

Bhutan

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The Economist Intelligence Unit

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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**
- 13 **The domestic economy**
- 15 **Foreign trade and payments**

List of tables

- 14 Consumer price inflation

List of figures

- 6 Foreign reserves
- 6 Money supply M2
- 9 Gross domestic product
- 9 Consumer price inflation
- 14 Inflation
- 15 Direction of trade

Summary

November 2003

- Outlook for 2004-05** A military clash between Bhutan and three Indian militant groups is increasingly likely. If the last attempt at negotiating a peaceful settlement fails, military action is likely to begin. Domestic political reform will continue to be a priority. A nationwide debate on the constitution will begin in the next few months. The nature of electoral politics is an increasing concern. A resolution to the dispute over 100,000 Nepalese-speaking refugees based in camps in Nepal is attainable, but Bhutan could face international criticism if it stalls over the repatriation of the refugees. The decentralisation of economic decision-making will continue. The economy is forecast to grow by around 7% in 2004 and 2005, driven by the construction of new hydroelectric projects. The currency will remain tied to the Indian rupee. The trade deficit will fluctuate in line with imports of capital goods for use in power projects.
- The political scene** Military action against Indian militant groups is increasingly likely. The speaker of the National Assembly has been re-elected. A reshuffle of senior civil servants has taken place. The UN Development Programme has lifted Bhutan's development category. The government has taken steps to tackle unemployment. An international seminar on Bhutan has taken place. A royal death sparked national mourning. A festival of India has been held in Bhutan. The Chinese vice-foreign minister, Liu Zhuqing, has visited Bhutan. The UN Refugee Agency (UNHCR) has announced a new strategy for dealing with refugees. Non-governmental organisations have called for donors to put pressure on Nepal and Bhutan. Nepal and Bhutan have announced a major breakthrough over the issue.
- Economic policy** Bhutan has received funding to join the World Trade Organisation. A crack-down on corruption has raised US\$61m. The Netherlands has funded a project to electrify rural areas. The government will finance agricultural improvements. The World Bank is funding a project to tackle AIDS.
- The domestic economy** GDP grew by 7% in fiscal year 2002/03 (July-June). Inflation has remained low. A committee will consider lowering income tax. The Bhutan National Bank (BNB) has lowered its interest rates in response to a cut from the National Pension and Provident Fund. BNB has made a rights offer.
- Foreign trade and payments** Bhutan's balance-of-payments position is strong. India remains Bhutan's key trading partner. Bangladesh has lowered taxes on some Bhutanese imports. Foreign companies are investing in the tourism sector. Tourist arrivals have continued to fall. Foreign-exchange reserves remain strong.
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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 by the end of the year	
National elections	The unicameral National Assembly has 153 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

	1998 ^b	1999 ^b	2000 ^b	2001 ^b	2002 ^b
GDP at market prices (Nu m)	16,271	19,161	21,749	24,895	28,495
GDP (US\$ m)	403.0	445.0	484.0	527.6	586.2
Real GDP growth (%)	6.4	7.6	5.3	6.6	7.7
Consumer price inflation (av; %)	10.6	6.9	4.0	3.4	2.5
Population (mid-year; '000) ^c	636	658	678	698	716
Exports fob (Nu m) ^d	4,455.6 ^e	4,987.9	4,615.8	4,708.6	n/a
Imports cif (Nu m) ^d	6,913.7 ^e	8,075.2	9,106.3	9,080.3	n/a
Reserves excl gold (US\$ m) ^e	249.6	274.4	295.4	284.6	320.6
Total external debt (US\$ m) ^f	171.0	183.8	203.3	265.2	n/a
Exchange rate (av; Nu:US\$)	41.26	43.06	44.94	47.19	48.61

^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

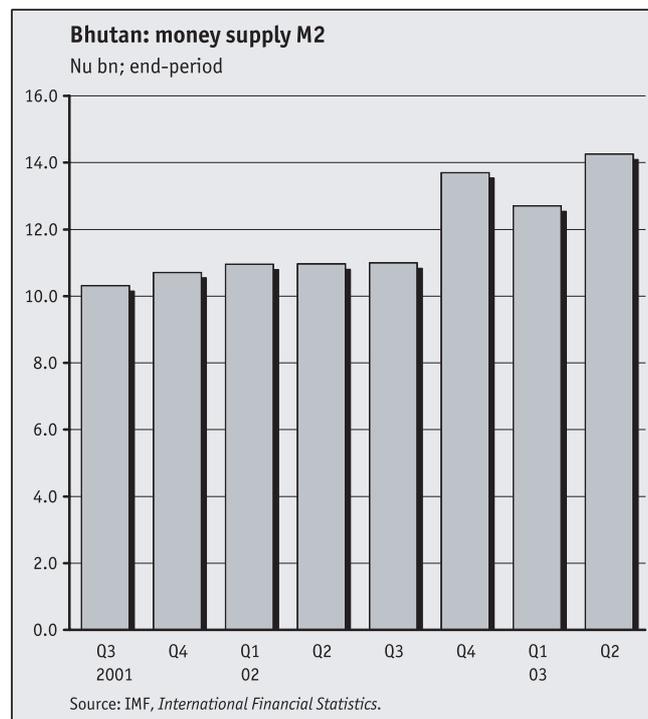
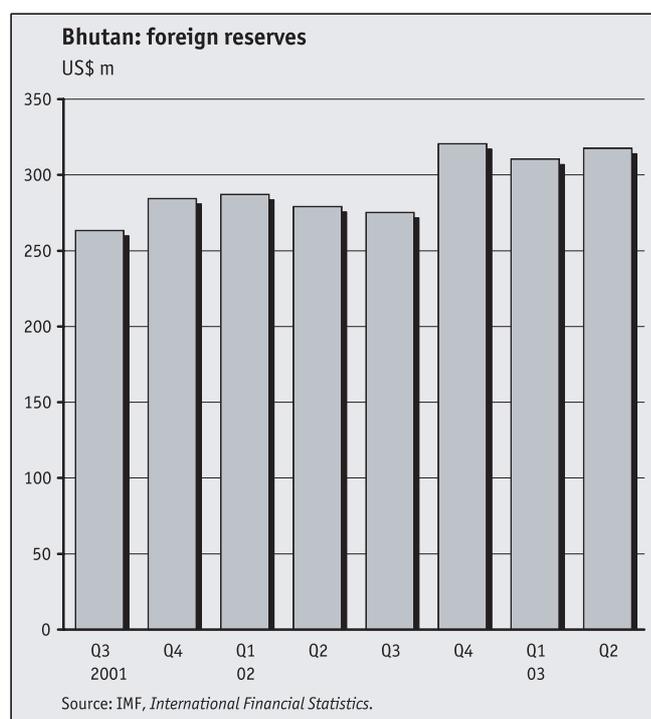
Main destinations of exports 2000 ^b	% of total	Main origins of imports 2000 ^b	% of total
India	94.0	India	78.0
Bangladesh	4.0	Japan	7.0

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

Quarterly indicators

	2001		2002				2003	
	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr
Prices								
Consumer prices (Dec 1979=100)	n/a	632.8	n/a	636.3	n/a	647.2	n/a	n/a
Consumer prices (% change, year on year)	n/a	3.2	n/a	2.7	n/a	2.3	n/a	n/a
Financial indicators								
Exchange rate Nu:US\$ (av)	47.31	47.98	48.59	48.96	48.60	48.29	47.77	47.06
Exchange rate Nu:US\$ (end-period)	47.86	48.18	48.80	48.87	48.38	48.03	47.55	46.47
M1 (end-period; Nu m)	4,413	5,058	4,753	4,914	5,167	6,975	5,910	6,804
M1 (% change, year on year)	-1.0	28.4	12.5	12.4	17.1	37.9	24.3	38.5
M2 (end-period; Nu m)	10,321	10,716	10,961	10,972	10,999	13,707	12,704	14,265
M2 (% change, year on year)	0.5	7.9	10.0	17.8	6.6	27.9	15.9	30.0
Foreign reserves (US\$ m)								
Reserves excl gold (end-period)	263.33	284.60	287.22	279.3	275.31	320.62	310.49	317.80

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



Outlook for 2004-05

Political outlook

Domestic politics

A military clash between Bhutan and two Assamese militant groups—the United Liberation Front of Assam (ULFA) and a tribal group, the National Democratic Front of Bodoland—as well as the Kamtapur Liberation Organisation (KLO) from West Bengal, is increasingly likely. King Jigme Singye Wangchuck announced during a visit to India on September 14th-18th that the government had written to the militant leaders asking for talks, and said that Bhutan was making every attempt possible to find a peaceful solution. If this last attempt at negotiation fails, the National Assembly has already given the Royal Bhutan Army (RBA) the mandate to remove them by force. With a military clash looming, national security will overshadow Bhutan in the outlook period and, if the talks fail, military action is likely to begin within months—possibly early in 2004.

While in India, King Wangchuck also said that the RBA had established 20 camps, housing 5,000 troops, along Bhutan's border with India and that the government had approved a security fund of up to Nu2bn (US\$43m) to finance military action. The government has also held a series of "security co-ordination meetings" to prepare the southern districts of Samdrup Jongkhar, Sarpang, Chukha and Pema Gatshel for the possible impact of a military clash, and has identified sites for two "transit camps" for displaced people.

Domestic political reform will continue to be a priority as the king pushes Bhutan towards a democratic system. The king is expected to start a nationwide debate on the second draft of the constitution later in 2003 by personally taking the draft around Bhutan for public discussion. The king has also proposed that the government invite constitutional experts from outside Bhutan to review the draft. In August the National Assembly resolved that the three branches of government—judicial, legislative and executive—would function completely independently of each other. On August 30th the king approved the establishment of a five-member National Judicial Commission to oversee the appointment of judges and other judicial staff, and on September 26th he reconstituted the Royal Civil Service Commission with seven new members. This body will have independent administrative power over the bureaucracy, a power earlier held by the Council of Ministers.

The District Development Committees (DYT) in each of Bhutan's 20 districts are expected to function with increasing independence from the government-appointed district commissioner (the executive head at district level) over the outlook period. The autonomy of both local committees—the DYT and the Geog (block or subdistrict) Development Committees (GYTs)—has already been strengthened in 2003 as rural taxes, which were previously collected by the centre, are now retained by the GYTs.

The nature of electoral politics is a growing concern in Bhutan, with the local elections in the past year witnessing a number of controversies, including unfair canvassing. The constitution drafting committee has proposed that an

election commission be established, pursuant to which, in the last week of September, the Speaker of the National Assembly, Dasho Ugye Dorje, invited the chief election commissioner of India, James Lyngdoh, to visit Bhutan. Mr Lyngdoh held talks with members of the constitution drafting committee, assembly members, government officials and the media.

International relations

Bhutan's key international dispute—with Nepal, regarding the status of around 100,000 refugees based in camps in Nepal—appears to be nearing a solution. If all goes to plan, refugees from the first camp will begin to be repatriated in a few months' time, and the verification process at other camps will be completed much faster than at the first camp. However, potential pitfalls remain: the bulk of the refugees will have to apply for Bhutanese citizenship, and it is possible that the process could stall at this point. This could threaten Bhutan's international standing.

Economic forecast

Policy trends

On August 30th King Wangchuck advised the council of ministers that, having decentralised decision-making powers, the districts and blocks must be given the funds they had been allocated. A significant decentralisation of government finance is expected in fiscal year 2003/04 (July-June). The Ministry of Finance is initiating a budgeting system based on geogs (subdistricts), with one accountant to be based in each geog within four years.

In July 2003 the Ministry of Finance announced a budget of Nu11.54bn for 2003/04. Of this, Nu5bn is current expenditure, Nu6.3bn is capital expenditure, Nu375m (US\$800,000) covers net lending and Nu225.4m is allocated to debt repayment. Expenditure has risen by 3% from 2002/03. Health and education will receive almost one-quarter of total expenditure, while agriculture will receive 12.6%, energy 7.3% and general public services 21.1%. The government expects to raise domestic revenue of Nu5.2bn and expects other receipts of Nu13.3m. Externally, Bhutan expects to receive grants of just under Nu5bn and project-tied loans of Nu953m, leaving a resource gap of Nu383m to be met through borrowing.

During the current five-year plan (July 2002-June 2007), the government expects 18 bilateral donors and 27 multilateral agencies to contribute Nu35bn out of planned expenditure of Nu70bn. During King Wangchuck's September visit to India, the Indian government agreed to contribute Rs16.1bn (US\$350m) towards the Ninth Plan—about Rs7.4bn will be "project-tied", and the remainder will be grant aid. Once the funds are released, the government should be able to implement the range of activities that have been frozen since 2002, the first year of the plan. The government also plans to borrow US\$30m from the World Bank. The creation of a Ministry of Labour and Human Resources and a Ministry of Information and Communications, and the separation of the Ministry of Health and Education into two separate ministries, is expected to cost Nu10.5m.

To boost private-sector development, the government has started work on an industrial estate in the southern town of Pasakha, and a dry port is being

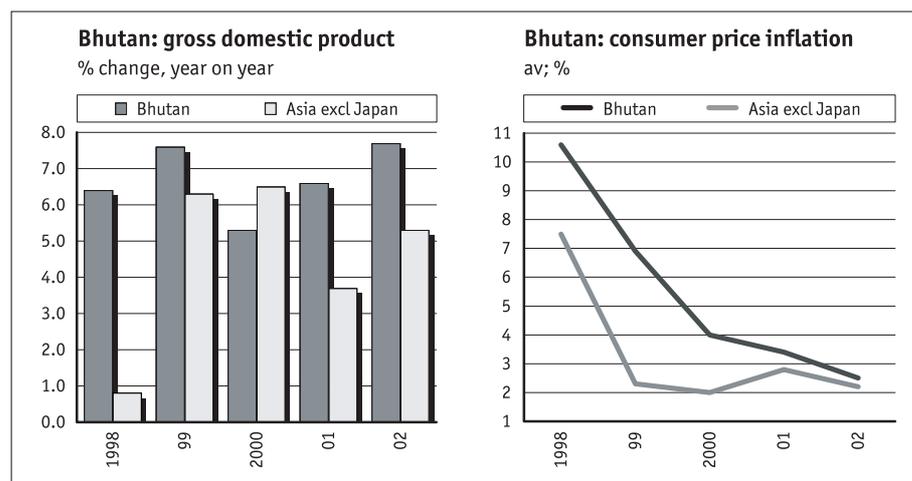
established in Phuentsholing, the largest town situated along the Bhutan-India border. Four more industrial estates have been planned in the districts of Gelephu, Mongar, Zhemgang and Samdrupjongkhar. Bhutan acceded to the World Customs Organisation in February 2002, and is seeking to join the World Trade Organisation (WTO) and the International Finance Corporation.

Economic growth

The Economist Intelligence Unit forecasts that Bhutan's GDP will grow by around 7% in 2004-05. The agricultural sector, which accounts for about one-third of GDP, will remain vital to the economy, and the main source of livelihood for the bulk of Bhutan's population. The key driver for growth will be the development of Bhutan's hydroelectric power and construction projects connected to this industry. The major hydroelectric projects—Chhukha (336 mw), Kurichu (45 mw) and Basochu (24 mw)—currently provide the government with 45% of its revenue. The 1,040-mw Tala project is still on schedule for completion in September 2005. India and Bhutan will discuss the level of Indian assistance to Bhutan once the Tala project is complete. Levels of Indian assistance are likely to fall, although receipts from power exports will compensate for this. Revenue from power exports to India is expected to provide 90% of government revenue by 2006. On September 15th King Wangchuck and India's prime minister, Atal Behari Vajpayee, signed a memorandum of understanding to assess another large hydroelectric project, the 870-mw Punatsangchu project, which is expected to cost about US\$813m.

External sector

Bhutan's currency, the ngultrum, will remain tied at parity to the Indian rupee through the outlook period, and India will become an even more important source of funding for Bhutan. We expect the Indian rupee to average Rs45.1:US\$1 in 2004 and to depreciate gently, to Rs46.5:US\$1, in 2005. Bhutan's goal of economic self-reliance will be within reach only after the forecast period when the Tala project begins to export electricity to India. The trade deficit will fluctuate, depending on the need for capital imports for use in power projects. However, foreign grants are expected to cover most of the current-account deficit. Bhutan will continue to receive large amounts of bilateral and multilateral aid.



The political scene

Military action against Indian militants is increasingly likely

The government has taken several new steps to prepare for military action against two Assamese militant groups, the United Liberation Front of Assam (ULFA) and the National Democratic Front of Bodoland, as well as against the Kamtapur Liberation Organisation (KLO) from West Bengal. On September 15th the Royal Bhutanese Army (RBA) completed the training of a militia force of 634 volunteers. They were selected from a list of about 5,000 names proposed by assembly members and were trained at military centres around the country. The volunteers were commissioned in the capital in the presence of the crown prince, Dasho Jigme Khesar Namgyal Wangchuck. The General Officer Commanding-in-Chief of the Indian army's eastern command, Lieutenant-General Jitendra Singh Varma, visited Bhutan on September 21st-25th, meeting the king and the Chief Operations Officer of the RBA.

The Bhutanese government has followed the National Assembly resolution of 2000 in adopting a four-pronged strategy to deal with the militants. The first three prongs consist of halting supplies to the camps, punishing people who support the militants, and initiating talks. The fourth prong is the removal of the militants through military action. The government expects 304 villages in ten districts to be directly affected if there is military action. There are 66,500 people living in these "high-risk" areas.

The National Assembly speaker is re-elected

The Speaker of the National Assembly, Ugyen Dorje, was re-elected on August 15th, winning 115 out of 152 votes. His opponent, the governor of Thimphu district, Sherab Gyeltshen, won the remaining votes. On August 30th the new prime minister, Jigmi Yozer Thinley, took office in a special cabinet sitting attended by the king. The king said that the five-year experiment to devolve executive power to the council of ministers had been a success. In the subsequent 81st session of the National Assembly, 12 new acts and conventions were passed. These included the Jabmi Act, which legalised the functions of professional legal counsels in court cases. Before the passage of act, litigants had to represent themselves in court, placing uneducated litigants at a disadvantage.

Senior civil servants are reshuffled

The creation of three new ministries in September (for Labour and Human Resources, Information and Communications, and Education) led to a massive reshuffling of senior bureaucrats. In a major reorganisation of the civil service, the government appointed eight new secretaries in the ministries, one in the Royal Civil Service Commission, one in the National Assembly, and one in the cabinet.

Bhutan's development category improves

According to the UN Development Programme (UNDP) *Human Development Report*, released in September, Bhutan was upgraded to the medium category of developing countries, and was ranked 136th out of 175 countries. The UNDP's resident representative, Renata Lok Dessalien, said that Bhutan's development had been greatly helped by its successful essential-drugs programme.

The government takes steps to combat unemployment

A total of 400 university graduates completed the government-orientation programme which ran between August 16th and September 7th. The graduates

are now hoping to join the workforce. Given that 50,000 people are expected to be seeking jobs over the next five years, the government sees employment as a potential problem in future. The creation of the Ministry for Labour and Human Resources was partly intended to deal with this issue.

An international seminar on Bhutan takes place

The first international seminar on Bhutan took place in the capital, Thimphu, on August 20th-22nd. A total of 26 papers, 14 by international scholars, were presented at the seminar, which was attended by 150 participants. The topics ranged from ancient history and folklore to language and religion, the WTO and foreign policy.

Royal death sparks nationwide mourning

On August 24th Bhutan came to a standstill when the widely respected grandmother of the king, Gayum Phuntsho Choden Wangchuck, died. Her body was kept at her retreat in Thimphu for 49 days and was then taken to central Bhutan and cremated on October 18th.

A festival of India is held in Bhutan

Bhutan's relationship with India continues to form the basis of its foreign policy. The six-month "Festival of India in Bhutan" opened on August 13th, with an elaborate programme of food festivals, music and dance programmes, a film festival of "Bollywood" hits and a handicrafts exhibition. A textile exhibition was held in the first week of September. The festival is expected to make a major impact on "people to people" relations between the two countries. The crown prince visited India in late August, and on August 29th the India-Bhutan Foundation was established in New Delhi. This is a fund that will facilitate an exchange of visits and other interaction such as seminars, aimed at expanding the scope of bilateral relations.

The Chinese vice-foreign minister visits Bhutan

During September 14th-18th, the former vice-foreign minister of China, Liu Zhuqing, paid a goodwill visit to Bhutan. In an interview with the Bhutanese weekly newspaper, *Kuensel*, he suggested that the two countries should have a formal diplomatic relationship. Bhutan and China have conducted annual boundary discussions since 1984 to settle a portion of the boundary that has not yet been demarcated. In recent years the relationship between the two countries has been improving, and the scope of discussions during the boundary talks has broadened.

The UNHCR announces a new strategy to deal with refugees

On September 29th Ruud Lubbers, the UN High Commissioner for Refugees, announced a change in policy by the UN Refugee Agency (UNHCR) towards the ethnic-Nepalese refugees in Nepal (who claim that they were forced out of Bhutan in the 1980s). The process of verifying the status of the 100,000 refugees has been painfully slow; the UNHCR has been excluded from the Bhutanese-Nepalese joint-verification team (JVT) and has not been granted access to visit potential areas of return in Bhutan. Describing the situation as a stalemate, Mr Lubbers said that the UNHCR would now promote self-reliance projects in Nepal for those refugees willing to remain in Nepal, and said that the agency would not promote returns to Bhutan, although he emphasised that Bhutan should respect the right of the refugees to return.

NGOs call for donors to put pressure on Nepal and Bhutan

In response to Mr Lubbers' speech, a group of six non-governmental organisations (NGOs)—Amnesty International, Habitat International Coalition, Human Rights Watch, the Jesuit Refugee Service, the Lutheran World Federation and the Bhutanese Refugee Support Group—said that the move would leave the refugees in a precarious position. The group called for an international conference to devise a solution to the dispute, and asked donors to put pressure on the two governments.

Nepal and Bhutan announce a major breakthrough

Although the UNHCR's statement drew little immediate response from Nepal and Bhutan, its comments, along with the criticism by the NGOs, reflected a growing disillusionment among donors towards the process of verifying the refugees' status. This pressure appears to have spurred Nepal and Bhutan to take steps to resolve the issue, and at the end of the 15th Bhutan-Nepal ministerial meeting, which was held on October 20th-23rd, a major breakthrough was announced. Back in June, the JVT had announced the findings of its investigation of the 12,183 refugees in the first camp, Khudunabari, which had begun in March 2001. The JVT found that 203 people had been "forcibly evicted"; 8,595 had "emigrated"; 2,948 people were "non-Bhutanese" and 347 were wanted for criminal acts.

The ministerial meeting agreed that the JVT would review the appeals of the "non-Bhutanese" by the end of January 2004. People who have committed crimes against Bhutan would be allowed to return and given a chance to prove their innocence in a court of law. Most importantly, those who had "emigrated" would be given the right to apply for Bhutanese or Nepalese citizenship. Those who receive Nepalese citizenship will be "resettled" in Nepal, and those receiving Bhutanese citizenship will be repatriated. According to Nepalese diplomats, repatriation will begin in four months' time, and around 70% of the refugees in the camp are expected to be repatriated. Although the verification process at the first camp took over two years, the assumption is that the process will be quicker at the other six camps. Provided that the refugee crisis is resolved, the key threat to Bhutan's international standing will be removed.

Economic policy

Bhutan receives funding to join the WTO

Bhutan is currently debating whether to join the World Trade Organisation (WTO). The minister for trade and industry, Yeshey Zimba, told a UN Development Programme (UNDP)-organised meeting on September 3rd that it was inevitable—Bhutan's small size means that it could be left behind if it remains outside the organisation. In March 2003 the WTO accepted the Bhutanese government's foreign-trade regime document, and this allowed Bhutan to start the formal process of applying for membership. In May, the EU had approved assistance of €15m (US\$17.6m) between 2002-06 to help in trade development projects related to the WTO, and to assist in agricultural development. Specific projects include livestock pest management, medicinal plants and export promotion.

A crackdown on corruption raises US\$61m

The Royal Audit Authority recovered Nu27.61m (US\$61m) in 2002 and Nu12.6m in the first half of 2003 from government departments, the army and public corporations. This is a part of the authority's policy of "zero tolerance" towards corruption in the public sector. In the last two years the Bhutanese media has focused on the misuse and wastage of funds by government organisations. These concerns prompted the National Assembly in July 2003 to ask government organisations to report on the actions they had taken in response to audit reports.

The Netherlands funds a project to electrify rural areas

Under an agreement signed between the Bhutan Power Corporation (BPC) and the sustainable development secretariat (an autonomous division of the budget department that disburses grant assistance from the Dutch government), BPC will electrify 3,150 houses in rural areas. This will be funded through a Nu301m (US\$6.6m) grant from the Dutch government and Nu22m from the Bhutanese government. Meanwhile, Nu23m in aid from Austria will enable 384 houses in the remote Trashiyangtse district to be provided with electricity. The government aims to electrify 15,000 houses in the Ninth Plan.

The government will finance agricultural improvements

The Ministry of Agriculture will use Nu370m raised from the subsidised sale of agricultural machinery provided by Japan to improve farm roads, agriculture and livestock programmes, environmental protection, and research facilities. The money was handed over by the finance minister, Wangdi Norbu, to the agriculture minister, Sangay Ngedup, on September 3rd.

The World Bank funds a project to tackle AIDS

In September the World Bank announced that it would provide Bhutan with a grant of US\$5.5m to help combat HIV/AIDS. The bank's representative in Bhutan, Hnin Hnin Pyne, said that a significant proportion of the funds would be spent on raising awareness. Bhutan has already established multi-sectoral task forces in every district to tackle HIV/AIDS. Since 1993 Bhutan has registered 42 cases of HIV/AIDS, and eight of those infected have died.

The domestic economy

GDP grew by 7% in 2002/03

According to the Central Statistical Office, Bhutan's GDP per head stood at US\$766 in 2002. The country achieved a growth rate of about 7% in fiscal year 2002/03 (July-June). The strong growth stemmed from some hydroelectric projects, including the Kurichu Hydro Power Project, coming on stream, and the continued construction of others, including the Tala Hydro-Power Project. The Changjiji housing project and construction of the Thimpu expressway also contributed to growth.

Inflation has remained low

Overall inflation stood at 2.3% year on year at the end of December 2002, down from 3.6% the end of December 2001. This was the lowest inflation rate recorded since 1980, and stemmed from a fall in the price of rice and a low rate of inflation in India. The average prices of food items increased by 1.9%, while non-food prices rose by 2.8%. Prices of fruits fell by 15.4%, while those of vegetables rose by 12.7%. The rise in vegetable prices was owing to a decrease in

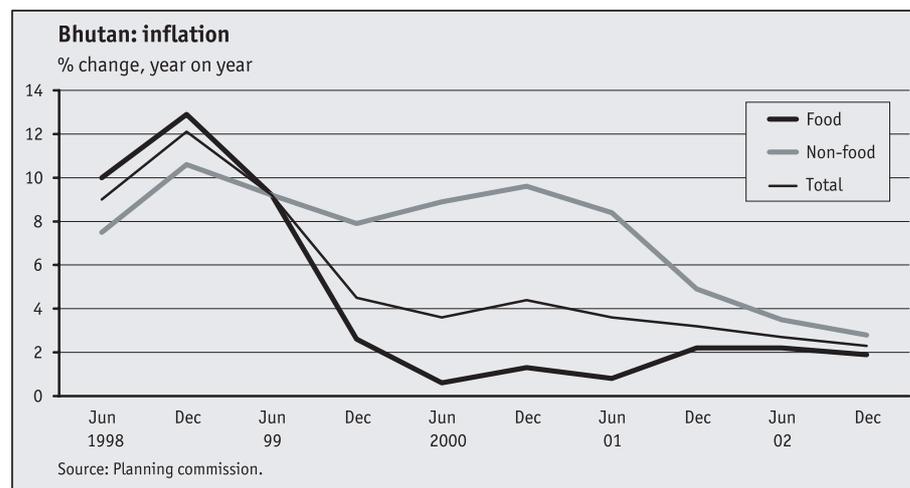
local production, leading to more imports from India. Inflation picked up in March, with non-food inflation rising to 4.6%.

Bhutan: consumer price inflation

(%; year on year)

	2001		2002		2003
	Jun	Dec	Jun	Dec	Mar
Food	0.8	2.2	2.2	1.9	2.6
Non-food	8.0	4.9	3.5	2.8	4.6

Source: Central Statistical Office.



A committee will consider lowering income tax

The National Assembly debated a proposal by the corporate sector to reduce the highest rate of personal income tax (PIT) from 25% to 15%. After a clash between ministers, who wanted to maintain the ceiling at 25%, and some assembly members, who were in favour of reducing the ceiling, the Speaker of the assembly, Ugyen Dorje, concluded that a special assembly committee should study the issue and submit a proposal to the National Assembly in 2004. In 2002 about 8,000 people paid PIT, providing the government with revenue of Nu91m (US\$2m).

The BNB responds to an interest rate cut

The Bhutan National Bank (BNB) announced in September that the interest rate payable on housing loans would be reduced from 13% to 10% from October 1st. The financial institutions had been thrown into a dilemma after the National Pension and Provident Fund (NPPF) announced that it would offer a special housing loan at an interest rate of 10% for its 30,000 members from July 1st, undercutting the banks that charged 13%. The BNB could have lost up to Nu22.7m from borrowers who were also members of the NPPF.

BNB makes a rights offer

The BNB made a rights offer of 475,437 shares to 407 shareholders between July and September. It also floated 119,063 equity shares, priced at a book value of Nu550 (US\$12) a share. The sale was announced after the Asian Development Bank decided not to buy its rights in a move to privatise the bank further. The Royal Stock Exchange of Bhutan expects that, after the initial drop from a ceiling of Nu2,000 a share, the share price will rise to about Nu700-800 within a year.

Foreign trade and payments

Bhutan's balance-of-payments position is strong

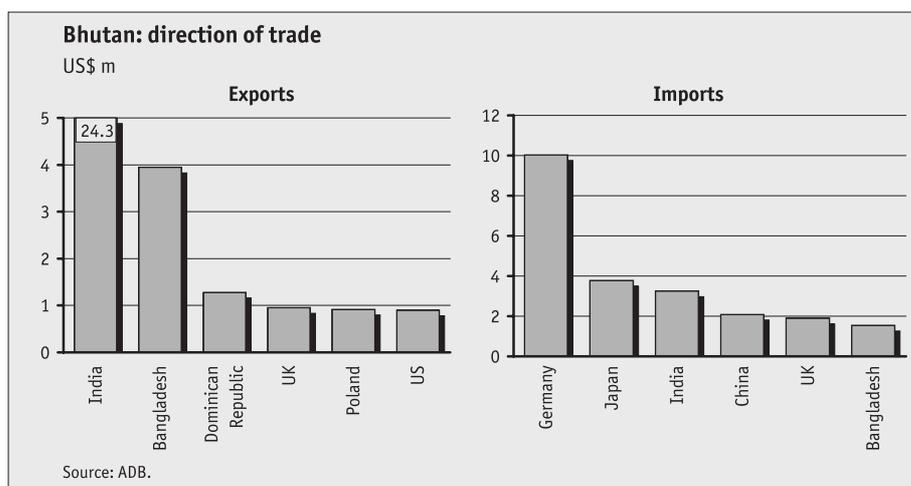
Bhutan's balance-of-payments position remains strong, with foreign aid, concessional loans and foreign investment offsetting the trade deficit. Bhutan's trade deficit stood at Nu4bn (US\$88m) in the first nine months of fiscal year 2002/03 (July-March). The deficit stood at Nu4bn in 2001/02. In the first nine months of 2002/03, imports stood at Nu9bn (having stood at Nu9.1bn in fiscal year 2001/02 as a whole), while exports stood at Nu5bn (having stood at Nu4.6bn in 2001/02).

India is Bhutan's main trading partner

The vast majority of Bhutan's trade is with India. In the first nine months of 2002/03, according to the Royal Monetary Authority (RMA, the central bank), Bhutan imported goods worth Nu8.2bn from India and exported goods to India worth Nu4.7bn. Exports rose after the Kurichu hydroelectric project started selling power with the rate fixed at Nu1.75 (about 4 US cents) per kwh, and imports fell as a result of the completion of the construction phase of the power project.

Bangladesh lowers taxes on some Bhutanese imports

After announcing a total waiver on imports from Bhutan in June, the Bangladesh government changed its decision and announced in August that taxes on 18 goods imported from Bhutan would be reduced from 50% to 15%. The affected goods are apples, mandarins, seed potatoes, mushrooms, asparagus, dried chillies, ginger, fruit juice, gum rosin, slate, boulders, dolomite, gypsum, limestone, coal, wood and timber. Bangladesh is the second largest market for Bhutan's exports. In 2001 Bhutan exported goods worth Nu222m to Bangladesh, and imported goods worth Nu65m from that country.



Foreign companies are investing in the tourism sector

Three luxury resort hotel groups are undertaking the first foreign direct investment (FDI) ventures in Bhutan. In 2004 a Singaporean company, Hotel Properties, plans to open a new hotel in Paro; another Singapore-based leisure company, the Amanresort group, is scheduled to complete six hotels; and the Indian Taj Hotel group has identified a site about 15 km from the capital, Thimphu. Under the government's FDI policy, foreign investors are permitted to own up to 70% of joint-venture companies. They are required to invest a

minimum of US\$1m in the manufacturing sector (which includes mineral processing, agro industries, forestry and wood-based industry, livestock, light industries, electronics and power-intensive industries). For the service sector, which includes hotels, tourism, information technology, financial services and housing, they must invest a minimum of US\$500,000.

Tourist arrivals are continuing to fall

Tourist arrivals are expected to fall again in the autumn season, which runs from September to December. The Tourism Authority of Bhutan estimates that around 1,380 tourists will visit in the autumn season; 2,229 visited in the same period of 2002. In the spring season (January-June) 2,737 tourists visited Bhutan, an increase on the 2,244 who arrived in the first half of 2002. Tourism arrivals grew by an annual average of 11% in the decade after tourism was privatised in 1991. However, numbers have fallen since the September 11th 2001 terrorist attacks on the US. From 7,559 visitors in 2000, only 6,462 visitors arrived in 2001 and just 5,730 in 2002. The government plans gradually to raise tourist traffic to 15,000 arrivals a year, and hopes to earn US\$21m annually from tourism.

Foreign-exchange reserves remain strong

Bhutan's foreign-exchange reserves provide well over a year's import cover, and stood at US\$355m in July 2003 (of which around US\$100m was held in Indian rupees), according to the Ministry of Finance. The total debt to GDP ratio was around 52%, and the debt-service ratio was 5.2%—the bulk of Bhutanese borrowing is at concessional rates. Bhutan's total external debt stood at US\$404m.