

Bhutan

February 2004

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The Economist Intelligence Unit

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London

The Economist Intelligence Unit
15 Regent St
London
SW1Y 4LR
United Kingdom
Tel: (44.20) 7830 1007
Fax: (44.20) 7830 1023
E-mail: london@eiu.com

New York

The Economist Intelligence Unit
The Economist Building
111 West 57th Street
New York
NY 10019, US
Tel: (1.212) 554 0600
Fax: (1.212) 586 0248
E-mail: dantecantu@eiu.com

Hong Kong

The Economist Intelligence Unit
60/F, Central Plaza
18 Harbour Road
Wanchai
Hong Kong
Tel: (852) 2585 3888
Fax: (852) 2802 7638
E-mail: hongkong@eiu.com

Website: www.eiu.com

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Contents

3	Summary
4	Political structure
5	Economic structure
5	Annual indicators
6	Quarterly indicators
7	Outlook for 2004-05
7	Political outlook
8	Economic forecast
10	The political scene
12	Economic policy
14	The domestic economy
15	Foreign trade and payments

List of tables

14	Bhutan: consumer price inflation
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List of figures

6	Bhutan: Money supply
6	Bhutan: Foreign reserves
9	Bhutan: gross domestic product
9	Bhutan: consumer price inflation
14	Bhutan: percentage of GDP, 2002
15	Bhutan: foreign-exchange reserves
15	Bhutan: tourist arrivals and revenue

Summary

February 2004

- Outlook for 2004-05** The ousting of anti-Indian militants from their camps in southern Bhutan should provide a boost to economic development, and will strengthen Bhutan's relationship with India. In Assam and West Bengal Bhutanese citizens may face retaliation from sympathisers of the groups. Political reform will continue as Bhutan moves towards democracy. The problem of 100,000 ethnic Nepalese refugees will be a major concern in 2004-05. The economy will grow strongly in 2004-05, driven by the continued growth of hydroelectric production. The merchandise trade deficit will fluctuate depending on the need for capital imports for use in power projects.
- The political scene** Negotiations with militant groups failed in December, when the Royal Bhutanese Army launched military operations against them. The army rapidly destroyed their camps. India provided logistical support for the operations. An attack on Bhutanese officials in December has stalled progress on refugee returns. Reform of the government has continued. The World Bank has provided funding to tackle AIDS. Crime is rising. Relations with India are good. The crown prince is increasingly visible. Thailand has opened a consulate in Bhutan. The king's grandmother has been cremated.
- Economic policy** Rural electrification has continued. Corruption in the public sector has been uncovered. Druk Air, the national carrier, has agreed to buy two new aeroplanes. A mobile-phone system has been introduced. Trading in a soft drinks company, BBCL, has been brisk. Interest rates payable on housing loans have been cut. A new housing scheme has been introduced.
- The domestic economy** The economy grew by 7.7% in 2002. Domestic credit grew strongly in 2003. External debt also rose substantially. Year-on-year inflation fell to 1.8% in June 2003. A quarter of recent graduates are still seeking work.
- Foreign trade and payments** Electricity exports dominate export receipts. The value of imports fell in 2003. At the end of 2003, Bhutan had almost two years of import cover. The tourism sector is recovering slowly.
- Editors:** Gareth Price (editor); Robert Ward (consulting editor)
Editorial closing date: January 14th 2004
All queries: Tel: (44.20) 7830 1007 E-mail: london@eiu.com
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Political structure

Official name	Kingdom of Bhutan	
Government	Monarchy with no written constitution. Executive power is vested in a Council of Ministers. The second draft of a constitution was submitted to the king in June 2003 and is expected to be released for public discussion in 2004	
National elections	The unicameral National Assembly has 154 members, 101 of whom are elected. The tenure of the elected members is three years, but elections are staggered. Six members are the elected royal advisory council members, ten are nominated by the clergy, 37 are chosen by the government and one represents the army	
National government	The king is head of state, but can be required to abdicate by a two-thirds vote in the National Assembly. The cabinet consists of ten ministers, six members of the royal advisory council and a chairman, and is presided over by the prime minister. The position of prime minister rotates annually among the five ministers who win the largest numbers of votes in the National Assembly when they are elected	
Main political organisations	Political parties are currently banned, although the constitution under discussion is likely to address this issue. Some anti-government groups are based in Nepal and India	
	Head of state (dragon king)	King Jigme Singye Wangchuck
Council of Ministers	Prime minister & minister for home affairs	Jigmi Yozer Thinley
Key ministers	Agriculture	Sangay Ngedup
	Education	Thinley Gyamtsho
	Finance	Wangdi Norbu
	Foreign affairs	Khandu Wangchuk
	Health	Jigmi Singay
	Information & communications	Leki Dorji
	Labour & human resources	Ugyen Tshering
	Trade & industry	Yeshey Zimba
	Works & human settlement	Kinzang Dorji
Speaker of the National Assembly	Ugyen Dorji	
Chairman of the royal advisory council	Rinzin Gyeltshen	
Chief justice	Sonam Tobgye	
Central bank chairman	Wangdi Norbu	

Economic structure

Annual indicators^a

	1999 ^b	2000 ^b	2001 ^b	2002 ^b	2003
GDP at market prices (Nu m)	19,161	21,749	24,895	28,495	n/a
GDP (US\$ m)	445.0	484.0	527.6	586.2	n/a
Real GDP growth (%)	7.6	5.3	6.6	7.7	n/a
Consumer price inflation (av; %)	6.9	4.0	3.4	2.5	n/a
Population (mid-year; '000) ^c	658	678	698	716	n/a
Exports fob (Nu m) ^d	4,987.9	4,615.8	4,708.6	n/a	n/a
Imports cif (Nu m) ^d	8,075.2	9,106.3	9,080.3	n/a	n/a
Reserves excl gold (US\$ m) ^e	274.4	295.4	284.6	320.6	n/a
Total external debt (US\$ m) ^f	183.8	203.3	265.2	n/a	n/a
Exchange rate (av; Nu:US\$)	43.06	44.94	47.19	48.61	46.57

^a Figures are sourced from the Central Statistical Office (CSO), the Planning Commission and the Royal Monetary Authority unless otherwise indicated. ^b Actual. ^c The UN estimates Bhutan's population at 1.9m in 1999, based on an estimated population of 1.04m in the last census taken in 1969. ^d Fiscal years ending June 30th. ^e IMF, *International Financial Statistics*. ^f World Bank, *Global Development Finance*.

Origins of gross domestic product 2002 ^a	% of total	Components of gross domestic product 2001 ^a	% of total
Services & others	51.0	Private consumption	51.6
Agriculture	32.4	Government consumption	20.5
Electricity, gas & water	11.0	Investment	48.1
Manufacturing	7.2	Exports	23.2
Mining	1.4	Imports	-43.4

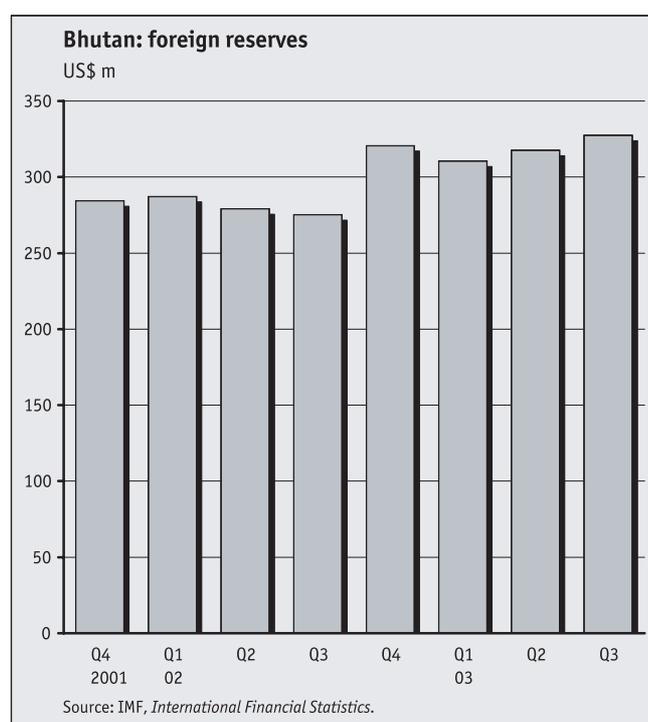
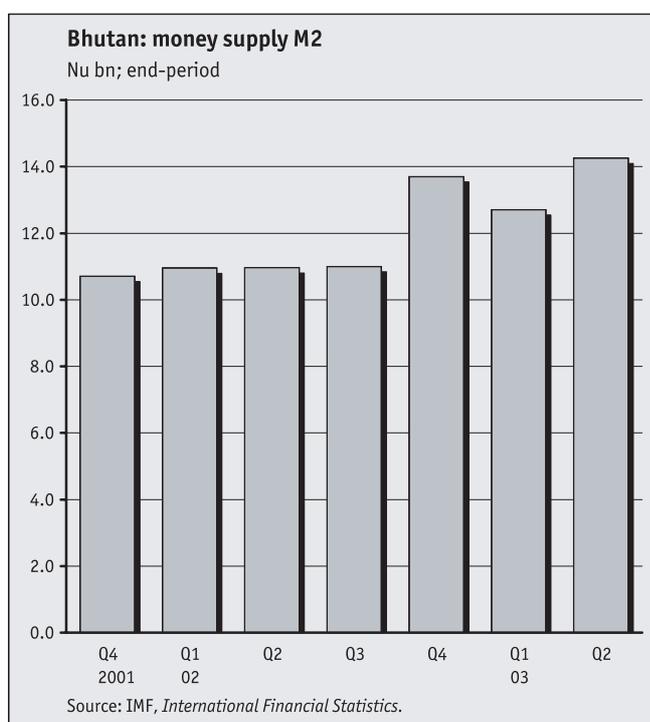
Main destinations of exports 2000 ^b	% of total	Main origins of imports 2000 ^b	% of total
India	94.0	India	78.0
Bangladesh	4.0	Japan	7.0

^a Asian Development Bank, *Key Indicators of Developing Asian and Pacific Countries*. ^b Department of Revenue and Customs.

Quarterly indicators

	2001	2002				2003		
	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr
Prices								
Consumer prices (Dec 1979=100)	632.8	n/a	636.3	n/a	647.2	n/a	637.8	n/a
Consumer prices (% change, year on year)	3.2	n/a	2.7	n/a	2.3	n/a	0.2	n/a
Financial indicators								
Exchange rate Nu:US\$ (av)	47.98	48.59	48.96	48.60	48.29	47.77	47.06	46.01
Exchange rate Nu:US\$ (end-period)	48.18	48.80	48.87	48.38	48.03	47.55	46.47	45.85
M1 (end-period; Nu m)	5,058	4,753	4,914	5,167	6,975	5,910	6,804	n/a
M1 (% change, year on year)	28.4	12.5	12.4	17.1	37.9	24.3	38.5	n/a
M2 (end-period; Nu m)	10,716	10,961	10,972	10,999	13,707	12,704	14,265	n/a
M2 (% change, year on year)	7.9	10.0	17.8	6.6	27.9	15.9	30.0	n/a
Foreign reserves (US\$ m)								
Reserves excl gold (end-period)	284.60	287.22	279.3	275.31	320.62	310.49	317.80	327.51

Sources: IMF, *International Financial Statistics* Royal Monetary Authority of Bhutan, *Selected Economic Indicators*.



Outlook for 2004-05

Political outlook

Domestic politics

After six years of negotiations between the Bhutanese government and leaders of three Indian insurgent groups that had established bases in the dense forests of southern Bhutan—the United Liberation Front of Asom (ULFA), the National Democratic Front of Bodoland (NDFB) and the Kamtipur Liberation Organisation (KLO)—Bhutanese security troops launched military operations in December 2003 to destroy 30 camps and 35 outposts established by the militants and to flush them out of Bhutan.

The Bhutanese National Assembly had resolved during its 81st session in July that the presence of the militants directly threatened Bhutan's security and its relations with India. If a final round of talks with militant leaders failed, it said, Bhutan would resort to military action. The last rounds of talks with the leaders of the ULFA and NDFB were held in October and November, but the militants said that they would not remove their camps.

Concerned about the reaction from sympathisers of the militants in Assam and West Bengal, the Bhutanese government emphasised that military action had been the last option, a painful process of dialogue with the militant leaders having failed after five rounds of talks since 1996. The government repeatedly asked the people of the two neighbouring Indian states—with which Bhutan has close economic ties—to understand that the operations were aimed at the militants and that Bhutan valued its relations with the ordinary people.

Years of concern over the capability of Bhutan's inexperienced security force of 6,000 troops against well-armed and trained militants proved unfounded. Once the military operations began the camps were destroyed and most of the militants flushed out of the country in about two weeks. This should provide a boost to development activity, which had come to a halt for several months in the run-up to the action.

Although political and economic activities in Bhutan will gradually return to normal, there may be some retaliation by the militants from bases outside Bhutan. One week after the start of the operations, the commander-in-chief of ULFA, Paresh Baruah, threatened all Bhutanese citizens in Assam, and on January 5th, ULFA's chairman, Arbinda Rajkhowa, said that "Bhutan would not sleep well when its neighbourhood burned in conflict". The KLO has similarly threatened Bhutanese citizens in West Bengal.

The military operation ends a peaceful era for Bhutan. The Royal Bhutanese Army is expected to patrol the militarised border with India permanently. Government and private-sector organisations in the country have adopted measures to strengthen security, and the Royal Bhutan Police has begun rounding up suspects who have assisted the militants in the past few years.

The move will strengthen Bhutan's relations with India. The Indian government welcomed Bhutan's action and provided political and military support for the Bhutanese operations. During the January South Asian

Association for Regional Co-operation (SAARC) summit in Islamabad, India's prime minister, Atal Behari Vajpayee, urged other South Asian countries to follow Bhutan's example.

Political reform will resume in the forecast period as the king, Jigme Singye Wangchuck, pushes Bhutan towards a democratic system of governance. With the military operations over, the king is expected to start a national debate on the second draft of the Bhutanese constitution in the coming months. The Ninth Five-Year Plan, which has been stalled by security concerns, is likely to progress more rapidly in the aftermath of the militants' expulsion. Launched in July 2002, local government has the prime development role in the Ninth Plan. Most activities of the plan had been frozen because of concerns related to the impending military operations.

International relations

The problem of 100,000 ethnic Nepalese refugees in Nepal (who claim that they were forced out of Bhutan in the 1980s), will be a major concern in 2004-05. During the 15th ministerial meeting in Thimphu in October last year, the Bhutanese foreign minister, Khandu Wangchuk, and Nepal's ambassador at large, Bekh Bahadur Thapa, had announced that "talks had moved to action". Following the meeting, it was expected that, with the verification of 12,183 refugees in the first camp, Khudunabari, completed, the repatriation of refugees would begin in February 2004.

The ministerial joint committee agreed that Bhutan would take back those found to have been "forcefully evicted", and those who had "emigrated" would be allowed to reapply for Bhutanese citizenship or to apply for Nepalese citizenship. Those categorised as criminals would be allowed to "defend themselves in a court of law" and "non-Bhutanese" would be asked to go back to their own countries. However, on December 22nd while the joint verification team (JVT), which comprises ten officials from each government, was briefing the refugees at the Khudunabari camp on the conditions of repatriation, the refugees attacked the Bhutanese officials, injuring three of them. The Bhutanese team left Nepal the next day, leaving the process at a standstill.

Meanwhile, several governments and non-governmental organisations (NGOs) continue to pressure the two governments to resolve the problem. During a visit to Bhutan in late November, four members of the European parliament urged the government to find a quick solution to the problem. The delegation met the king, Jigme Singye Wangchuck, on November 23rd and held discussions with government leaders. If Bhutan is seen to be deliberately stalling the process, it be criticised by Western governments.

Economic forecast

Policy trends

With the launch and conclusion of military operations against Indian rebels in December 2003, Bhutan's Ninth Plan (July 2002-June 2007), is expected to progress more rapidly in 2004. During the September visit of the king, Jigme Singye Wangchuck, to India, the Indian government agreed to contribute Rs16.14bn (US\$350m) to fill in the resource gap for the plan. (The total budget for the plan is Nu70bn or US\$1.5bn). Of the Indian assistance, Rs7.4bn will be

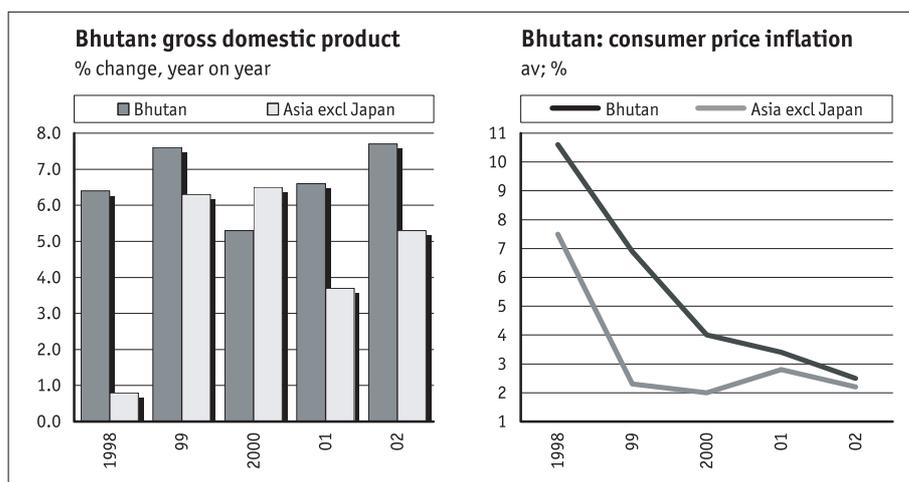
"project tied" and the remainder in grant form. The funds, some of which will be released in 2004, will enable the government to implement a range of activities that had been frozen since July 2002.

Economic growth

Bhutan's economy is likely to record growth rates of 7-8% in 2004-05. Hydroelectric power will continue to be the main driver of economic growth. Three major hydroelectric projects—Chhukha (336 mw), Kurichu (45 mw) and Basochu (24 mw)—currently provide 45% of government revenue. The 1,040-mw Tala project is reported to be on schedule for completion in September 2005. Revenue from power exports to India is expected to account for 90% of the national revenue by 2006. The Indian government also signed in September 2003 a memorandum of understanding with Bhutan to conduct a detailed project report for another major hydropower project, the Punatsangchu project. This 870-mw project is estimated to cost about US\$813m. Bhutan's goal of economic self-reliance will not be attainable until the Tala project begins to export electricity to India.

External sector

The merchandise trade deficit will fluctuate, depending on the need for capital imports for use in power projects. Foreign grants, however, are expected to cover most of the current-account deficit. Bhutan will continue to receive large amounts of bilateral and multilateral aid, estimated at about 50% of the budget. On December 17th a 20-bed hospital in Trongsa was completed by the Danish government at a cost of Nu88m (US\$1.9m), a part of Denmark's annual support of US\$10m to the health sector. On December 15th the Danish government also approved a new aid package of Nu564m for the education sector for the 2003-2008 period. About 75% was approved as a budgetary grant and the rest for specific projects. The Swiss government approved a five-year assistance of Nu97m in December for the rural natural resources sector, with a thrust on agricultural research. During the current five-year plan, the government expects 18 bilateral donors and 27 multilateral agencies to contribute Nu35bn out of total spending of Nu70bn.



The political scene

Negotiations with militants fail

In 2000 Bhutan's National Assembly (parliament) passed a resolution to deal with three groups of militants from north-east India who had set up camps in Bhutan. The four-pronged strategy involved halting supplies to the camps, punishing people who supported the militants, initiating talks and, as a last resort, removing the militants through military action. After a series of cabinet meetings, the prime minister, Jigmi Yozer Thinley, announced on December 13th 2003 that attempts to resolve the situation peacefully had failed and that the royal government had no choice but to turn to the fourth prong of the strategy and use the Royal Bhutan Army (RBA) to oust the militants.

The army quickly destroys the militants' camps

Two days later 6,000 Bhutanese soldiers simultaneously attacked the 30 camps and 35 outposts established by the militants along the 720-km Indo-Bhutan border. Within days the operation was declared a success. On December 27th the RBA announced that all the militant camps had been burnt down and the militants "flushed out". By the end of 2003 Bhutanese soldiers were combing the forests for the last of the militants hiding in the forests.

The RBA did not release the number of casualties, although Indian newspapers reported that between ten and 40 Bhutanese and more than 100 militants had died. An unconfirmed number of militants were killed by Indian troops as they tried to cross into India and several hundred, including senior militant leaders, were reported to have surrendered. Others are believed to have escaped into India, Bangladesh and Myanmar. The three insurgent groups were reported to have had about 3,000 militants based in Bhutan at the start of the operation.

India provides logistical support for the operations

King Jigme Singye Wangchuck, who is the commander-in-chief of the RBA, controlled the military operations from a base in the southern district of Samdrup Jongkhar. The crown prince, Dasho Jigme Khesar Namgyal Wangchuck, represented the king in the capital, Thimpu, while the second prince, Dasho Jigyel Wangchuck, took leave from Oxford University to join a 730-strong militia force that supported the Bhutanese troops. The Indian army provided logistical support, and injured Bhutanese troops were evacuated by Indian army helicopters to military hospitals in India for treatment.

An attack on officials stalls progress on refugee returns

Mr Thinley met the Nepalese prime minister, Surya Bahadur Thapa, during the January South Asian Association for Regional Co-operation (SAARC) summit in Islamabad, Pakistan and agreed to investigate an attack on Bhutanese officials by refugees in eastern Nepal on December 22nd. The Nepalese officials on the Joint Verification Team (JVT, which comprises ten officials from both Nepal and Bhutan and is assessing the claims of the refugees) allege that the Bhutanese members had provoked the incident, whereas the Bhutanese officials insisted that the attacked had been pre-meditated. The Bhutanese team has accused the Nepalese officials of not providing adequate security and of undermining the process at a critical stage through a lack of co-operation.

The JVT interviewed 12,183 refugees in the first camp, Khudunabari, between March 2001 and June 2003, and announced the result of its findings on June 18th. A total of 203 people were placed in Category I (forcefully evicted); 8,595 in Category II (emigrated); 2,948 people were in category III (non-Bhutanese); and 347 in Category IV (wanted for criminal acts).

The refugees assaulted the Bhutanese officials after they laid down conditions under which Category II refugees could return home. According to the Nepalese foreign ministry, the Bhutanese officials gave the impression that only Category I refugees could return, and those that returned would not qualify for compensation for their land and property. The Bhutanese officials apparently also told the refugees that they would have to live in "transit camps" for two years as "foreigners", with no freedom of movement or social security.

At the 15th Ministerial Joint Committee meeting, on October 21st, the two governments agreed that refugees falling into category I, II and IV were to be repatriated, and those wanted for criminal acts would be tried according to the laws of the two countries. Family members of criminals would not be penalised. At the conclusion of the meeting, the Nepalese foreign secretary, Madhu Raman Acharya, said that the two countries were "sometimes inching forward, sometimes leaping forward, but definitely moving forward".

Reform of the government continues

In a ceremony attended by senior figures from government, the judiciary and the bureaucracy, the re-constituted Royal Civil Service Commission was formally launched on October 30th. With members from the government, judiciary, legislature, and independent corporations, the commission was reconstituted by a decision of the 81st session of the National Assembly in July 2003 to ensure that the Bhutanese bureaucracy remained independent in the changing political environment.

The World Bank provides funding to tackle aids

On December 1st, World AIDS Day, Bhutan announced that there were 43 HIV/AIDS confirmed cases. The World Bank will release an assistance package of US\$5.5m by July 2004 to strengthen measures to prevent the spread of the disease.

Crime is rising

Crime, including rape and murder, is on the rise in Bhutan. On December 16th two robbers who desecrated a religious *stupa* (a Buddhist monument) were sentenced to life imprisonment and a man was sentenced to life by the Paro district court, in western Bhutan, in October for the rape and killing of a minor. In December another four men were charged for the attempted rape of a minor. The rise in crime is widely seen as a side effect of the development process. New problems, including money counterfeiting, are also emerging. In the first week of December, a bank in the remote eastern district of Lhuentse uncovered Nu150,000 (US\$3,300) in fake currency.

Relations with India are good

Bhutan's relationship with India continues to form the basis of its foreign policy and the above-noted ousting of the militants will work to strengthen Bhutan's relations with India. The four queens, other members of the royal family, the prime minister, and government and private dignitaries attended a grand closing ceremony of the six-month Festival of India in Bhutan on

November 26th. The festival included food festivals, music and dance programmes, a film festival of Bollywood hits, a handicrafts exhibition, a textile exhibition and a seminar on Buddhism.

The crown prince is increasingly visible

Bhutan's crown prince, Dasho Jigme Khesar Namgyal Wangchuck, is becoming increasingly visible. In late August 2003 he visited India to launch the India Bhutan Foundation, a fund intended to facilitate an exchange of visits and seminars to expand the scope of bilateral relations. On November 11th he launched a Bhutan India Friendship Association website (www.bifa.org.bt). As president of the association, the crown prince will spearhead a number of activities aimed at promoting interaction between the two countries. On December 17th, Bhutan's National Day, he made his first address to the nation and later announced the success of Bhutan's military operations against the Indian militants and commended the military troops, volunteer militias and the rural population for their support.

Thailand opens a consulate

Mr Thinley attended the SAARC summit in Islamabad from January 4th to 6th, and he will also attend the February 9th summit of BIMSTEC—a grouping to promote economic co-operation comprising Bangladesh, India, Sri Lanka, Thailand, Myanmar and Nepal. Bhutan will formally join the organisation in February. Thailand opened a consulate in Thimphu on November 20th. Apart from promotional activities, the consulate will issue Thai visas in Thimphu, thereby saving Bhutanese travellers a long wait at Bangkok airport.

The king's grandmother is cremated

On October 18th, Bhutan came to a standstill when the king's grandmother, Gayum Phuntsho Choden Wangchuck, was cremated in the historic valley of Bumthang in central Bhutan. Gayum Phuntsho Choden, queen to the second king of Bhutan, was widely respected. Her body was kept at her retreat in Thimphu for 49 days before being taken Bumthang.

Economic policy

Rural electrification is continuing

Bhutan, which hopes to achieve economic self-reliance largely by exporting hydroelectric power, aims to achieve universal electrification by 2020. The government has taken several steps to achieve its goal of providing electricity to 15,000 households at a cost of Nu1.5bn (US\$33m) in the Ninth Five-Year Plan, which began in July 2002. In October the Asian Development Bank (ADB) approved a loan of US\$9.4m for rural electrification. Together with two technical grants, the project is expected to electrify 8,000 households. The Bhutan Power Corporation (BPC) will spend a Nu301m (US\$6.6m) grant from the Dutch-funded Sustainable Development Secretariat (SDS) plus Nu22m from the Bhutanese government to electrify 3,150 rural houses. Meanwhile, 384 houses in the remote Trashiyangtse district are being given electricity with Nu23m of Austrian aid.

Corruption in the public sector is uncovered

In October last year, the Royal Audit Authority (RAA) announced that financial irregularities by government ministries, the Royal Bhutan Army, and public-sector corporations totalled Nu625m. The Ministry of Trade and Industry was

responsible for the largest irregularities, totalling Nu240m. Irregularities at the now-bifurcated Ministry of Health and Education totalled Nu139m, and those of the Ministry of Home Affairs Nu68.78m. This move is part of the RAA's policy of "zero tolerance" towards corruption, stemming from increased government concern about the issue. In the last two years, Bhutan's media has widely covered the misuse and wastage of funds by government organisations. This prompted the National Assembly (parliament) in July 2003 to ask government organisations to report on the actions they have taken in response to audit reports.

Druk Air agrees to buy two new planes

The national airline, Druk Air, signed an agreement on October 13th last year to buy two Airbus A319 jets for US\$78m. The government will pay 30% of the cost within six months and the remainder on delivery, which is scheduled for late 2004. The move will reduce Bhutan's foreign-exchange reserves. The jets will replace the Druk Air fleet of two BAe 146 jets, which were purchased in 1988 and 1990.

A mobile-phone system is introduced

On November 11th state-owned Bhutan Telecom introduced a mobile-phone system, to celebrate the 48th birthday of the king. The B-Mobile division of the corporation hopes to attract about 10,000 subscribers in one year, and more than 3,000 had subscribed by the end of 2003. Described by telecommunications officials as a "giant leap forward in the Bhutanese communication system", the mobile-phone system was introduced at a cost of Nu400m and covers three districts in western Bhutan.

Trading in BBCL is brisk

The most actively traded company on the Bhutanese stockmarket in 2003 was the most recently listed company, Bhutan Beverages Company (BBCL), which produces Coca-Cola products. A total of 27,346 shares worth Nu8.74m were traded in the secondary market at an average of Nu320 (US\$6.9) a share. BBCL was the 15th company to be listed, and floated 345,000 shares—representing 30% of its paid-up capital—in 2002. It started commercial production in January 2003, bottling, manufacturing, packaging and distributing several brands of soft drinks and water for Coca-Cola. More than 90% of its output is sold in India.

Interest rates on housing loans are cut

In January 2004 the Royal Insurance Corporation of Bhutan became the second financial institution to reduce its interest rates payable on housing loans from 13% to 10%. The Bhutan National Bank had announced a similar reduction on housing loans on October 1st last year. The cuts stem from an earlier move by the National Pension and Provident Fund (NPPF), which began to offer a special housing loan at an interest rate of 10% for its 30,000 members. This undercut the banks, which had offered housing loans at 13%.

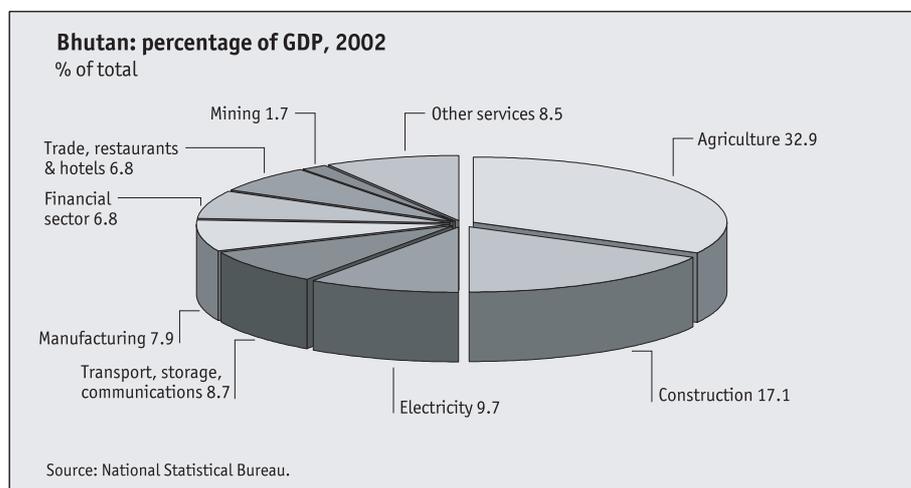
A new housing scheme is introduced

With the shortage of housing a growing problem in urban centres like Thimphu, the NPPF introduced a new housing scheme and rented out new apartments to 48 families in December. The NPPF plans to construct another 110 apartments by the end of 2004, but with more than 200 applicants already waiting, housing will continue to be a serious problem in urban areas.

The domestic economy

The economy grows by 7.7% in 2002

According to the annual report of the Royal Monetary Authority (RMA), released in the first week of January 2003, real GDP grew by about 7.7% in 2002. The renewable natural resource sector—farming, forestry and agriculture—employs 75% of the country's workforce, but only provided 33% of GDP. The construction sector contributed 17% and electricity generation 9.7%.



Domestic credit grows strongly in 2003

Domestic credit in 2003 grew to Nu3,815m (US\$84m) from Nu2,280.5m in 2002, stimulating private-sector growth. However, the fiscal deficit also grew. In 2003 the overall budget deficit increased to Nu2,784m from 1,225.4m in the previous year. This is equivalent to around 10% of GDP, against the targeted deficit of 3%. Borrowing at concessional rates, however, helped to ease the deficit. Although domestic revenue was more than sufficient to finance current expenditure and some capital expenditure, Bhutan was still highly dependent on external assistance through grants and concessional loans to finance infrastructure and other capital-related projects.

External debt rises substantially

External debt grew by 40% to US\$405.5m at the end of 2003. Bhutan's largest creditor was India. Bhutan's total outstanding debt to India stood at US\$228.7m. Bhutan's next largest creditor was the Asian Development Bank, which it owed US\$75.8m, followed by the World Bank (US\$42.9m), and Austria (US\$34.7m). Debt-servicing costs were easily manageable, equivalent to just 4.9% of the total export receipts for good and services.

Inflation falls to 1.8% in June 2003

In June 2003 inflation fell to 1.8%, recording a 20-year low, according to the consumer price index (CPI) of the National Statistical Bureau. The drop was attributed to the drop in the price of non-food items like clothing and footwear. Inflation has followed a similar trend to that in India, although some doubts remain on the accuracy of Bhutan's data, since the CPI still uses 1979 as the base year.

Bhutan: consumer price inflation

(%; year on year)

	2001		2002		2003
	Jun	Dec	Jun	Dec	Jun
Food	0.8	2.2	2.2	1.9	2.6
Non-food	8.0	4.9	3.5	2.8	4.6
Total	3.6	3.2	2.7	2.3	1.8

Source: Central Statistical Office.

A quarter of recent graduates are still seeking work

By November last year 138 out of the 400 university graduates who had completed the government orientation programme in September were given government jobs. Of these, 30 were selected for the "officers' cadre" in the civil service. Although graduates in engineering and other professions are in high demand, one-quarter of the 400 are still seeking work. With 50,000 people expected to be looking for employment in five years, the government sees unemployment as a potential problem. To help to tackle the problem, it established the Ministry for Labour and Human Resources in July.

Foreign trade and payments**Electricity exports dominate export receipts**

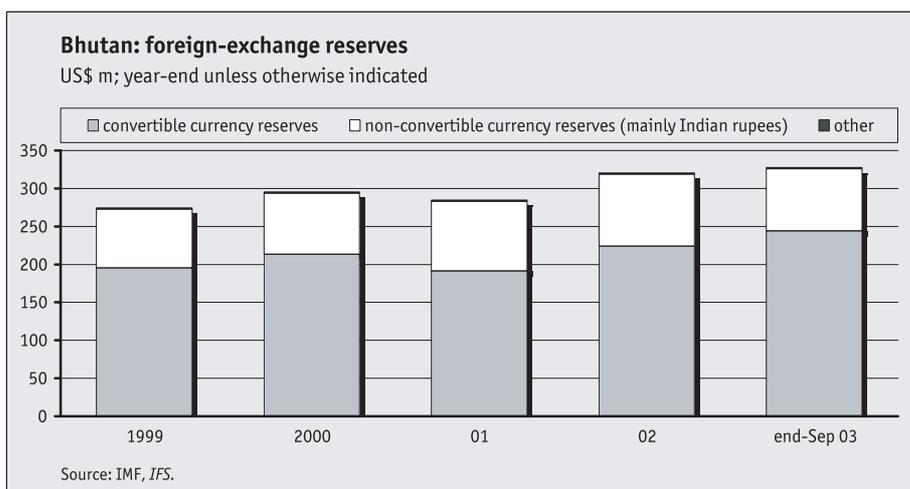
Bhutan's total exports were worth Nu5,261.8m (US\$112m) in 2002/03 (July-June), a year-on-year rise of 8.2%. India was by far Bhutan's largest trading partner, receiving exports of Nu4,919.1m. Bhutan exported goods to Bangladesh, the next major market, worth Nu222.7m. Electricity exports were worth Nu2.1bn, at an average cost of Nu1.5 per kwh. Other significant exports included chemical products, metal, wood, processed foods, mineral products and textiles.

Imports fell in 2003

Imports to Bhutan fell to Nu8,023.7m in 2002/03 from Nu8,990.2m the previous year. The bulk of imports, worth Nu6,051.1m, was from India, followed by Nu326.9m from Japan and Nu282.3m from the UK. Imports from Singapore and Thailand totalled Nu487m. Major import items included fuel, cereals, motor vehicles, machinery and mechanical appliances, metal products, plastic and rubber products.

Bhutan has almost two years of import cover

Meanwhile, Bhutan recorded another balance-of-payments surplus in 2003, and foreign-exchange reserves reached US\$374m, sufficient to finance over 23 months of imports. The increase in reserves, according to the Royal Monetary Authority (RMA, the central bank), was mainly propelled by inflows of loans, grants and foreign direct investment largely to finance the construction of international resorts. The Bhutanese currency, the ngultrum, which is pegged to the Indian rupee at parity, strengthened against the US dollar over the course of 2003 as India's currency strengthened.



The tourism sector is recovering slowly

Bhutan's tourism industry suffered in the aftermath of the Iraq war and the outbreak of Severe Acute Respiratory Syndrome (SARS) in Asia. Visitor arrivals stood at 6,093 in 2003, compared with 5,599 in 2002, but this remains well below the 2000 figure. Tourism receipts rose to US\$8.4m from US\$8m in 2002. In the first week of January 2004, the International Finance Corporation, the private-sector arm of the World Bank, approved a loan of US\$10m for a joint venture to build six resorts in Bhutan. The international luxury chain, Aman Resorts, and the Bhutan Tourism Corporation will also invest US\$10m in the project. This is the largest foreign investment in the Bhutanese private sector.

