Finally, and once appropriate regulations for the regional market have been developed, the RGoB should explore the potential for developing overland tourism routes from India to southern and eastern Bhutan, which may then be marketed to younger demographic segments interested in adventure travel and more activity-oriented pursuits. With the goal of transforming Bhutan into a

four-season travel destination, the RGoB and tour operators should identify summer and winter festivals and summer and winter sporting events—such as biking, trekking, kayaking, archery—that can provide experiences which differ from existing offerings.

**By diversifying tourist activities and enabling customization of itineraries, Bhutan can appeal to the younger generation of tourists and ensure the sustainability of flows.** Historically, the so-called baby boom generation has made up the bulk of tourists in Bhutan. However, as that generation ages, the demographic make-up of tourists is shifting to younger generations with different tastes and preferences. Developing a tourism product that will appeal to the younger demographic will require innovation in and the diversification of activity offerings, such as by offering greater opportunities to engage in adventure-related outdoor activities (mountain biking, rafting, trekking, etc.) and cultural immersion and by increasing opportunities to develop customized vacations that can be booked locally. Through challenge grants, technical assistance, cooperative marketing campaigns, and/or tax incentives, the RGoB may consider supporting the development of more activity-oriented programs and opportunities for cultural emersion (for example, river rafting, trekking, homestays, artisans in action, etc.).

**The growth in the number of regional tourists visiting Bhutan can be managed through a new fee regime and through the creation of facilities for low-spending tourists near the border.** The large increase in flows of tourists from neighboring countries not subject to the MDPP has reduced the average revenue generated by tourists while threatening to affect negatively Bhutan's cultural and environment resources and the experience of higher spending visitors. To address this concern, the RGoB should continue its development of an entrance fee regime for visitors not subject to the MDPP. The entrance fee could potentially take the form of a road toll assessed on vehicles entering Bhutan or a tourist card required to be purchased by foreign visitors entering overland. The RGoB might also consider

requiring all visitors to popular heritage sites and festivals to pay an entrance fee and/or to hire a guide to accompany them. To reduce overcrowding at popular sites and festivals in the interior, the RGoB may also consider creating attractions, accommodations, and visitor services near the border targeted specifically at low-spending visitors.

### 3.3.1.3 Marketing and Management

#### **Increased dialogue between public- and private-sector entities and coordination of tourism-related policies will improve the performance of the sector.**

To improve policy coordination, the RGoB might consider exploring further the separation of promotional and regulatory functions while also providing more funding for human resources, marketing and market research.

#### **By improving coordination between private- and public-sector marketing and through utilizing digital marketing, Bhutan can attract greater volumes of high-paying tourists.**

Some tour operators and hoteliers want to work more closely with TCB to develop marketing activities. To facilitate such joint marketing activities, the RGoB should: (i) evaluate the current marketing strategy and define new approaches for attracting a broader demographic; (ii) develop a framework, criteria, and process for selecting and prioritizing geographical markets; (iii) overhaul the national tourism website to utilize best practices in destination website design, use, and maintenance; (iv) improve the use of social media to increase engagement between TCB and travelers; and (v) organize an annual Discover Bhutan Travel Mart, inviting members of the travel trade to Bhutan for familiarization trips and business-to-business networking sessions.

## 3.3.2 INFORMATION AND COMMUNICATIONS TECHNOLOGY

**To exploit its latent comparative advantage in ICT exports, the RGoB must address skills shortages and high Internet costs, as well better market Bhutan as an ICT investment destination.** While several

foreign companies have been attracted to Bhutan's ICT sector by the country's stable business climate, several investors have been deterred by an unanticipated deficit in essential skills among the workforce, high Internet costs, and the slow growth of the sector (Subsection 1.4.3). While durably addressing the skills gaps requires educational reforms, investor concerns can be addressed in the short run by developing targeted incentives for job training and a specialized channel for migrant labor in ICT (Subsection 3.3.2.1). To reduce Internet costs for the sector, the RGoB should pursue establishing a new gateway with Bangladesh and PPP-based investments to improve infrastructure (Subsection 3.3.2.2). Finally, a targeted investment promotion strategy, revisions of public procurement rules, and the establishment of an advisory council can also promote the sector (Subsection 3.3.2.3).

### 3.3.2.1 Skills

**The provision and/or subsidization of training on soft skills can help address factors constraining the productivity of ICT firms and heighten the attractiveness of investments in the sector.** Conversations with firms in Thimphu Techpark suggest that Bhutan's low wages are attractive for investors in the ICT sector, but that this advantage is offset by low productivity. In addition to concerns about the availability of middle management and technical skills, firms also noted deficits in soft skills—such as punctuality and professionalism—among employees. Key informants reported that such deficits have imperiled the fulfillment of international supply contracts and negatively affected firms' reputations. While the RGoB has specific policies to subsidize training through MoLHR's Guarantee Employment program (Bhutan, MoLHR 2014), additional programs may be devised to provide remedial training in soft skills to employees of ICT and other firms engaged in the export of services, as well as to university students and job seekers. Alternatively, the MoLHR may consider subsidizing firm-level training.

**A specialized channel for high-skilled migration can address skill shortages, while providing graduates from northeast India with an attractive**

**alternative to India’s business process outsourcing (BPO) sector.** Firms noted that stringent immigration regulations—which apparently contradict the more lenient but unapplied FDI regulations—preclude the recruitment of foreign expatriates to fill critical skill shortages. To relax the skills constraint over the short run, the RGoB should establish a specialized channel to allow a limited number of high-skilled foreign expatriate workers to work in the Thimphu Techpark on multi-year contracts. Following the creation of this channel, targeted promotion may be undertaken among persons originating from northeastern India with training and experience in ICT and/or BPO. Currently, many ICT graduates from this area find work elsewhere in India (Nandakumar and Arakali 2014; Lalrampuii 2016), but report instances of discrimination (Abbas and Varma 2014; Das 2014). Given its cultural similarities with parts of northeastern India, Bhutan may represent a more attractive destination for such graduates. Such a program is not unprecedented, with the Ministry of Education recruiting teachers from northeast India to address a shortage in 2006 (Hindustan Times 2006).

### 3.3.2.2 Connectivity

**The establishment of a new Internet link with Bangladesh can provide Bhutan with the world-class connectivity necessary to support the growth of the ICT sector.** Key informants in the Thimphu Techpark identified the cost—which is reportedly twice as high as in neighboring countries—and speed of Internet access as another factor that adversely affects the ICT sector in Bhutan. While the competitiveness of the Internet service provider (ISP) sector has increased in recent years, Bhutan Telecom Ltd. still captures most of the demand, including 513 of the country’s 854 leased line subscribers and 28,431 of the country’s 28,538 ASDL broadband subscribers as of June 2016 (Bhutan InfoComm and Media Authority 2016). As of late 2016, the Department of IT and Telecom (DIT) was exploring the possibility of importing 2.5 to 10 Gbps of Internet bandwidth from Bangladesh, which would lower costs by as much as two-thirds and provide alternate redundant connectivity over and above the existing two gateways (Tshedup 2016). To

ensure that Bhutan’s nascent ICT industry has the requisite infrastructure to compete internationally, this new link should be pursued. RGoB may also wish to explore the possibility of attracting PPP-based investments in Internet connectivity.

### 3.3.2.3 Investment Promotion and Product Development

**Investment promotion and public procurement can help develop the ICT sector.** The Thimphu Techpark has served as a proof-of-concept for the feasibility of ICT in Bhutan. However, a critical mass of investments will be required to ensure the continued development of the nascent industry. Achieving this will require more active FDI promotion to build awareness of opportunities in ICT. Promotion may be particularly focused on investors already based in the region, given that several firms currently based in the Thimphu Techpark—such as Selsie and Scan Café—opted to relocate from neighboring countries. In addition to investment promotion, the RGoB can also use public procurement to stimulate the domestic market for ICT services. Various government agencies are in the process of digital transformations. Procurement rules for the provision of related services should be formulated to enable companies based in Bhutan to benefit from these contracts.

**Establishing a panel of advisors can help Bhutan take advantage of emerging opportunities in ICT.** Key informants report that, due to its abundant electricity, low cost base, temperate climate and physical proximity to the Bangladeshi and Indian markets, Bhutan potentially possesses a competitive advantage in data storage. Given the rapidly developing nature of the sector worldwide, additional opportunities inevitably exist—or will emerge—for which Bhutan is well positioned. To enable the RGoB to identify such opportunities and develop appropriate strategies, a panel of ICT investors may be convened to advise the government. The RGoB may also leverage the country’s tourism product to attract luminaries to Bhutan to participate in conferences and meetings with appropriate officials and local investors.

### 3.3.3 AGRIBUSINESS

**Increasing investment and productivity in agribusiness can be achieved by reforming subsidies, developing trade infrastructure, and implementing the Brand Bhutan strategy.** To ameliorate the adverse effect of subsidies and other public interventions on the agricultural and rural sector, the RGoB should undertake reforms to optimize incentives for private investment and firm efficiency (Subsection 3.3.3.1). To promote the development of markets for high-value niche crops and domestic livestock products, the RGoB should invest in storage and logistics and market infrastructure (Subsection 3.3.3.2). Finally, to enable producers and traders to exact full value from Brand Bhutan, it is imperative that the RGoB develop and implement a regulatory framework, resolve the division of labor between participating agencies, and communicate with producers about the innovation (Subsection 3.3.3.3).

#### 3.3.3.1 Subsidies and Incentives

**By overhauling public investments, the RGoB can increase investment and efficiency in agribusiness.** Currently, several well-intentioned interventions—such as megafarms, Farm Shops, and the Agricultural Machinery Center (AMC) and various subsidies—suppress private-sector investment and promote inefficiency (Subsection 1.4.4). The RGoB’s public interventions in agribusiness should be reviewed and reformed to ensure that, wherever possible, market-based solutions are favored, and competition and efficiency is promoted. Specifically, rather than deciding for farmers which crops they should grow and where they should buy inputs, MoAF should consider a voucher system, similar to India’s Kisan Credit Card, allowing farmers to spend vouchers at any private provider. The Farm Shops program should develop a clear plan to transition away from its current model and move toward full private ownership. In addition, the retail sale of subsidized food staples by the Farm Shops should be reexamined to integrate vouchers. The RGoB should also rebalance subsidy programs to support the marketing side of the value chain—rather than just the production or supply side—to promote market development and reduce excess production.

**BDBL and other private financial institutions could help increase mechanization by developing new loan products.** Subsidies provided through the Agriculture Machinery Centre (AMC) incentivize use of cooperatives over more entrepreneurial models, which in turn perpetuates a business model unable to maximize productivity.<sup>84</sup> Individual ownership, on the other hand, places responsibility for maintenance and income generation in the hands of one person, facilitating decision making and innovation. Leasing provides one of the best options for the rural poor, who have no collateral and few assets, to obtain equipment, and in some cases it may be more effective than promoting cooperative ownership. Accordingly, the BDBL and other banks should explore mechanisms for providing loans for or leasing agribusiness machinery and equipment to small entrepreneurs.

#### 3.3.3.2 Market Development

**By investing in storage and logistics, the RGoB can promote exports of high-value, niche crops.** Bhutan possesses several potential niche crops—noncommoditized products with low volumes of international trade—which are not currently produced in volumes comparable to commodities like grains, but which may potentially command high value in export markets like Bangkok, Singapore, and Dubai. These products include fresh wild-collected mushrooms (matsutake, morels, chanterelles),<sup>85</sup> retail honey, crated fruit (mandarins and kiwi fruit), asparagus, processed hazelnuts, walnuts, black pepper, Sichuan pepper, retail-packaged cardamom, processed ginger products, and seed potatoes. The RGoB can support the development of export markets for these high-value niche products by promoting innovations in storage and logistics, for instance by establishing an export terminal equipped with cold storage and customs and loading facilities at Paro airport.<sup>86</sup> Seed

84. According to World Bank (2017), the FAO’s Agriculture Sector Review of Bhutan states that the AMC’s farm mechanization effort has been met with limited success, yet more funding is currently being put into providing power tillers to small cooperatives formed for that purpose.

85. Owing to the extensive forest cover, the collection of wild-growing mushrooms is a very common livelihood in rural Bhutan.

86. The facility at the Lahore airport in Pakistan, from which the famous Kinnow mandarin is exported, may serve as a good benchmark for such a facility.

potato production can be promoted through investments in laboratories and inspection protocols as well as research into new varieties and the development of microtuber production. In addition, the Bhutan Exporters Association (BEA) may assist by consulting with traders and brokers in the European Union, Canada, and Japan to explore the feasibility of developing these markets.

### **The increasing demand for livestock products in Bhutan represents an excellent opportunity for domestic farmers and agribusinesses to expand.**

The RGoB should encourage greater replacement of imported animal protein products, such as milk, beef, pork, poultry, and honey. Currently, the Department of Livestock funds the development and management of model farms for livestock rearing, processing, and marketing, yet these efforts risk suppressing private initiatives. Instead, the RGoB should emphasize linking smaller domestic market hubs and establish market infrastructure in Bhutan's secondary cities. In addition, separate livestock product markets could be created in major urban areas and hub cities to better serve this subsector. The RGoB should encourage investments in abattoirs and create a regulatory framework to support the growth of the post-harvest and marketing aspects of the livestock subsector.

#### **3.3.3.3 Marketing**

**The RGoB should develop and implement a regulatory framework for the management of Brand Bhutan, including the regulation of quality and standards.** Brand Bhutan represents a promising means of leveraging Bhutan's unique image to promote the country's products and command premium prices in high-value markets. However, further steps are required to realize the strategy's potential. Notably, the Ministry of Economic Affairs must formally launch Brand Bhutan and create a framework for its management. This framework should (i) establish standards for products bearing the Brand Bhutan identity and associated labels; (ii) outline procedures for private-sector use of the brand;

(iii) establish and publish sanctions and penalties for misuse of the brand; and (iv) create systems for controlling the quality of products sold under the brand.

### **Better delineation of functions between relevant agencies and enhanced communication strategies will enable producers to better exploit the value of Brand Bhutan.**

While the MoEA holds overall responsibility for the brand, the Bhutan Agriculture and Food Regulatory Authority and the Bhutan Standards Bureau will serve an essential role in enforcing standards. To support this, RGoB should ensure the correct structure, function, capacities, and funding arrangements for the two agencies and an appropriate degree of separation both between their roles and between the regulatory and services functions of the strategy. To build awareness of the brand among consumers in target markets, MoEA should also develop effective communications strategies to ensure that exporting firms avail themselves of the benefits of Brand Bhutan and comply with its standards.

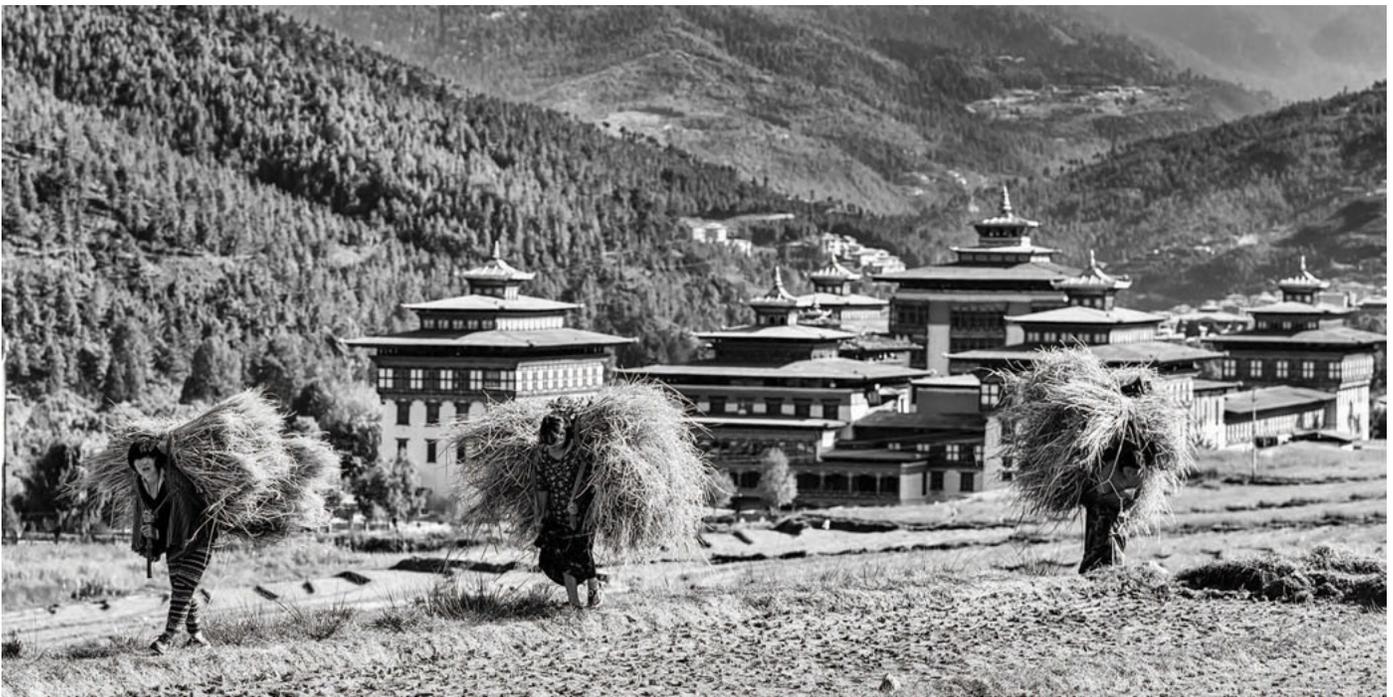
#### **3.3.4 HYDROPOWER**

### **To increase the benefits of hydropower construction for the broader economy, the RGoB should ensure the enhanced participation of local firms and workers in hydropower projects.**

Anecdotal evidence suggests that hydropower investments have failed to generate the positive spillovers for the wider economy—such as enhancement of the technical and managerial capacity of Bhutanese and the employment of local labor—that were anticipated. While Bhutanese firms have landed some civil works subcontracts, Indian agencies have taken the lead in planning, designing, and managing many projects and have handled all major construction and supply contracts (Premkumar 2016). Likewise, construction work for projects is reportedly undertaken mainly by the 60,000 Indian nationals living in Bhutan and the 8,000 to 10,000 workers who cross the border every day (Premkumar 2016). To increase the benefits of the hydropower projects for Bhutanese firms

and workers, the RGoB should undertake the following measures: (i) commission a study of factors inhibiting Bhutanese firms from winning hydropower-related contracts (either outright or on a joint venture basis) and Bhutanese workers from being employed on hydropower projects; (ii) ensure that hydropower agreements include

appropriate provisions to enable the contracting of Bhutanese firms and the employment of Bhutanese workers where feasible; and (iii) provide training and associated measures to increase the capacity of local firms and workers to participate in hydropower projects.



Women carrying bales of straw in front of Tashichhoedzong, Thimphu, October 2015.

## CHAPTER 4

# CONCLUSION

**Fueled by booms in hydropower and tourism, Bhutan’s economy has been transformed.** These changes have brought about rapid income growth and poverty reduction. However, the impact of the transformation on the population has been muted by a lack of dynamism in the agriculture, manufacturing, and the services sector, which employ the overwhelming majority of the private workforce. Bhutan’s private economy remains dominated by microenterprises that struggle to increase productivity, attract investment, expand employment, and access international markets without assistance from intermediaries.

**Given its small market and high trade costs, Bhutan’s prospects for achieving inclusive development rely on tradable services and high-value niche products.** With its unique package of institutional assets—robust public institutions, civil and political stability, low corruption, a commitment to protecting the country’s unique cultural heritage and environment, an English-speaking workforce, and cheap and reliable electricity—Bhutan represents an attractive proposition for investors and can extract a premium for exports marketed to leverage the country’s international reputation. To achieve this, however, Bhutan will need to address constraints that undermine productivity and discourage investments in promising high-value sectors such as ICT, tourism, and agribusiness.

**Bhutanese firms are constrained by limited access to key inputs and markets.** The ability of firms to access credit is inhibited by financial illiteracy, weak regulation, and limited credit information and by difficulties in collateralizing assets. Limited access to skilled labor—which results from low levels of education, competition with the public sector, and restrictions on employing expatriates—is another key factor inhibiting firms from increasing productivity and investment. Bhutanese firms also face hurdles in accessing external markets, not just due to the country’s adverse geography but also because of deficiencies in infrastructure, an underdeveloped logistics sector, limited foreign investment, and deficits in firm capacities. While Bhutan has robust institutions, the ability of private firms to compete domestically is

adversely affected by inequalities in access to policy makers, while a lack of knowledge of accounting standards undermines the transparency of taxation.

**Maximizing Bhutan’s development potential will require reforms to address prevailing business constraints.** To improve the access of firms to credit, the RGoB should focus on deepening credit information and strengthening the legal rights of creditors and borrowers. Improving firms’ access to skilled labor can be achieved by developing channels to facilitate the employment of skilled expatriates, bringing public-sector compensation packages into line with those offered by the private sector, and promoting vocational training. Facilitating greater access of the private sector to external markets will require improvements in border processing and transport infrastructure, capacity building in quality standards and certification, implementation of the Brand Bhutan strategy, promotion of e-commerce, and a well-targeted promotion strategy to attract FDI. The RGoB can further encourage the development of the private sector by rationalizing the role of state-owned enterprises, establishing

mechanisms for public-private dialogue, and revising public procurement procedures.

**Addressing sector-specific constraints is essential to promoting development in key industries.** Bhutan’s tourism industry has grown rapidly in recent years, but it must evolve further to better distribute economic impacts and minimize adverse cultural and environmental effects. Bhutan’s ICT industry is still nascent, but it has the potential to emerge as a key export earner if policy changes help address the skill deficits currently facing the industry. The development of high-value niche agricultural products is likewise in its infancy, but with investments in trade infrastructure, reform of subsidies, and better marketing, the sector can provide broad-based benefits to Bhutan’s rural population. Finally, while hydropower has grown to be the most important industry in Bhutan, ensuring that the sector helps rather than hinders the wider economy will require further efforts to promote the involvement of local firms and workers in project construction. Table 11 summarizes the main policy recommendations to support private-sector development in Bhutan.

TABLE 11: SUMMARY OF POLICY RECOMMENDATIONS

Policy Area	Recommendations	Timeline
<b>Crosscutting Recommendations</b>		
<b>Access to Finance</b>	<b>Priority Actions:</b> Expand scope of collateralizable assets. Deepen and broaden credit information.	Short
	Approve and implement new insolvency bill. Reduce risks of e-banking for customers.	Medium
	<b>Other Actions:</b> Improve management of property records to facilitate collateralization of land. Expand BDBL’s scope to provide export financing for agriculture and group lending to cooperatives.	Short
	Encourage growth of microfinance institutions by rationalizing licensing and reporting requirements. Provide targeted financial literacy training to financial providers and users.	Medium
	Improve monitoring and evaluation of priority lending programs.	Short
<b>Access to Labor</b>	<b>Priority Actions:</b> Introduce dedicated channel for skilled migration. Provide vocational training to adult labor force.	Short
	Realign public compensation packages with private sector.	Medium
	<b>Other Actions:</b> Offer scholarships for intensive business education. Reward private-sector experience in public-sector recruitment.	Medium

Policy Area	Recommendations	Timeline
<b>Crosscutting Recommendations</b>		
<b>Access to Markets</b>	<b>Priority Actions:</b> Promote use of e-commerce platforms. Increase awareness and use of quality standards and certifications. Develop and implement investment promotion strategy.	Short
	Introduce risk-based border inspections and coordinate border procedures.	Medium
	<b>Other Actions:</b> Develop logistics skills for industry professionals. Phase in the Bangladesh, Bhutan, India, and Nepal Motor Vehicles Agreement.	Medium
	Improve transport and logistics infrastructure. Improve regulatory and operational functions of airports through skills upgrading.	Medium–Long
	Diversify transport corridors.	Long
	<b>Competition</b>	<b>Priority Actions:</b> Create a public-private dialogue platform to provide equal access to policy feedback. Monitor anti-competitive practices and effect of SOEs on private investment.
<b>Other Actions:</b> Introduce a national e-procurement strategy to enhance private-sector competitiveness.		Medium
Create a legal framework to prevent anti-competitive practices, monopolies, and cartels.		Long
<b>Taxation</b>	<b>Priority Actions:</b> Increase awareness of taxation policy and accounting standards.	Short
	<b>Other Actions:</b> Amend the Companies Act.	Short
	Streamline licensing procedures.	Medium
<b>Sector-Specific Recommendations</b>		
<b>Tourism</b>	Build capacity of three-star accommodation and restaurant providers. Support development of programs to geographically and temporally diversify flows.	Short
<b>ICT</b>	Develop sector-specific high-skilled migration channel. Upgrade skills of existing and prospective ICT workers. Develop and implement sector-specific investment promotion strategy.	Short
	Upgrade Internet infrastructure.	Medium
<b>Agribusiness</b>	Develop regulations, oversight roles, and communication strategy for Brand Bhutan.	Short
	Promote storage and logistics investments to facilitate exports of high-value products. Reform subsidies and interventions to optimize incentives for private investment.	Medium
<b>Hydropower</b>	Commission study of involvement of local firms/workers in hydropower projects.	Short
	Increase capacity of local firms/workers to participate in hydropower projects. Ensure that hydropower agreements include appropriate provisions to facilitate contracting of Bhutanese firms and employment of Bhutanese workers.	Medium



Typical Bhutanese shop and restaurant facades, Thimphu, August 2015.

## REFERENCES

- AASBB (Accounting and Auditing Board of Bhutan). 2015. *The Second Report of AASBB 2013–2015*. [http://www.aasbb.com.bt/Publish/Annual\\_Reports/721649859240733184.pdf](http://www.aasbb.com.bt/Publish/Annual_Reports/721649859240733184.pdf)
- Abbas, Rameez, and Divya Varma. 2014. “Internal Labor Migration in India Raises Integration Challenges for Migrants.” *Migrant Information Source*. Migration Policy Institute. March 3. <http://www.migrationpolicy.org/article/internal-labor-migration-india-raises-integration-challenges-migrants>
- ACC (Anti-Corruption Commission). 2016. *Improving Business Environment: The Case of the Mining Industry in Bhutan*. Thimphu, Bhutan: Anti-Corruption Commission.
- ADB (Asian Development Bank). 2013. *Bhutan: Critical Development Constraints*. Country Diagnostics Studies. Thimphu, Bhutan.
- . 2014. *Bhutan’s Hydropower Sector: 12 Things to Know*. January 13. <https://www.adb.org/features/bhutan-s-hydropower-sector-12-things-know>. Thimphu, Bhutan.
- . 2016a. *Public–Private Partnership Funds: Observations from International Experience*. <https://www.adb.org/sites/default/files/publication/202486/eawp-06.pdf>. Thimphu, Bhutan.
- . 2016b. *Air Transport Connectivity Enhancement Project (RRP BHU 44239-013): Economic and Financial Analysis*. <https://www.adb.org/sites/default/files/linked-documents/44239-013-bhu-efa.pdf>. Thimphu, Bhutan.
- Akamai. 2017. *Q1 2017 State of the Internet/Connectivity Report*. <https://www.akamai.com/us/en/about/our-thinking/state-of-the-internet-report/global-state-of-the-internet-connectivity-reports.jsp>
- Anderson, Stephen J., Rajesh Chandy, and Bilal Husnain Zia. 2016. “Pathways to Profits: Identifying Separate Channels of Small Firm Growth through Business Training.” Policy Research Working Paper 7774, World Bank, Washington, DC.
- Bertelsmann Stiftung. 2016. *BTI 2016—Bhutan Country Report*. Gütersloh: Bertelsmann Stiftung.
- Bhutan, MoAF (Ministry of Agriculture and Forests). 2010. *Renewable Natural Resources Census: 2009*. Thimphu: Ministry of Agriculture and Forests.

- . 2011. *Interim Guideline on Lease of GRF Land for Commercial Agriculture*. Thimphu: Ministry of Agriculture and Forests.
- . 2016. *RNR Statistics 2015*. Thimphu: Ministry of Agriculture and Forests, Policy and Planning Division.
- Bhutan, MoEA (Ministry of Economic Affairs). 2012. *Diagnostic Trade Integration Study*. [www.enhancedif.org/en/file/260/download?token=MToOw7Nm](http://www.enhancedif.org/en/file/260/download?token=MToOw7Nm)
- Bhutan, MoF (Ministry of Finance) and World Bank Group. 2016. *Public Financial Management Performance Report*. September. <https://openknowledge.worldbank.org/bitstream/handle/10986/25722/110293-PER-P116874-PUBLIC-WB-Bhutan-Report-15-11-16.pdf?sequence=1&isAllowed=y>
- Bhutan, MoIC (Ministry of Information and Communications). 2014. *Bhutan e-Government Master Plan*. [http://www.moic.gov.bt/wp-content/uploads/2016/05/bhutan\\_e\\_gov\\_master\\_plan\\_14953.pdf](http://www.moic.gov.bt/wp-content/uploads/2016/05/bhutan_e_gov_master_plan_14953.pdf)
- Bhutan, MoLHR (Ministry of Labour and Human Resources). 2014. *Guideline on Direct Employment Scheme 2014*. Department of Employment. <http://www.molhr.gov.bt/molhrsite/wp-content/uploads/2014/09/e.pdf>
- . 2015a. *Labour Market Information Bulletin 2015*. Labour Market Information and Research Division, Department of Employment. <http://www.molhr.gov.bt/molhr/wp-content/uploads/2016/05/LFS2015-Report-Final.pdf>
- . 2015b. *Handbook on Recruitment and Employment of Foreign Workers*. Department of Labour. February. <http://www.molhr.gov.bt/molhr/wp-content/uploads/2015/02/ROYAL-GOVERNMENT-OF-BHUTAN.pdf>
- . 2015c. *Labor Force Survey Report 2015*. Department of Employment, Labour Market Information and Research Division. February. <http://www.molhr.gov.bt/molhr/wp-content/uploads/2015/02/ROYAL-GOVERNMENT-OF-BHUTAN.pdf>
- . 2016. *National Workforce Plan 2016–22*. <http://www.molhr.gov.bt/molhr/wp-content/uploads/2016/06/National-Workforce-Plan-2016-22.pdf>
- Bhutan, MoWHS (Ministry of Works and Human Settlement). 2012. *Long-Term Plan for Water Supply Infrastructures*. June. Thimphu, Bhutan: Department of Engineering Services, Ministry of Works and Human Settlement.
- Bhutan, RAA (Royal Audit Authority). 2016. *Report on Performance Audit of Business Income Tax Administration*. Thimphu, Bhutan: Royal Audit Authority.
- Bhutan, RGoB (Royal Government of Bhutan). 2016. *Public Private Partnership Policy*. [http://www.mof.gov.bt/wp-content/uploads/2014/07/PPP\\_Policy\\_2016.pdf](http://www.mof.gov.bt/wp-content/uploads/2014/07/PPP_Policy_2016.pdf)
- Bhutan Broadcasting Service. 2013. “Thimphu” January 10.
- Bhutan InfoComm and Media Authority. 2016. *Telecommunication Market Profile*. [http://www.bicma.gov.bt/bicmanew/?page\\_id=555](http://www.bicma.gov.bt/bicmanew/?page_id=555)
- Bhutan National Bureau of Statistics 2015. *Statistical Yearbook 2015*. RGoB.
- Bhutan National Bureau of Statistics 2016. *Statistical Yearbook 2016*. RGoB.
- Bhutan National Statistics Bureau, and World Bank. 2014. *Bhutan Poverty Assessment 2014*. Washington, DC: World Bank
- Bhutan Telecom Ltd. 2017. *Internet Leased Line*. Retrieved: July 8. [https://www.bt.bt/?page\\_id=60](https://www.bt.bt/?page_id=60)
- Calderón, G., J. M. Cunha, and G. De Giorgi. 2013. *Business Literacy and Development: Evidence from a Randomized Controlled Trial in Rural Mexico*. Cambridge, MA: National Bureau of Economic Research.
- Christensen, Garry, Turi Fileccia, and Aidan Gulliver. 2012. *Bhutan: Agricultural Sector Review*. FAO Investment Centre Country Highlights. Rome: FAO & The World Bank Cooperative Programme. [http://www.fao.org/fileadmin/templates/tci/pdf/Buthan\\_Voll\\_web.pdf](http://www.fao.org/fileadmin/templates/tci/pdf/Buthan_Voll_web.pdf)
- CSCP (Collaborating Centre for Sustainable Consumption and Production). Undated. *Green Public Procurement (GPP) in Bhutan*. Retrieved: July 8, 2017. <http://www.scp-centre.org/our-work/gpp-in-bhutan/>
- Das Gupta, Moushumi, and Jayanth Jacob. 2016. “Bhutan Blocks India’s Ambitious Sub-Regional Road Connectivity Plan.” *Hindustan Times*. November. <http://www.hindustantimes.com/india-news/bhutan-blocks-india-s-ambitious-sub-regional-road-connectivity-plan/story-xyRIYcCvvyFg8czANisIJ.html>
- DataSoft. 2010. *Custom House Automation Project (Bangladesh)*. [http://www.witsa.org/awards10/nominees/public/DataSoft\\_Attachment01\\_CustomHouseAutomation\\_At\\_a\\_Glance.pdf](http://www.witsa.org/awards10/nominees/public/DataSoft_Attachment01_CustomHouseAutomation_At_a_Glance.pdf)

- DHI (Druk Holding and Investments). 2011. *Royal Charter for Druk Holding and Investments*, 3rd Edition.
- . 2017. DHI Annual Report 2016. Corporate Performance Department, Planning and Monitoring Division. <http://www.dhi.bt/documents/10180/17712/final+Annual+Report+2016.pdf/2f0d4981-beae-4152-a780-e19ad486991b>
- Djankov, Simeon, Frederica Saliola, and Asif Islam. 2016. “Is Public Procurement a Rich Country’s Policy?” *Governance for Development* (blog), December 1. <http://blogs.worldbank.org/governance/public-procurement-rich-country-s-policy>
- Dorji, Minjur. 2013. “Thimphu.” *The Bhutanese*. May 1.
- Dorji, Tshering. 2016. “BOiC Closes Shop, REDCL Launched.” *Kuensel*. May 23.
- DRC (Department of Revenue and Customs, Bhutan). 2016. *Performance Indicator Report—2015*. Thimphu, Bhutan: Ministry of Finance.
- eBay. 2013. *Commerce 3.0 for Development: The Promise of the Global Empowerment Network*. [https://www.ebaymainstreet.com/sites/default/files/eBay\\_Commerce-3-for-Development.pdf](https://www.ebaymainstreet.com/sites/default/files/eBay_Commerce-3-for-Development.pdf)
- The Economist. 2013. “How did Estonia become a leader in technology?” July 31. <https://www.economist.com/blogs/economist-explains/2013/07/economist-explains-21>
- Ernst & Young. 2014. *Bhutan: Promising Sectors for Public Private Partnership (PPP) Projects and Key Challenges*. <http://www.unescap.org/sites/default/files/4.%20PPP%20promising%20sectors%20in%20Bhutan.pdf>
- Fastmetrics. 2017. “Internet Speeds by Country (Mbps).” Retrieved: July 8. <https://www.fastmetrics.com/internet-connection-speed-by-country.php>
- Future Brand. 2015a. *Brand Bhutan Project*. [http://www.undp.org/content/dam/bhutan/FutureBrand\\_Brand%20Bhutan%20Executive%20Summary\\_100915.pdf](http://www.undp.org/content/dam/bhutan/FutureBrand_Brand%20Bhutan%20Executive%20Summary_100915.pdf)
- Galay, Karma. 2014. *Status of the Development of the Asian Highway Route in Bhutan*. [http://www.unescap.org/sites/default/files/Bhutan\\_0.pdf](http://www.unescap.org/sites/default/files/Bhutan_0.pdf)
- Gennaioli, Nicola, Yueran Ma, and Andrei Shleifer. 2016. “Expectations and Investment.” *NBER Macroeconomics Annual* 30 (2015): 379–442.
- The Hans India. 2017. “What Is BBIN/MVA?” *The Hans India*. Feb. <http://www.thehansindia.com/posts/index/Education-&-Careers/2017-02-17/What-is-BBIN-MVA/281280>
- Hindustan Times. 2006. “Bhutan Lures Indian Teachers with Special Packages.” *Hindustan Times*. <http://www.hindustanimes.com/india/bhutan-lures-indian-teachers-with-special-packages/story-NISUqExSE8ijFq85rMv5M.html>
- ICA Costa Rica. 2002. <http://documents.worldbank.org/curated/en/657991468018065525/Costa-Rica-Investment-Climate-Assessment>
- ICA Nepal. 2012. <http://documents.worldbank.org/curated/en/343221468157793055/Nepals-investment-climate-leveraging-the-private-sector-for-job-creation-and-growth>
- IFC (International Finance Corporation). 2016. *Integrating Risk-Based Principles into Border Inspections and Clearance in Zambia*. <http://documents.worldbank.org/curated/en/204481488785800764/pdf/113171-BRI-IFC-SMART-LESSONS-BRIEF-PUBLIC-20170302T171815-2016-Border-Inspections-Clearance-Zambia-B.pdf>
- India, PPIAF (Public-Private Infrastructure Advisory Facility). 2011. *How to Engage with the Private Sector in Public-Private Partnerships in Emerging Markets*. <http://documents.worldbank.org/curated/en/995241468337913618/pdf/594610PUB0ID1710Box358282B01PUBLIC1.pdf>
- Kee, Hiau Looi, Alessandro Nicita and Marcelo Olarreaga. 2009. “Estimating trade restrictiveness indices,” *Economic Journal* 119: 172–199.
- Kelly, Tim; Liaplina, Aleksandra; Tan, Shawn W.; Winkler, Hernan. 2017. *Reaping Digital Dividends: Leveraging the Internet for Development in Europe and Central Asia*. Europe and Central Asia Studies, Washington, DC: World Bank.
- Kettle, Stewart, Marco Hernandez, Simon Ruda, and Michael Sanders. 2016. “Behavioral Interventions in Tax Compliance Evidence from Guatemala.” Policy Research Working Paper, World Bank, Washington, DC. <https://www.irs.gov/pub/irs-soi/15resconhemandez.pdf>
- Kunaka, Charles. 2014. “Bhutan: Connectivity in the Cloud(s).” *The Trade Post: Making International Trade Work for Development* (blog). World Bank, Washington, DC. <http://blogs.worldbank.org/trade/bhutan-connectivity-clouds>

- Lalrampuii, Rosie. 2016. "Economic Perspective of Migration in North-East India." *DU Journal of Undergraduate Research and Innovation* 2 (2): 128–36. <http://journals.du.ac.in/ugresearch/pdf-vol5/14.pdf>
- Lamsang, Tenzing. 2016. "DHI: A Corporate Game Changer." *The Bhutanese*, December 9.
- Li, Y., and M. Rama. 2015. "Firm Dynamics, Productivity Growth, and Job Creation in Developing Countries: The Role of Micro- and Small Enterprises." *The World Bank Research Observer* 30 (1): 3–38.
- Lopez-Acevedo, Gladys C., Denis Medvedev, Vincent Palmade, Gonzalo J. Varela, Antonio Martuscelli, Felipe Lage De Sousa, Deeksha Kokas, Michael Joseph Ferrantino, Gaurav Nayyar, Xavier Cirera, Ana Paula Cusolito, Dominique Van Der Mensbrugge, Bill Shaw, and Priyam Saraf. 2016. *New Perspectives on Productivity*. Washington, DC: World Bank Group.
- MinCIT (Ministerio de Comercio, Industria y Turismo de Colombia), Columbia. 2014. *Experiencia: Ventanilla Única de Comercio Exterior*. [http://centrodeinnovacion.gobiernoonline.gov.co/sites/default/files/fichaexp\\_2015\\_9\\_vuce\\_comercio\\_exterior\\_v1\\_0.pdf](http://centrodeinnovacion.gobiernoonline.gov.co/sites/default/files/fichaexp_2015_9_vuce_comercio_exterior_v1_0.pdf)
- Ministerio de la Producción del Perú. 2016. "Mesas Ejecutivas: A new tool for productive diversification." <http://www2.law.columbia.edu/sabel/papers/LIBRO%20MESAS%20EJECUTIVAS%20English%20version.pdf>
- Ministerio de la Producción del Perú. 2016. Mesas Ejecutivas: Nueva Herramienta para la diversificación productiva en el Perú. <http://www2.law.columbia.edu/sabel/papers/LIBRO%20MESAS%20EJECUTIVAS%2017X24cm%20FINAL.pdf>
- Mitra, Devirupa. 2016. "Bhutan's Upper House Rejects Modi's Dream for Regional Transport Corridor." *The Wire*. Nov 2016. <https://thewire.in/80729/bhutans-upper-house-rejects-modis-dream-for-regional-transport-corridor/>
- Murgatroyd, Paul, et al. 2016. "Kingdom of Bhutan: Financial Sector Development Action Plan." *World Bank: Finance and Markets Global Practice, South Asia Region*. March.
- Nandakumar, Indu, and Harichandan Arakali. 2014. "Why IT Industry Is Not Growing in Northeast." *GadgetsNow*. February 10. <http://www.gadgetsnow.com/tech-news/Why-IT-industry-is-not-growing-in-northeast/articleshow/30169028.cms>
- Numbeo. 2017. "Southern Asia: Prices by City of Internet (60 Mbps or More, Unlimited Data, Cable/ADSL) (Utilities (Monthly))." Retrieved July 7, 2017. [https://www.numbeo.com/cost-of-living/region\\_prices\\_by\\_city?displayCurrency=USD&itemId=33&region=034](https://www.numbeo.com/cost-of-living/region_prices_by_city?displayCurrency=USD&itemId=33&region=034)
- OECD (Organisation for Economic Co-operation and Development). 2017. "The Online Platform, Trade, MSMEs and Women: Lessons from eBay towards User-Driven Economic Empowerment." Available at: <https://oecd-development-matters.org/2017/03/15/the-online-platform-trade-msmes-and-women-lessons-from-ebay-towards-user-driven-economic-empowerment/>
- Philippines, NCCP (National Competitiveness Council Philippines). 2015. *Ease of Doing Business*. <http://www.competitive.org.ph/doingbusiness/References.html>
- Premkumar, Lakshmi. 2016. *A Study of the India-Bhutan Energy Cooperation Agreements and the Implementation of Hydropower Projects in Bhutan*. Vasudha Foundation: New Delhi, January.
- Rahman, Kazi Mahmudur, and Tariqur Rahman. 2016. "Cost Benefit Analysis of Cooperation in Motor Vehicle Agreement in Bangladesh, Bhutan, India and Nepal Region." Copenhagen Consensus Center. [http://www.copenhagenconsensus.com/sites/default/files/rahman\\_transportation\\_hub\\_mv.pdf](http://www.copenhagenconsensus.com/sites/default/files/rahman_transportation_hub_mv.pdf)
- SANDRP (South Asia Network on Dams, Rivers and People). 2016. *Bhutan Hydropower Developments in 2015*. January 26. <https://sandrp.wordpress.com/2016/01/26/bhutan-hydropower-developments-in-2015/>
- Schwab, Klaus, ed. 2016. *The Global Competitiveness Report 2016–2017*. Geneva: World Economic Forum. [www.weforum.org/gcr](http://www.weforum.org/gcr)
- Subba, M. B. 2017. "Indian Trucks Operating in Bhutan: Truckers." *Kuensel*, January 21. <http://www.kuenselonline.com/indian-trucks-operating-in-bhutan-truckers/>
- Thimphu TechPark. 2017. <http://www.thimphutechpark.com/about-us.html>. Accessed April 4, 2017.
- Tshedup, Younten. 2016. "Bhutan to Import Internet from Bangladesh." *Kuensel*, November 11. <http://www.kuenselonline.com/bhutan-to-import-internet-from-bangladesh/>
- UNCTAD (United Nations Conference on Trade and Development). 2011. *Trust Fund for Trade Facilitation Negotiations*.

- Technical Note No. 14: Border Agency Coordination. [http://unctad.org/en/Docs/TN14\\_BorderAgencyCoordination.pdf](http://unctad.org/en/Docs/TN14_BorderAgencyCoordination.pdf)
- . 2013. *Optimizing Government Services: A Case for Joint Investment and Trade Promotion?* [http://unctad.org/en/PublicationsLibrary/webdiaepcb2013d1\\_en.pdf](http://unctad.org/en/PublicationsLibrary/webdiaepcb2013d1_en.pdf)
- . 2014. *Skills and FDI Promotion: What Can an IPA Do?* [http://unctad.org/en/PublicationsLibrary/webdiaepcb2014d2\\_en.pdf](http://unctad.org/en/PublicationsLibrary/webdiaepcb2014d2_en.pdf)
- . 2015. “Bhutan Finalizes National Competition Policy, with UNCTAD Assistance.” <http://unctad.org/en/pages/newsdetails.aspx?OriginalVersionID=912>
- . 2017. *Bhutan Rapid eTrade Readiness Assessment*. [http://unctad.org/en/PublicationsLibrary/dtlstict2017d1\\_en.pdf](http://unctad.org/en/PublicationsLibrary/dtlstict2017d1_en.pdf)
- United Nations. 2014. *E-Government Survey 2014*. New York: United Nations. <https://publicadministration.un.org/egovkb/en-us/Reports/UN-E-Government-Survey-2014>
- . 2016. *E-Government Survey 2016*. New York: United Nations. <https://publicadministration.un.org/egovkb/en-us/Reports/UN-E-Government-Survey-2016>
- United Nations Department of Economic and Social Affairs. 2016. “High-Tech Dreams in the Land of the Thunder Dragon.” May 2. United Nations, New York.
- WCO (World Customs Organization). 2011. *WCO Customs Risk Management Compendium*. <http://www.wcoomd.org/en/topics/enforcement-and-compliance/instruments-and-tools/compendiums/rmc.aspx>
- Wik, Mette, Pingali, Prabhu, Brocai, Sumiter. 2008. *Global Agricultural Performance: Past Trends and Future Prospects*. Washington, DC: World Bank.
- World Bank. 2007. *Quality Systems and Standards for a Competitive Edge*. Washington, DC: World Bank. [http://site.resources.worldbank.org/EXTEXPCOMNET/Resources/2463593-1213887855468/69\\_LAC\\_Quality\\_and\\_Standards\\_Pub\\_Nov\\_2007.pdf](http://site.resources.worldbank.org/EXTEXPCOMNET/Resources/2463593-1213887855468/69_LAC_Quality_and_Standards_Pub_Nov_2007.pdf)
- . 2009. *Doing Business 2010: Reforming Through Difficult Times*. Washington, DC: World Bank. <http://www.doingbusiness.org/~media/WBG/DoingBusiness/Documents/Annual-Reports/English/DB10-FullReport.pdf>
- . 2010. *Bhutan Investment Climate Assessment Report: Vitalizing the Private Sector, Creating Jobs*, Vol. 2. Washington, DC: World Bank.
- . 2014. *Improving Trade and Transport for Landlocked Countries*. Washington, DC: World Bank. <https://openknowledge.worldbank.org/bitstream/handle/10986/21800/954470WP0P12900d0Countries00PUBLIC0.pdf?sequence=1>
- . 2016a. *Bhutan PPP Country Profile*. Washington, DC: World Bank. <https://pppknowledgelab.org/countries/bhutan>
- . 2016b. *Connecting to Compete: 2016 Trade Logistics in the Global Economy*. Global Trade Unit. Washington, DC: World Bank.
- . 2016c. *Transforming Markets Through Competition*. Washington, DC: World Bank. <http://documents.worldbank.org/curated/en/640191467990945906/pdf/104806-REPF-Transforming-Markets-Through-Competition.pdf>
- . 2016d. *Doing Business 2017: Equal Opportunity for All*. Washington, DC: World Bank. <http://www.doingbusiness.org/~media/WBG/DoingBusiness/Documents/Annual-Reports/English/DB17-Chapters/DB17-Mini-Book.pdf?la=en>
- . 2016e. *The Logistics Performance Index and Its Indicators*. Washington, DC: World Bank. [https://wb-lpi-media.s3.amazonaws.com/LPI\\_Report\\_2016.pdf](https://wb-lpi-media.s3.amazonaws.com/LPI_Report_2016.pdf)
- . 2016f. *Benchmarking Public Procurement: Assessing Public Procurement Regulatory Systems in 180 Economies*. Washington, DC: World Bank. <http://bpp.worldbank.org/~media/WBG/BPP/Documents/Reports/Benchmarking-Public-Procurement-2017.pdf>
- . 2017a. *Increasing Agribusiness Growth in Bhutan*. Washington, DC: World Bank.
- . 2017b. “Bhutan Public Procurement.” Confidential Assessment Note, World Bank, Washington, DC.

World Bank Group. 2014. *A Guide to Investor Targeting in Agribusiness*. World Bank, Washington, DC. <https://openknowledge.worldbank.org/handle/10986/21720>

World Bank Group, and Ministry of Labor and Human Resources, Royal Government of Bhutan. 2016a. *Bhutan's Labor Market: Toward Gainful Quality Employment for All*. Washington, DC: World Bank.

World Bank Independent Evaluation Group (IEG). 2007. *The Development Potential of Regional Programs: An Evaluation of World Bank Support of Multicountry Operations*. Washington, DC: World Bank.

Xu, Lisa, and Bilal Zia. 2012. *Financial Literacy around the World: An Overview of the Evidence with Practical Suggestions for the Way*

*Forward*. Washington, DC: World Bank. <https://openknowledge.worldbank.org/bitstream/handle/10986/9322/WPS6107.pdf?sequence=1&isAllowed=y>

Yasui, Tadashi. 2010. *Benefits of the Revised Kyoto Convention*. Brussels: World Customs Organization. [http://www.wcoomd.org/~media/wco/public/global/pdf/topics/research/research-paper-series/rkc\\_benefits.pdf?la=en](http://www.wcoomd.org/~media/wco/public/global/pdf/topics/research/research-paper-series/rkc_benefits.pdf?la=en)

Zambia, MoCTI (Ministry of Commerce, Trade and Industry). 2011. *Implementation of Customs Cooperation by Zambia*. <http://tfig.unece.org/contents/case-studies.htm#3>

# ANNEX 1

## THE ENTERPRISE SURVEY

**This report draws on data from the World Bank Enterprise Survey (WBES) that provides a standardized way of measuring and comparing firm performance and investment climate conditions for 130,000 firms across 135 countries.** The whole population, or universe, of the WBES is the nonagricultural economy. Typically, data are nationally representative of formal (registered) private firms with five or more employees. This is the case for the 2009 survey round in Bhutan. In the Bhutan 2015 round, however, the survey was expanded to include micro-firms, i.e., those with fewer than five employees. In addition, the sample contains panel data following 110 establishments interviewed in 2009.

**Bhutan 2015 data, collected between April 2015 and January 2016, were drawn primarily from the Department of Revenue and Custom's taxpayer database.** This database contains a full list of businesses registered for operating licenses as well as for a Corporate Income Tax (CIT) or Business Income Tax (BIT)'s ID. In addition, the list of 250 firms surveyed in 2009 was included to form the panel firms. A random subset of 6,000 businesses from this list was then used for verification. During the verification process, most BIT records were found to be out of date, duplicates, or otherwise ineligible for the survey. To compensate for the poor quality of the BIT list, fresh BIT establishments were enumerated during the physical verification process and made eligible for the survey. The resulting list of eligible establishments used as the sample frame consisted of 1,833 firms (see Table 12 for the distribution of the frame).

TABLE 12: BHUTAN ES SAMPLE FRAME

		Food & Beverages	Other Manufacturing	Tourism	Other Services	
<b>Thimphu-Paro</b>	0—Micro (1–4)	4	29	139	665	<b>1148</b>
	1—Small (5–19)	2	25	66	130	
	2—Medium (20–99)	0	7	21	44	
	3—Large (100+)	0	2	3	11	
<b>Phuentsholing</b>	0—Micro (1–4)	3	22	27	120	<b>310</b>
	1—Small (5–19)	4	14	7	49	
	2—Medium (20–99)	6	15	13	19	
	3—Large (100+)	0	8	0	3	
<b>Gelephu</b>	0—Micro (1–4)	4	4	12	58	<b>100</b>
	1—Small (5–19)	0	3	2	10	
	2—Medium (20–99)	0	5	0	2	
	3—Large (100+)	0	0	0	0	
<b>Samdrup Jongkhar</b>	0—Micro (1–4)	1	11	47	165	<b>275</b>
	1—Small (5–19)	0	13	12	20	
	2—Medium (20–99)	0	3	0	2	
	3—Large (100+)	0	1	0	0	
<b>Grand Total</b>		<b>24</b>	<b>162</b>	<b>349</b>	<b>1298</b>	<b>1833</b>

From this frame, the sample was selected using stratified random sampling. Three levels of stratification were used in Bhutan: type of industry, firm size, and geographic region. The universe was stratified into four sectors: Food and Beverages, Other Manufacturing, Tourism, and Other Services. Size stratification was defined following the standardized definition: micro (fewer than five employees), small (5 to 19 employees), medium (20 to 99 employees), and large (more than 99 employees). For stratification purposes, an employee was defined as a permanent full-time worker. This definition of the labor force was appropriate because seasonal/casual/part-time employment is not a common practice in Bhutan, other

than in the construction and agriculture sectors. Regional stratification was defined in four regions: Thimphu-Paro, Phuentsholing, Gelephu, and Samdrup Jongkhar.

The resulting sample includes 367 businesses representative of all registered firms operating in the nonagricultural economy in the four regions covered (see Table 13 for the distribution of the achieved sample). The stratification of the sample allows statistically significant inferences regarding the effects of the investment climate across four regions, four broad sectors, and four firm-size categories.

TABLE 13: ES ACHIEVED SAMPLE

		Food & Beverages	Other Manufacturing	Tourism	Other Services	
<b>Thimphu-Paro</b>	0—Micro (1-4)	1	9	13	33	<b>177</b>
	1—Small (5-19)	2	21	25	22	
	2—Medium (20-99)	0	4	15	23	
	3—Large (100+)	0	1	3	5	
<b>Phuentsholing</b>	0—Micro (1-4)	3	14	2	7	<b>85</b>
	1—Small (5-19)	2	11	5	6	
	2—Medium (20-99)	5	7	8	11	
	3—Large (100+)	0	3	0	1	
<b>Gelephu</b>	0—Micro (1-4)	4	4	4	7	<b>38</b>
	1—Small (5-19)	0	2	2	10	
	2—Medium (20-99)	0	4	0	1	
	3—Large (100+)	0	0	0	0	
<b>Samdrup Jongkhar</b>	0—Micro (1-4)	1	11	4	18	<b>67</b>
	1—Small (5-19)	0	12	10	6	
	2—Medium (20-99)	0	2	0	2	
	3—Large (100+)	0	1	0	0	
<b>Grand Total</b>		<b>18</b>	<b>106</b>	<b>91</b>	<b>152</b>	<b>367</b>



Kids running on the street, Thimphu, September 2015.

## ANNEX 2

# BHUTAN LICENSING REGIMES AND ESTIMATED SIZE OF PRIVATE SECTOR

In Bhutan, the regulatory framework governing firm registration is comparatively complex. Limited liability companies (LLCs) are required to register with the Registrar of Companies. This remains a very small segment of the private sector. Sole proprietors form by far the largest segment of domestic firms in Bhutan, and the main forms of legal registration for them require registering for an operating license with line departments at the Ministry of Economic Affairs and registering for a Taxpayer Number (TPN) from the Department of Revenue and Customs. Operating licenses are managed by different departments at MoEA depending on their indicated sector and size. Table 14 summarizes the different licensing requirements for firms by legal status, size, and sector.

TABLE 14: BUSINESS REGISTRATION FRAMEWORK

Sector	Size (self-declared initial fixed investments)	Type of License	Licensing Agency
<b>For Companies</b>			
<b>All Sectors</b>	All Sizes	Limited-Liability Legal Status	Registrar of Companies (Department of Industry, MoEA)
<b>For Sole Proprietors/Partnerships</b>			
<b>Manufacturing, Construction &amp; Services</b> (except wholesale/retail trade)	Medium and Large (Investment > 1 Mil Nu)	Business License	Department of Industry, MoEA
	Cottage and Small Businesses (Investment < 1 Mil Nu)	Business License	Department of Cottage and Small Industry (DCSI), MoEA
<b>Retail</b>	Micro (Investment < 1 Mil Nu)	Microtrade Registration Certificate	Department of Trade, MoEA
	Small, Medium, Large (Investment > 1 Mil Nu)	Retail Trade License	
<b>Wholesale</b>	All Sizes	Wholesale Trade License	

Source: <https://bhutan.eregulations.org>; conversations with MoEA staff.

**The differing licensing schemes are intended to provide smaller firms with simplified registration processes and better incentives.** For example, the micro-trade registration certificate is renewable without fees while providing businesses with tax exemption benefits. Registering with DCSI allows firms to access priority finance from the Rural Enterprise Development Corporation.<sup>87</sup>

**However, the system's several shortcomings emerge in practice.** One key shortcoming is a lack of harmonized definitions on firm size between licensing schemes and financing schemes. Further, the current firm size definition is based on initial investments in fixed assets, which is self-declared by firms at registration and in practice is decided at the discretion of the licensing official without any uniform verification process. This lack of verification potentially creates misleading information on the overall firm-size distribution. Further regulatory inconsistencies and/or redundancies undermine Bhutan's ability to monitor its private-sector activities efficiently. For example, currently cottage (micro-) and small firms experience no difference in benefits, rendering the distinction irrelevant. For non-LLCs, MoEA also does not require them to report changes in size, economic activity, or operating status.

## 2.1 ESTIMATED SIZE OF THE ENTERPRISE SECTOR

**Since coordination among these agencies remains limited, estimates of the size of the private sector in Bhutan vary widely.** The Bureau of Statistics publishes annual reports on the size of the private sectors, based on the number of licenses as indicated by the corresponding line departments. For example, in 2014, the total reported number of firms in all sectors except mining was 69,847 firms. These figures do not reflect firm exits, however, and hence substantially overestimate the number of existing businesses in the country.

**The number of businesses as indicated by the number of operational TPNs provides a more accurate picture of the size of the private sector.** Bhutan requires firms wishing to renew their licenses to register with the DRC. This applies for even the smallest traders under the micro-trade certificate scheme. In practice, the number of licenses exceeds the number of tax numbers, and tax data are thus more likely to provide the true number of existing businesses. This is so for several reasons:

- » The DRC does not have a mechanism to enforce TPN registration by all licensed businesses.
- » MoEA departments responsible for approving operating licenses keep track of license renewals, but beyond licensing, they do not have a mechanism to track firms' operational status. In contrast, firms report their operating status in their filings with the DRC.
- » Both tax return data and fieldwork to form the ES sampling suggested that businesses, to keep their licenses, maintain tax filings with DRC even when not operational.
- » Finally, a business can have multiple licenses but files for only one TPN.

**Our best estimate of the current number of existing businesses in Bhutan is around 28,000.** The DRC maintains information on the status of firms based on their tax filing records (Figure 26). First, nonexisting businesses that do not keep contact with the DRC will have their TPNs deactivated. Among active accounts, businesses that are not tax exempt must file taxes annually, thus reporting on their operational status. In 2016, 19,287 businesses submitted filings to the DRC electronically, of which about 23.12 percent were nonoperational. The operational status of the remaining 17,620 active TPNs, the holders of which either filed taxes non-electronically or were tax exempt (mostly micro-businesses), is unknown. Nevertheless, assuming the same rate of operations for 2016 of around 77 percent, our best estimate on the number of operating BIT payers is around 28,374. Given the minimal number of LLCs and publicly traded companies, the true population of registered firms in Bhutan is likely close to this number.

87. Previously the Business Opportunity and Information Center.

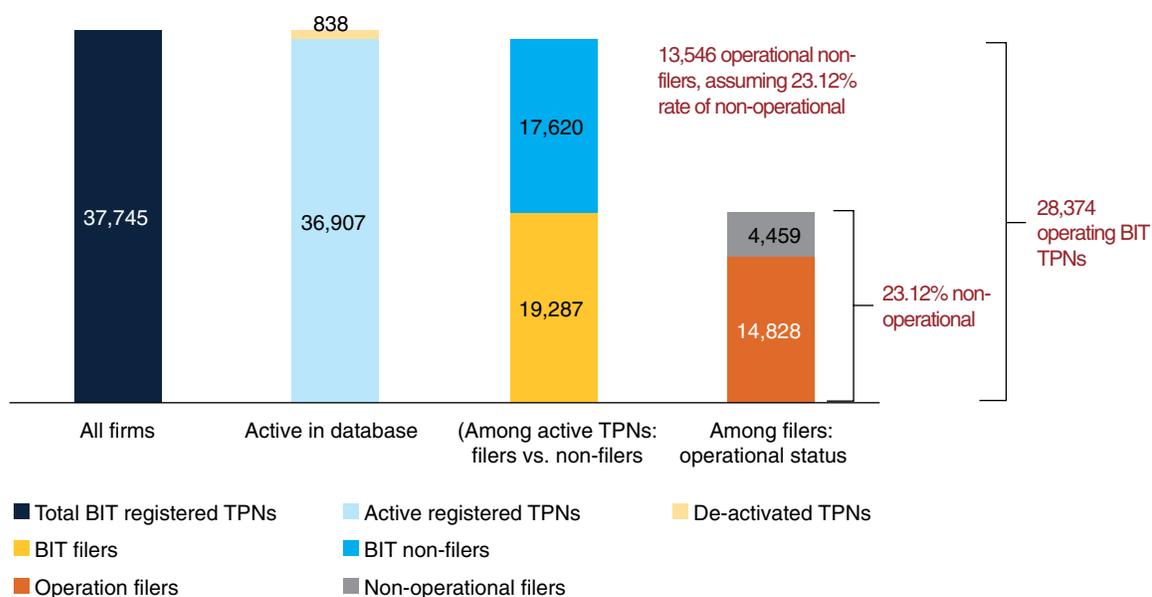


Figure 26: Number of BIT Firms by Status in DRC Tax Database, 2016  
 Source: Information from conversations with MoEA and DRC staff.

## 2.2 EXTENT OF INFORMALITY

**Formality is a multifaceted concept.** At the firm level, it can include various forms of legal registration (trade license, tax identification number), membership in business associations and the chamber of commerce, to the use of formal finance, the degree of information technology used by the firm, and the business practices and record keeping that a firm does.

**Based on WBES 2015 data, the vast majority of firms are formal based on the criteria of having a business license or paying some taxes.** If defined as being an LLC while not registered with the company registrar, informality is somewhat more common (at 12 percent). However, this definition is not very informative, as a mere 1.59 percent of all firms are LLCs. The limitation of the WBES, of course, is that the sample frame is based on the list of licensed companies and taxpayers, hence by definitions we cannot observe firms outside this system. Existing household data also do not allow for estimating the extent of business informality in Bhutan.

**Defining formality as meaning registered for an operating license, the share of informal firms in**

**Bhutan is also likely to be negligible.** Besides the licensing schemes discussed above, rural businesses and businesses with investment below Nu 100,000 (about US\$1,560) are not required to register.<sup>88</sup> According to MoEA staff, for other businesses, the cost of being formal—in terms of both tax burdens and registration costs—are sufficiently low that almost all businesses with a permanent outlet would have some form of licensing. The ratio of registered firm per employed person (28,000/339,568, i.e., 1 registered firm per every 12 employed persons) appears in line with this assessment.<sup>89</sup>

**Informality defined by a firm's registration and tax status is rare, but informality in terms of employment is common.** Based on the WBES 2015, in aggregate, 50 percent of all full-time workers in the formal (registered) sector are employed with a temporary contract. This definition will exclude one-person companies without employees and hence underestimates those working in, for example, household enterprises.

88. Throughout the report, we use the 2015 official exchange rate of Nu 64.15 to US\$1 to convert nominal values.

89. The Gallup World Poll survey in 2016, for example, suggests that the percentage of Bhutanese adult population owning a business is 9 percent (see Annex 3, Section 3.5, for more detail).

Based on household surveys and a broader definition of informality, informal employment is even more prevalent. Based on the 2014 labor force data (World Bank 2016a) and ILO definition of informality, the rate of informal employment in 2014 is 79.8 percent. Expectedly, it is a phenomenon more common among those with less education and in poorer households (World Bank 2016a).

TABLE 15: SHARE OF INFORMAL FIRMS IN BHUTAN

Definition	Informality Share	Source/Year
<b><i>Firm-level:</i></b>	(% of all firms)	
<b>Being a LLC and not registered with the company registrar</b>	12.10%	WBES 2015
<b>Operating without a license</b>	0%	WBES 2015
<b>Not paying taxes</b>	2.20%	WBES 2015
<b><i>Employee level:</i></b>	(% of total employment)	
<b>Informal employment defined following ILO (2013) as those employed but not in regular wage/salaried work or high-end self-employment<sup>90</sup></b>	79.80%	LFS 2014
	79%	LFS 2007
<b>Employees with a temporary (as opposed to permanent) contract</b>	50%	WBES 2015

90. This definition encompasses all workers who work as casual paid employees, contract/piece paid workers, own-account workers, and family workers. In addition, regular paid employees without a contract of employment and/or access to any kind of fringe benefits (gratuity, provident fund payments, overtime payments, annual payments, sick leave, casual leave, maternity/paternity leave, or compensation for injury, disability or death due to work accidents or occupational disease) are also counted as informally employed.

# ANNEX 3

## ADDITIONAL TABLES AND FIGURES

### 3.1 MEASURES OF LABOR PRODUCTIVITY

Value added per worker is a basic measure of labor productivity. We measure, per equivalent full-time worker, the value of goods and services that the firms produce, less the cost of raw materials and intermediate inputs. Labor productivity can be affected by differences in technology, organizational structure, or quality of the firm’s human resources that enable it to produce more output with the same labor and other resources. Productivity is also higher in firms that use capital more intensively. A better measure of efficiency is total factor productivity (TFP), which accounts for the use of capital, but missing data on capital means that TFP cannot be estimated for the majority of firms

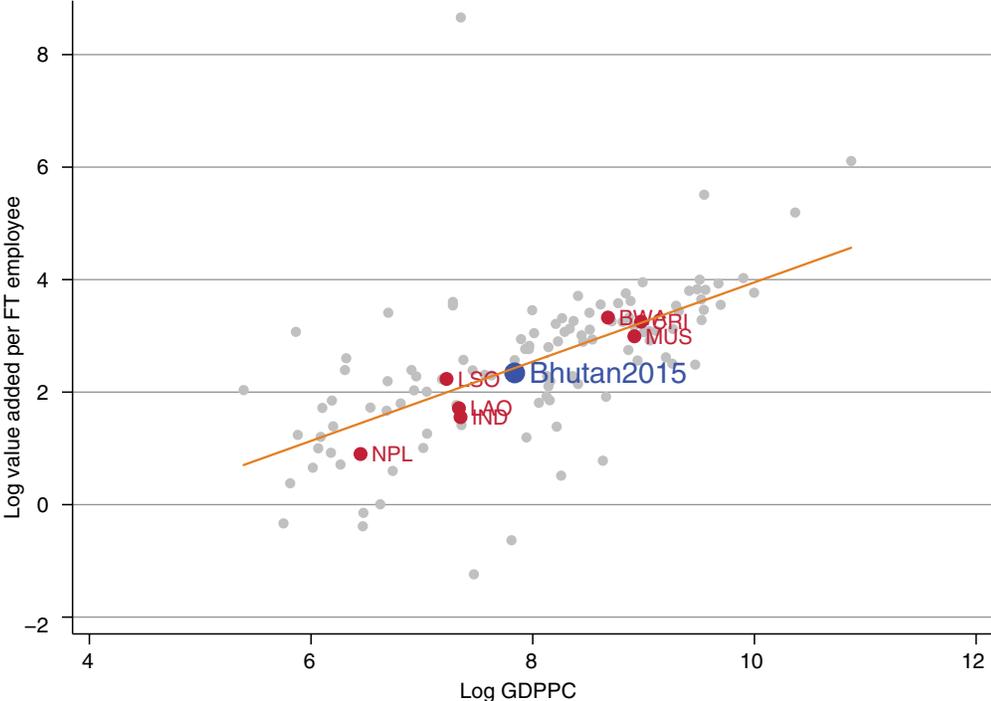


Figure 27: Correlation of Income and Labor Productivity

TABLE 16: MEDIAN LABOR PRODUCTIVITY (VALUE ADDED PER FULL-TIME WORKER) BY INDUSTRY IN BHUTAN

ISIC	Sector Name	2009	2015
10	Mining of coal and lignite; extraction of peat	60.05	
15	Manufacture of food products and beverages	5.66	1.45
17	Manufacture of textiles	2.12	0.01
18	Manufacture of wearing apparel; dressing and dyeing of fur	0.68	
20	Manufacture of wood and of products of wood and cork, except furniture; manufacture of articles of straw and plaiting materials	1.86	1.47
21	Manufacture of paper and paper products	4.16	1.52
22	Publishing, printing, and reproduction of recorded media	1.60	1.49
24	Manufacture of chemicals and chemical products	10.07	
25	Manufacture of rubber and plastics products	2.57	20.12
26	Manufacture of other nonmetallic mineral products	27.59	4.42
27	Manufacture of basic metals	17.51	3.12
28	Manufacture of fabricated metal products, except machinery and equipment	0.86	6.05
31	Manufacture of electrical machinery and apparatus n.e.c.	38.78	11.09
32	Manufacture of radio, television, and communication equipment and apparatus	356.72	
36	Manufacture of furniture; manufacturing n.e.c.	2.16	8.11
37	Recycling		0.32
45	Construction	6.76	17.76
50	Sale, maintenance, and repair of motor vehicles and motorcycles; retail sale of automotive fuel	2.35	2.66
51	Wholesale trade and commission trade, except of motor vehicles and motorcycles	11.77	101.09
52	Retail trade, except of motor vehicles and motorcycles; repair of personal and household goods	5.75	23.44
55	Hotels and restaurants	5.67	2.73
60	Land transport; transport via pipelines	1.49	14.07
62	Air transport	92.36	
63	Supporting and auxiliary transport activities; activities of travel agencies	5.66	20.68
64	Post and telecommunications	6.89	5.91
72	Computer and related activities	4.81	9.15
74	Other business activities	3.59	

*Note:* Value added is measured in thousand US\$, in 2010 prices.

in Bhutan's dataset. Consequently, we use value added per worker as the only measure of firm productivity. One key caveat of productivity measures using revenue (as opposed to the amount of physical outputs and inputs)

is that high productivity measures might reflect higher prices due to conditions such as higher demand or mark-ups by firms with market power

## 3.2 PRICE LEVELS

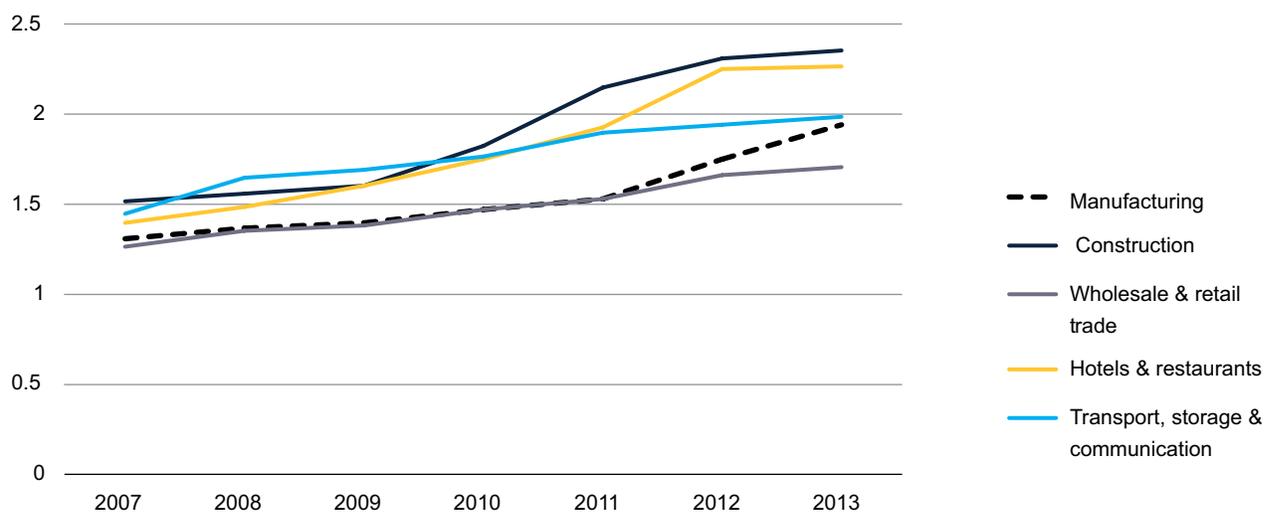


Figure 28: Price Levels Relative to 2000

*Note:* Price levels are calculated as the ratio between GDP by economic activity in current and constant LCU. Data are from the national accounts series published by the NSB at <http://www.nsb.gov.bt/xl/?dir=SUBJECTS/NATIONAL%20ACCOUNTS/Annual%20National%20Accounts>

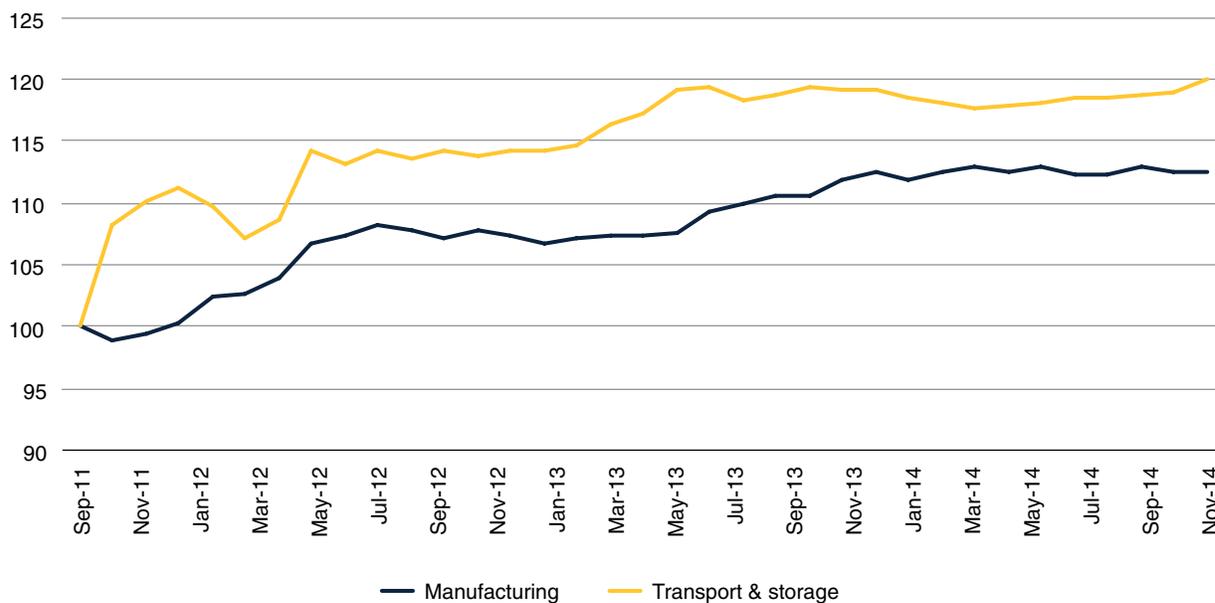


Figure 29: Producer Price Index

*Note:* Based on PPI data published by NSB at <http://www.nsb.gov.bt/xl/?dir=SUBJECTS/PRODUCERS%20PRICE%20INDEX>

### 3.3 DETERMINANTS OF LABOR PRODUCTIVITY AND EMPLOYMENT GROWTH

Assume a Cobb-Douglas production function of the form  $Y = K^\alpha L^\beta$ , where  $\alpha + \beta = \theta$ , so that output per worker can be written as a function of capital intensity and employment:

$$\log\left(\frac{Y}{L}\right) = \alpha \log(K) + (\beta - 1)\log L = \alpha \log\left(\frac{K}{L}\right) + (\theta - 1)\log L$$

Under these assumptions, a model on the determinants of labor productivity can be estimated in a regression of (log) labor productivity on capital intensity and employment, and other firm characteristics. The results are presented below. The estimated positive coefficients on log(employment) in the manufacturing sector indicates potential increasing returns to scale in this sector. (This is because the estimated coefficient on labor,  $(\theta - 1)$ , gives an indication on economies of scale. A positive coefficient indicates increasing returns to scale as this implies:  $\alpha + \beta > 1$ ).

TABLE 17: DETERMINANTS OF LABOR PRODUCTIVITY

Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Employment (natural log)	0.0930 (0.0863)	-0.0198 (0.0972)	0.151* (0.0903)	0.361** (0.142)	-0.0748 (0.0984)	0.0811 (0.0869)	-0.0336 (0.102)	0.271 (0.212)
Capital labor ratio (natural log)				0.412*** (0.0724)				0.400*** (0.0954)
Phuentsholing	-0.494 (0.317)	-0.471* (0.240)	-0.531 (0.328)	0.753* (0.423)	-0.281 (0.312)	-0.672* (0.368)	-0.370 (0.320)	0.713 (0.512)
Gelephu/Sarpang	-1.165*** (0.386)	-0.967** (0.416)	-1.079*** (0.407)	0.102 (0.733)	-1.044*** (0.383)	-1.130*** (0.382)	-0.885** (0.413)	0.238 (0.842)
Samdrup Jongkhar	-0.634 (0.388)	-0.534 (0.349)	-0.579 (0.367)	0.610 (0.530)	-0.660* (0.361)	-0.593 (0.391)	-0.505 (0.343)	0.233 (0.633)
Foreign-owned	-0.851** (0.426)	-1.168** (0.463)	-0.713 (0.459)	0.242 (1.539)	-1.150*** (0.365)	-0.922** (0.433)	-1.253*** (0.415)	-0.356 (1.879)
Limited liability company (llc)	0.306 (0.387)	0.242 (0.429)	0.343 (0.417)	0.152 (0.453)	0.185 (0.414)	0.263 (0.396)	0.160 (0.456)	0.283 (0.627)
Other legal status	0.107 (0.363)	-0.0481 (0.299)	0.0865 (0.335)	-0.0461 (0.557)	0.159 (0.346)	0.107 (0.354)	0.0447 (0.297)	0.00707 (0.540)
Age	0.0163 (0.0238)	-0.00160 (0.0329)	0.0374 (0.0277)	0.0768 (0.0560)	0.0274 (0.0238)	0.0181 (0.0235)	0.0232 (0.0345)	0.0821 (0.0754)
Non-food manufacturing	1.892*** (0.349)	1.142** (0.500)	1.823*** (0.389)	-0.157 (0.469)	1.658*** (0.356)	1.865*** (0.348)	0.979** (0.496)	-0.232 (0.525)
Tourism services	3.379*** (0.268)	2.790*** (0.348)	3.486*** (0.417)		3.333*** (0.252)	3.292*** (0.273)	2.738*** (0.437)	
Other services	4.233*** (0.201)	3.619*** (0.384)	4.266*** (0.298)		4.119*** (0.194)	4.198*** (0.202)	3.573*** (0.422)	
Owner's age		0.0126 (0.00940)					0.0107 (0.00950)	
Owner's education: some secondary		0.330 (0.218)					0.141 (0.219)	

Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Owner's education: post-secondary		1.113*** (0.334)					0.683** (0.333)	
Owner born outside bhutan		0.133 (0.284)					0.195 (0.339)	
Manager's experience			-0.0233* (0.0121)				-0.0126 (0.0144)	0.0256 (0.0349)
Female manager			-0.241 (0.257)				0.0273 (0.255)	
Share of skilled labor			0.00865* (0.00483)				0.00734* (0.00416)	-0.00881 (0.00815)
Have formal training			-0.370 (0.273)				-0.215 (0.264)	-0.233 (0.592)
Have internationally recognized quality certificate					0.621 (0.532)		0.423 (0.608)	-0.390 (0.672)
Invested in it					0.821** (0.328)		0.526* (0.302)	0.102 (0.502)
Regulatory time tax						0.00353 (0.00303)	0.00213 (0.00310)	0.00399 (0.00568)
Observations	334	319	332	78	331	334	314	75
R-squared	0.911	0.923	0.915	0.829	0.916	0.911	0.927	0.831

Note: Robust standard errors in parentheses: \*\*\*p < 0.01, \*\*p < 0.05, \*p < 0.1. Labor productivity is measured as log value added per worker. Skilled labor includes those with at least a high school education.

TABLE 18: DETERMINANTS OF EMPLOYMENT GROWTH

Variables	(1)	(2)	(3)	(4)	(6)	(7)
Sales growth (log scale)	0.205*** (0.0563)	0.201*** (0.0570)	0.163*** (0.0483)	0.195** (0.0801)	0.191*** (0.0528)	0.163*** (0.0534)
Small (5–20)	0.120 (0.0768)	0.135 (0.0818)	0.150* (0.0767)	0.242 (0.152)	0.102 (0.0835)	0.101 (0.0832)
Medium (20–99)	0.275*** (0.0773)	0.323*** (0.0863)	0.272*** (0.0911)	0.387* (0.214)	0.302*** (0.0942)	0.301*** (0.0950)
Large (100+)	0.185 (0.151)	0.232 (0.163)	0.125 (0.166)	1.077*** (0.206)	0.161 (0.177)	0.195 (0.166)
Non-food manufacturing	-0.146 (0.113)	-0.0983 (0.133)	-0.181 (0.119)	-0.113 (0.142)	-0.00453 (0.140)	0.0297 (0.135)
Tourism services	-0.180 (0.124)	-0.145 (0.142)	-0.313** (0.127)		-0.0774 (0.126)	-0.0157 (0.109)
Other services	-0.0442 (0.0904)	-0.00184 (0.114)	-0.115 (0.103)		0.0838 (0.120)	0.147 (0.112)

Variables	(1)	(2)	(3)	(4)	(6)	(7)
Phuentsholing	0.0627 (0.0852)	0.0748 (0.103)	0.0960 (0.0933)	0.124 (0.148)	0.0145 (0.101)	0.00921 (0.103)
Gelephu/Sarpang	0.115 (0.0815)	0.0908 (0.0756)	0.0986 (0.0624)	-0.0420 (0.107)	0.100 (0.0792)	0.0843 (0.0802)
Samdrup Jongkhar	0.00587 (0.0804)	-0.0124 (0.0824)	0.0247 (0.0786)	0.608*** (0.166)	-0.0251 (0.0862)	-0.0386 (0.0861)
Foreign owned	0.396** (0.187)	0.450** (0.219)	0.365** (0.174)	1.275** (0.629)	0.388* (0.219)	0.383* (0.222)
Owner's age		-6.69e-05 (0.00216)	9.88e-05 (0.00204)	-0.000156 (0.00352)	-0.000513 (0.00224)	-0.00112 (0.00218)
Owner's education: some secondary		-0.0412 (0.0784)	-0.0138 (0.0653)	0.189 (0.165)	-0.00530 (0.0762)	-0.0118 (0.0768)
Owner's education: post-secondary		-0.136* (0.0741)	-0.00930 (0.0858)	0.189 (0.128)	-0.0808 (0.0893)	-0.0773 (0.0872)
Owner born outside Bhutan		-0.0429 (0.0994)	0.0265 (0.0817)	-0.194 (0.324)	-0.0540 (0.101)	-0.0454 (0.103)
Manager's experience			-0.000721 (0.00318)			
Female manager			0.202*** (0.0627)			
Share of skilled labor			-0.00381 (0.00280)			
Have formal training			0.141** (0.0611)			
Capital labor ratio (natural log)				-0.0504* (0.0293)		
Access to finance is major or severe obstacle					-0.204* (0.105)	-0.318** (0.144)
Access to finance * sales growth						0.250 (0.173)
Observations	293	279	277	74	272	272
R-squared	0.301	0.307	0.398	0.677	0.338	0.356

Note: Robust standard errors in parentheses: \*\*\*p < 0.01, \*\*p < 0.05, \*p < 0.1.

The dependent variable is employment growth, calculated as the log of (employment in 2014/employment in 2012).

Skilled labor includes those with at least high school education. Other controls not reported: legal status, age, age squared.

TABLE 19: DRIVERS OF EXPANSION PLANS

Total Number of Firms with Expansion Plan	Reason for Expansion (%)			
	Increased Demand for Goods and Services	Product Diversification	Easy Access to Credit Facilities	Other Reasons
2,335	74%	4%	1%	21%
Total Number of Firms without Plans for Expansion	Main Reasons for Not Expanding (%)			
	Market Competition	Lack of Demand for Goods & Services	Credit Constraints	Other Reasons
3,542	48%	5%	40%	6%

Source: Establishment Census 2016.

## 3.4 PHYSICAL AND HUMAN CAPITAL

TABLE 20: QUALITY AND INVESTMENTS IN PHYSICAL AND HUMAN CAPITAL

	Median Capital Intensity (Mfg.)	Invested in Fixed Assets (Mfg.)	Invested in Fixed Assets (All)	High School Educated Workers	Mgr. Years of Experience (Avg.)	Provides Formal Training
Bhutan 2009		46%	52%		16	23%
Bhutan 2015	2.93	43%	40%	28%	12	26%
Botswana 2010	10.68	66%	68%	37%	18	52%
Costa Rica 2010	17.98	61%	60%	38%	20	55%
India 2014	7.42	26%	25%	51%	11	36%
Lao PDR 2016	5.85	17%	17%	20%	15	7%
Lesotho 2016	0.83	27%	27%	69%	10	31%
Mauritius 2009	9.27	63%	52%		17	26%
Nepal 2013	8.59	35%	28%	24%	16	32%

Note: Capital intensity (total fixed assets per equivalent FT employee), measured in thousand US\$ per FT worker, is available for manufacturing sector only. Since investment data are subject to high levels of measurement errors, we report the share of firms reporting any positive investments in fixed assets.

## 3.5 LABOR REGULATIONS AND PERCEPTION ON LABOR CONSTRAINTS IN BHUTAN

TABLE 21: LABOR REGULATIONS IN BHUTAN AND SOUTH ASIA

Economy	Fixed-Term Contracts Prohibited for Permanent Tasks	Maximum Length of Single Fixed-Term Contract	Maximum Length of Fixed-Term Contracts (Incl. Renewals)	Minimum Wage Applicable to Worker Assumed in Case Study	Ratio of Minimum Wage to Value Added per Worker
Afghanistan	No	No limit	No limit	0	0
Bhutan	No	No limit	No limit	\$58.2/month	0.2
Maldives	No	24 months	24 months	0	0
Nepal	Yes	No limit	No limit	\$93.5/month	0.9
Sri Lanka	No	No limit	No limit	\$78.5/month	0.2
India: Delhi	No	No limit	No limit	\$180.7/month	0.9
Pakistan: Lahore	Yes	9 months	9 months	\$121.9/month	0.6
Bangladesh: Chittagong	No	No limit	No limit	0	0
Bangladesh: Dhaka	No	No limit	No limit	0	0
India: Mumbai	No	No limit	No limit	\$136.1/month	0.7
Pakistan: Karachi	Yes	9 months	9 months	\$121.9/month	0.6

Source: World Bank (2016d).

TABLE 22: FIRM'S PERCEPTION OF DIFFERENT LABOR CONSTRAINTS

At Least Moderate Obstacle	Employment Protection	Salary Costs	Restrictiveness of Immigration Rules	Undereducated Workforce
All	11%	22%	17%	20%
Food & beverages	0%	51%	13%	3%
Other manufacturing	11%	27%	25%	31%
Tourism	14%	33%	17%	24%
Services	9%	16%	17%	17%
Micro	9%	19%	12%	19%
Small	13%	29%	22%	23%
Medium	21%	32%	49%	28%
Large	16%	47%	54%	19%
Without temporary workers	9%	14%	13%	16%
With temporary workers	16%	44%	28%	30%
Without foreign workers	12%	24%	10%	23%
With foreign workers	8%	19%	34%	14%

Source: World Bank (2016a).

## 3.6 MAIN CORPORATE AND BUSINESS TAXES BHUTAN

TABLE 23: MAIN CORPORATE AND BUSINESS TAXES IN BHUTAN

<b>Main Corporate Taxes</b>	<b>Statutory Rate</b>	<b>Tax Base</b>
Corporate income tax (CIT)	30%	Net profit
Business income tax (BIT)	30%	Net profit
Tax rate for foreign companies	30%	Net profit
Capital gains taxation	Taxes on capital gains are levied on the actual or presumptive net income of corporations and enterprises.	
Main allowable deductions and tax credits	Income Tax Deductions: (i) Direct costs associated with the operation of the business that may be directly attributed to the generation of income shall be allowed as deductions; (ii) Wage, salary, and bonus paid to the employees shall be deductible as per the limits and rules prescribed by the Ministry.	
<b>Other Taxes</b>	<b>Statutory Rate</b>	<b>Tax Base</b>
Property tax	Varies from BTN 500 to 25,000	Size of building/land
Business license	BTN 75	Per unit
Vehicle tax	BTN 6,000 (fees and charges) + BTN 7,000 (motor vehicle tax)	Fixed fee
Stamp duty	BTN 10	
Property transfer tax	5%	
Withholding taxes	Dividends: 10% Interest: 5% Royalties: 5%	
Double taxation treaties	Bhutan is a signatory of the SAARC Agreement on Avoidance of Double and Mutual Administrative Assistance on Tax Matters, which includes India, Bangladesh, Maldives, Nepal, Pakistan, and Sri Lanka.	

Source: Department of Revenue and Custom, Ministry of Finance; *Doing Business 2017*.



Woman weaving a kira, Koma Village, April 2014.

