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# Implementation Report of the Vienna Programme of Action (VPoA)

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March 2023



Office of Cabinet Affairs and Strategic  
Coordination  
Cabinet Secretariat  
Royal Government of Bhutan

## Acronym

ADB	:	Asian Development Bank
AKRAs	:	Agency Key Result Areas
ALDG	:	Agriculture Land Development Guidelines
APA	:	Annual Performance Agreements
BAFRA	:	Bhutan Agriculture and Food Regulatory Authority
BCCI	:	Bhutan Chamber for Commerce and Industry
BEFIT	:	Bhutan Economic Forum for Innovative Transformation
BIMSTEC	:	Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation
BITS	:	Bhutan Integrated Tax System
BSB	:	Bhutan Standards Bureau
CSI	:	Cottage and Small Industries
DFQF	:	Duty-free Quota-free
DGPC	:	Druk Green Power Corporation
DoR	:	Department of Roads
ECCD	:	Early Child Care Development
EU	:	European Union
EV	:	Electric vehicle
FMCL	:	Farm Machinery Corporation Limited
FTA	:	Free Trade Agreement
FYP	:	Five Year Plan
GC	:	Gewog Center
GDP	:	Gross Domestic Product
GNH	:	Gross National Happiness Commission
GNHC	:	Gross National Happiness Commission

GoI	:	Government of India
GPS	:	Global Positioning System
GST	:	Goods and Services Tax
ICAO	:	International Civil Aviation Organization
ICIMOD	:	International Centre for Integrated Mountain Development
JTCM	:	Joint Trade Committee Meeting
KPIs	:	Key Performance Indicators
LDC	:	Least Developed Countries
LGKRAs	:	Local Government Key Result Areas
LLDC	:	Landlocked Least Developed Countries
MDPR	:	Minimum Daily Package Rate
MFN	:	Most Favored Nation
MoWHS	:	Ministry of Works and Human Settlement
MRA	:	Mutual Recognition Agreements
NCD	:	Nationally Determined Contributions
NKRAs	:	National Key Result Areas
NRP	:	National Rehabilitation Programme
NTTFC	:	National Transport and Trade Facilitation Committee
ODA	:	Official Development Assistance
PSDC	:	Private Sector Development Committee
PSL	:	Priority Sector Lending
PTA	:	Project Tied Assistance
PTA	:	Preferential Trade Agreement
REDCL	:	Rural Enterprise Development Corporation Limited
RSTA	:	Road Safety and Transport Authority
S&D	:	Special and Differential

SAARC	:	South Asian Association for Regional Cooperation
SAFTA	:	South Asian Free Trade Area
SAPA	:	Sector Adaptation Plan of Action
SAPTA	:	SAARC Preferential Trading Agreement
SASEC	:	South Asian Sub-regional Economic Cooperation
SDF	:	Sustainable Development Fee
SDGs	:	Sustainable Development Goals
SHDP	:	Sustainable Hydropower Development Policy
SOE	:	State Owned Enterprise
TCB	:	Tourism Council of Bhutan
TLP	:	Trade Liberalization Programme
UNIDO	:	United Nations Industrial Development Organization
VPoA	:	Vienna Programme of Action
WHO	:	World Health Organization
WTO	:	World Trade Organization

# Executive Summary

## Introduction

In keeping with the international commitments, Bhutan as an LLDC implemented the Vienna Program of Action (VPoA) in 2014. VPoA's six priority areas include fundamental transit policy issues, infrastructure development and maintenance, international trade and trade facilitation, regional integration and cooperation, structural economic transformation, and means of implementation, all of which were in sync with national development needs. The monitoring and review of the progress and achievements of the VPoA were undertaken along with the review and evaluation of the country's five-year plan (FYP) such as mid-term plan review and terminal plan evaluation. This implementation report of the VPoA provides an overview of the progress, significant achievements, and challenges in regard to the six priorities of VPoA.

## VPoA mainstreaming

The priority areas of the VPoA were considered, integrated, and mainstreamed into the national development plans, policies, and milestones. Both the 11th FYP and 12th FYP Bhutan had National Key Result Areas (NKRAs) which placed emphasis on focus areas of VPoA and SDGs. Besides, these priority areas were integrated and cascaded to relevant Agency Key Result Areas (AKRAs) and Local Government Key Result Areas (LGKRAs) ensuring that various sectors and agencies contributed to their achievement. In this way, it garnered multi-sectoral efforts and contributions in maximizing the progress and success of the VPoA.

## Fundamental transit policy

Bhutan strengthened trade and transit agreements with her trading partners through the renewal of existing trade agreements, entering into new trade agreements, and signing of memorandum of understanding. Today, Bhutan continues to enjoy free trade with her major trading partner, India and has established preferential trade agreements with the Government of the People's Republic of Bangladesh. Bhutan had also signed a memorandum of understanding on the use of Bangladesh's waterways and transit routes for export and import of Bhutanese goods to other countries.

## Infrastructure development and maintenance

As of 2020, Bhutan's road network culminated to a total road length of 18,355.62 kilometers (KM). This comprises 61% of farm roads, 15% of national highways, and 11% of district roads. In 2008, Bhutan had only 5,362 KM of roads which increased to 10,578 KM by the end of 2013. Bhutan has also begun her transition into "*Bhutan Sustainable Low-emission Urban Transport Systems*." In 2022, Bhutan recorded a total of 431 electric vehicles including 237 EV taxis plying on the roads.

Strengthening air transport was also prioritized. Augmenting airport infrastructures and introduction of helicopter services for transport and medical evacuations were key initiatives. Bhutan also made significant progress in the development of trade infrastructure. The first mini-dry port at Phuentsholing was completed in 2022 while development of dry ports at

Nganglam, Gelephu, and the largest mega-dry port at Pasakha are being pursued in the 12th FYP.

Further, Bhutan emphasized the development of hydropower. Currently, the country has a total installed capacity of 2,334 megawatts (MW). Four hydropower projects with a total capacity of 2,938 MW are at various stages of construction and upon completion, the total installed capacity will increase to 5,264 MW with a total firm power of 909.35 MW. Due to progress in hydropower development and rural electrification, 99.71% of households in Bhutan have access to electricity with 100% in urban areas and 99.5% in rural areas. Bhutan also focused on developing telecommunication and internet services. Today, all 20 districts and 205 blocks have access to cellular connectivity. Internet and broadband penetration in all 20 districts has reached 75% and more than 100 numbers of public services are provided online through electronic platforms.

### **International trade and trade facilitation**

Interventions geared towards resolving trade issues, promoting market access, and expanding trade capabilities were undertaken through establishment of a trade information system, conduct of market studies, and agreement on various trade cooperations. Key interventions included the development of dry ports, promotion of Brand Bhutan, and modernization and digitization of customs procedures through the introduction of Bhutan Electronics Management Systems and National Single Windows. Other measures include regulatory reforms and facilitation of Bhutanese exports at regional and international trade expositions.

Bhutan has made remarkable progress in cross-border trading. Out of 183 economies, Bhutan ranked 30th in Trading Across Borders in 2020 according to the World Bank. Despite various initiatives undertaken to promote export and facilitate international trade, challenges persist in terms of product certification, trade infrastructure, and high transit costs among others. Very recently, the Royal Government of Bhutan has also provided the green light to accede to the World Trade Organization.

### **Regional integration and cooperation**

Participation in bilateral and regional integration provided an opportunity to expand the regional market and enhance collaboration in myriad areas of socio-economic development such as regional trade, transport, communications, energy networks, and others. Bhutan's regional integration and cooperation include her engagement with organizations such as SAARC, BIMSTEC, and ICIMOD. Regionally, Bhutan's engagement has been predominant with India followed by Bangladesh, Nepal, Japan, and Thailand. The country's major engagement with regional partners had been greatly driven by bilateral agreements or memorandum of understanding.

Despite the presence of regional cooperation frameworks and significant progress in integration, there are opportunities to further strengthen cross-border trade and mutual recognition of certification agencies. With countries such as Nepal and Thailand, Bhutan has no trade agreements, and therefore the signing of trade agreements remains a priority.

## **Structural economic transformation**

Bhutan successive governments have developed policies, strategies, and plans aimed at building macroeconomic stability, diversifying economic base, and achieving progressive, balanced, and sustainable development. Notable initiatives were undertaken in terms of promoting cottage and small industries, private sector development, policy reforms in the service sector such as tourism, investment in hydropower and agriculture sector, and focus on human capital development. This in turn is expected to structurally transform the Bhutanese economy from agriculture dependent to industry and service oriented.

Despite various initiatives, challenges exist in terms of limited productive capacity, high unemployment rate, poor market access, stagnant private sector growth, limited domestic resources, and inadequate human capital especially in the education and health sector. Climate change and natural disasters also pose serious impediments to the country's development efforts.

## **Means of implementation**

Bhutan's developmental activities including the implementation of VPoA were financed through domestic resources and overseas development assistance. In the 11th and the 12th plan periods, overseas development assistance financed around 54% of the plan activities. Significant achievements have been recorded in terms of attracting FDI. In 2022, there were 108 FDI projects in Bhutan with a majority of the FDI sourced in India (51%) followed by Singapore (15%) and Thailand (10%). With more than 24,500 establishments, the private sector employed more than 90,000 Bhutanese with an employment share of 28.7% in the private business and 3% in private sector companies. The private sector continues to be a strategic partner of the state in achieving VPoA priorities.

## **Monitoring and review**

Bhutan's FYPs employ a results-based management strategy through NKRA, AKRA, and LGKRA, along with corresponding KPIs and programs. On a yearly basis, these KRAs are prioritized and transformed into annual performance agreements (APA) with key success indicators, activities, and budgets, with an emphasis on accountability. Mid-term reviews and terminal evaluations are also conducted to monitor and review the plan's progress. Since the VPoA was mainstreamed in the national plans, it has been monitored and reviewed in the process of monitoring and reviewing the plans.

## **Towards the next program of action**

Given combined challenges of limited productive capacity, inadequate domestic resources, low human capital, and high vulnerability to future shocks and climate change, the next development agenda shall focus on addressing these challenges. Renewed emphasis needs to be placed on leveraging science and technology, identifying and mobilizing innovative sources of finance, and supporting structural economic transformation. Disaster preparedness, full recovery from COVID-19, building resilience, and adaptation to impacts of climate change should also be prioritized in the next program of action

## I. Introduction

Bhutan is a small developing nation nestled in the eastern Himalayas. The country has a total land area of 38,394 square kilometers with a total population of 735,553<sup>1</sup>. The country is a member of the global community and is party to numerous international and regional commitments including the pursuit of Sustainable Development Goals (SDGs) and the implementation of the Vienna Programme of Action (VPoA). Since international commitments feature Bhutan's development needs in sync with her socio-economic priorities, all relevant SDGs and priority areas of VPoA have been closely considered during the formulation of national socio-economic development plans known as Five-Year Plans (FYPs) in Bhutan. As such, the focus areas of VPoA are mainstreamed into the national policies and development frameworks.

The erstwhile Gross National Happiness Commission (GNHC) was the apex planning body responsible for developing and spearheading national socio-economic development planning, policy formulation, evaluation, and resource allocation. The commission had ensured the mainstreaming of international commitments into the national plans, policies and strategies while also ensuring that commitments are cascaded into sectoral plans, programmes, and milestones. The commission was also tasked with monitoring and evaluation of progress and achievements of the national FYPs through mid-term reviews conducted in the middle of a plan implementation period and terminal evaluation conducted at the end of the plan period. As such, progress and achievement of the SDGs and VPoA being integrated into the national plans are reviewed in the process of national plan evaluations.

In the exercise of various public sector reforms, GNHC as an agency has been recently dissolved. With its dissolution, the national perspective planning, policy formulation and evaluation functions have been merged with Cabinet Secretariat and other mandates of resource mobilization, local development, and plan monitoring and coordination have been placed under the Ministry of Finance.

This document evaluates the implementation of the VPoA in Bhutan and presents an overview of the progress made, policy changes implemented, and initiatives undertaken. It also highlights the challenges confronted by Bhutan in implementing the priority areas of the VPoA and presents areas that require further support from development partners and international communities.

## II. Mainstreaming of the VPoA into national development planning process and coherence with the 2030 Agenda and other global processes

The launch of the Vienna Programme of Action in 2014 coincided with the start of the 11th FYP of Bhutan. Its implementation timeframe spanned over two national plans, the 11th and the 12th FYP. As such, all priorities of the VPoA were well in sync with the focus areas of the Royal Government of Bhutan providing a conducive space for integration and mainstreaming. The 11th FYP had 16 National Key Result Areas (NKRAs) with the ultimate objective of achieving "*Self Reliance and Green Socio-economic Development.*" These NKRAs

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<sup>1</sup> Population and Housing Census of Bhutan 2017. National Statistical Bureau.



which were categorized under the four GNH pillars complemented by the Agency Key Result Areas (AKRAs) and LG Key Result Areas (LGKRAs) aptly featured the priorities of the VPoA. For instance, the four NKRA namely Sustained Economic Growth, Poverty Reduced and MDG plus achieved, Food Secured and Sustained, and Employment Generation under the pillar of “*Sustainable and Equitable Socio-economic Development*” were aimed to transform the Bhutanese economy and enhance livelihood.

The VPoA was also integrated into the 12th FYP which is currently under implementation. The priority areas of the VPoA have been mainly integrated into its 17 NKRA and various AKRAs and LGKRAs, especially under NKRA 2: Economic Diversification, NKRA 3: Reducing poverty and inequality, NKRA 6: Carbon neutrality, climate and disaster resilient, NKRA 7: Quality education and skills, NKRA 8: Food and nutrition security, NKRA 9: Infrastructure, communication and public services and NKRA 11: Productive and gainful employment. Similarly, all relevant SDGs are also mapped against the NKRA and incorporated into the national development plans, policies, and milestones.

Bhutan had already integrated the social, economic, and environmental aspects of sustainable development into its development framework long before Agenda 2030 and SDGs were introduced. Bhutan's development approach, which is based on Gross National Happiness (GNH) includes nine domains<sup>2</sup>, covers these three dimensions and also incorporates additional elements emphasized by Agenda 2030. These new elements include a greater emphasis on qualitative understanding and recognizing the significance of good governance as an objective in itself and a way to attain all other domains or objectives.

Bhutan uses the nine GNH domains to guide policy formulation, conducting comprehensive social, economic, environmental, and cultural impact assessments to minimize or alleviate any negative effects on her sustainable development path. The GNH Policy Screening tool evaluates proposed policies based on 22 variables to determine whether they are in alignment to sustainable development, with a pass mark of 66 out of 88 points. This screening mechanism helps to ensure that policies formulated are in line with SDGs, given the correlation between GNH and SDGs.

In 2015, Bhutan conducted a Rapid Integrated Assessment of its 11th FYP and found that out of the 143 relevant SDG targets, 134 were consistent with the indicators of the 11th FYP. Bhutan prioritized three SDGs namely SDG 1: No Poverty, SDG 13: Climate Action, and sdg 15: Life on Land for immediate implementation in the 11th FYP based on the urgency of people's needs in Bhutan, commitment to remaining carbon-neutral, and her desire to be a global biodiversity leader.

Under the 11th FYP, Bhutan made significant strides in reducing multidimensional poverty, improving access to water and sanitation, achieving nearly 100% electrification of households with clean energy, and achieving gender parity in secondary-level school enrolment. The current national development plan, the 12th FYP, focuses on "consolidation, coordination, and collaboration" to build on these achievements and establish a strong foundation for the continued pursuit of GNH and the SDGs. The 12th FYP's overarching

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<sup>2</sup> The nine domains are education, living standard, health, psychological well-being, community vitality, cultural diversity, time use, good governance, ecological diversity and resilience.

goal is "A Just, Harmonious, and Sustainable Society with Enhanced Decentralization," and its 17 NKRAAs and KPIs align closely with the 17 SDGs.

### **III. Assessment of key economic, social and environmental development trends**

Guided by the development philosophy of Gross National Happiness (GNH), Bhutan has recorded significant socio-economic progress. GDP grew at an average rate of 7.5% and GNI per capita increased by around eight times to USD 3,109.33 between 2015 and 2019<sup>3</sup>. However, GDP dropped to -10.08% and fiscal deficit widened by 7.4% in 2020 due to the setbacks generated by the COVID-19 pandemic. The pandemic also contributed to a drop in exports by 33.65% with unemployment rate increasing from 2% to 5% and youth unemployment from 11.9% to 22.6% in 2020<sup>4</sup>. With the easing of social and mobility restrictions complemented by continued economic stimulus supports provided by the government, Bhutan recorded an economic growth of 4.1% in 2021 and same GNI growth of 4.1%<sup>5</sup>.

Significant progress has been achieved in social sectors such as education and health. Bhutan's literacy rate increased from 63%<sup>6</sup> in 2017 to 70.2%<sup>7</sup> in 2022. The government invested heavily in education infrastructure, with number of schools increasing from 365 in 2001 to 603 in 2019<sup>8</sup>. Prioritization of investment in health has brought about improved health outcomes for the Bhutanese people. For instance, life expectancy increased from 66.3 years in the 2000s to 72.3 years. Similarly, the poverty rate decreased from 23.2% in 2007 to 8.2%<sup>9</sup> in 2017 and 12.4%<sup>10</sup> in 2022.

Bhutan has acknowledged the importance of its natural environment and rich biodiversity. In line with the constitutional mandate to maintain at least 60% of forest cover for all times to come, the country today has 70.46% of its total land under forest cover presently. Towards furthering protecting the lush natural endowments, Bhutan embarked on the path of transforming modern transport through use of electric vehicles, investment into alternative renewable sources of energy, sustainable tourism, and sustainable land management among others.

Despite these significant achievements, various challenges persist ahead of its socio-economic development trajectory. Some key constraints include lack of skills/capabilities, diversification, value addition, opportunities, accountability, plateauing traditional sources of growth, low average productivity and inefficiencies, increasing kidu dependency, and decreasing aid and assistance. There also remains an uncertain future rife with challenges stemming from climate change, global pandemic, increasing population growth and related conflicts, and unequal access to knowledge and technology.

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<sup>3</sup> World Bank. (2021). Bhutan Overview: Development news, research and data. <https://www.worldbank.org/en/country/bhutan/overview>

<sup>4</sup> Labour Force Survey Report 2020. National Statistics Bureau.

<sup>5</sup> Macroeconomic Situation Report, Fourth Quarter Update Report: FY 2021/2022. (2022). Department of Macroeconomic Affairs, Ministry of Finance.

<sup>6</sup> Bhutan Living Standard Survey 2012. National Statistics Bureau.

<sup>7</sup> Bhutan Living Standard Survey 2022. National Statistics Bureau.

<sup>8</sup> Bhutan Education Statistics 2020. Ministry of Education, Royal Government of Bhutan.

<sup>9</sup> Bhutan Poverty Analysis Report 2017. National Statistics Bureau.

<sup>10</sup> Bhutan Poverty Analysis Report 2022. National Statistics Bureau.

## IV. Assessment of progress and challenges in the implementation of the Vienna Program of Action

### Priority Area 1: Fundamental transit policy issues

Bhutan made significant progress in addressing her transit policy issues through various legal instruments including agreements, conventions, and through enhanced national coordination.

Bhutan made concerted efforts to sign trade agreements with the government of the People's Republic of Bangladesh aimed at strengthening trade facilitation and ensuring effective transportation of goods. *"Agreement on Trade Between the Royal Government of Bhutan and the Government of the People's Republic of Bangladesh"* was signed on December 6, 2014. The two governments agreed to give each other the same treatment as they would provide to their most favored trading partners when it comes to issuing licenses, carrying out customs formalities, imposing customs duties and other taxes, storing goods, and charging fees and handling charges related to export and import of goods between the two countries<sup>11</sup>. The agreement also highlighted granting tariff concessions and formation of the Joint Working Group, which will be responsible for trade promotion and expansion.

Pursuant to the agreement, the two countries endorsed the *"Protocol to The Agreement on Trade Between the Royal Government of Bhutan and the Government of the People's Republic of Bangladesh"*. Bhutan agreed to designate six entry and exits for trade with Bangladesh in Samdrup Jongkhar, Gelephu, Sarpang, Phuentsholing, Samtse, and Paro while Bangladesh designated nine entry and exit points for conducting trade with Bhutan<sup>12</sup>.

Based on the Trade Agreement Between Bangladesh and Bhutan of 2014 and Protocol on Transit and Trade Between Bangladesh and India of 1972, Bhutan and Bangladesh signed a memorandum of understanding to strengthen mutual cooperation in the field of cargo transportation through sea routes and waterways of Bangladesh. The *Memorandum of Understanding on Use of Inland Waterways for Transportation of Bilateral Trades and Transit Cargoes Between the Royal Government of Bhutan and the Government of the People's Republic of Bangladesh* was signed in 2017.

To further enhance trade between the two countries, Bhutan and Bangladesh signed the *"Preferential Trade Agreement Between the People's Republic of Bangladesh and the Royal Government of Bhutan"* in 2020. With the signing of the agreement, 18 Bhutanese products and 90 Bangladeshi products enjoying duty-free access were exempted from paying customs duties and other charges collected at the customs points<sup>13</sup>. The preferential trade agreement further granted duty-free access to 16 more Bhutanese products and 10 Bangladeshi products

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<sup>11</sup> Agreement on trade between the royal government of Bhutan and the government of the people's republic of Bangladesh. (2014). Department of Trade, Ministry of Industry, Commerce and Employment.

<sup>12</sup> Protocol to the trade agreement between the royal government of Bhutan and the people's republic of Bangladesh. (2014). Department of Trade, Ministry of Industry, Commerce and Employment.

<sup>13</sup> Preferential trade agreement between the people's republic of Bangladesh and the people's republic of Bhutan. (2020). Department of Trade, Ministry of Industry, Commerce and Employment.

Provided that India is a major trading partner of Bhutan, Bhutan and India have engaged in free trade since the start of their diplomatic relations. The previously existing trade agreement between Bhutan and India signed in 2006 had been in force for ten years. With its expiry, Bhutan and India renewed and signed the “*Agreement on Trade, Commerce and Transit Between the Royal Government of Bhutan and the Government of the Republic of India*”. The agreement saw the addition of five more entry and exit points for imports into and exports from Bhutan to India such as Dalu, Gasapusa, Loksan, Kulkuli, and Nagartala<sup>14</sup>.

Bhutan also signed along-term cooperation agreement to promote, facilitate and develop trade and economic cooperation. The “*Trade and Economic Cooperation Agreement Between The Government of the Kingdom of Thailand and the Royal Government of Bhutan*” was signed in 2013. Through the agreement, the two countries agreed to exempt certain goods from duties, taxes, and other duties<sup>15</sup>.

Bhutan became the 96th contracting party of the “*Revised Kyoto Convention on the Simplification and Harmonization of Customs Procedures*” in 2014<sup>16</sup>. In accordance with this revised convention and other international best practices, Bhutan enacted her Bhutan Customs Act 2017 and embarked on an intensive process of revising relevant laws and regulations. Bhutan also passed the Customs Duty Act of Bhutan 2021 which repealed the customs duty guaranteed under certain provisions of the acts. As part of the legislative policy reform process, various measures were examined such as the provision of transit rights to facilitate international trade and transport agreements and harmonization of customs documentation, procedures, and formalities through bilateral and regional initiatives. Other measures included the integration of cross-border facilities such as dry ports, and pre-shipment customs clearance facilities. Cascading the principles and the provisions enshrined in this act, the Customs Rules and Regulations 2017 which outlined the trade procedure including e-commerce trade was passed<sup>17</sup>.

To amplify coordination and multi-sectoral participation in trade facilitation, a National Trade Facilitation Committee (NTFC) was established in 2013. The members of the committee comprise representatives from key government agencies and the private sector.

The institutional framework to facilitate logistics flows between Bhutan and Bangladesh is almost in place. Both governments are working out to make sure that logistics are properly facilitated because there are implementation challenges being faced currently for example in the exports of Bhutanese boulders to these countries.

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<sup>14</sup> Agreement on trade, commerce and transit between the royal government of Bhutan and the government of the republic of India. (2016). Department of Trade, Ministry of Industry, Commerce and Employment.

<sup>15</sup> Trade and Economic Cooperation Agreement Between The Government of the Kingdom of Thailand and and the Royal Government of Bhutan. (2013). Department of Trade, Ministry of Industry, Commerce and Employment.

<sup>16</sup> Major milestones in customs and excise division. Customs and Excise Division, Department of Revenue and Customs, MoF.

<sup>17</sup> General requirements for export include document submission such as export declaration, invoice, shipping bill, certificate of origin insurance document, export permit and any other relevant documents deemed necessary

## Priority Area 2: Infrastructure development and maintenance

### *Transport*

The development of the transport sector in Bhutan has been guided by the National Transport Sector 2006, Road Sector Master Plan 2000-2027, Civil Aviation Master Plan, Surface Transport Development Plan 2017, and Transport 2040: Integrated Strategic Vision.

Road transport is a predominant mode of transport in Bhutan and the country has achieved significant progress in the expansion of the road network. As of 2020, Bhutan's road network culminates to a total road length of 18,355.62 KM<sup>18</sup>. This comprises 61% of farm roads, 15% of national highways and 11% of district roads, accounting for 11,257.16 KM, 2,840.93 KM, and 2,072.86 KM of roads respectively<sup>19</sup>. Municipality roads which make up about 3% and access roads making up 10% of the total roads are the other categories of roads. In 2008, Bhutan only had 5,362 KM of roads which increased to 10,578 KM by the end of 2013.

Expansion of road networks had been complemented by upgradation of existing road networks. One of the most crucial road activities undertaken was the implementation of the Northern-East-West highway Project by DoR under MoWHS and Project Dantak in the 11th FYP which spanned from 2013 to 2017. The project which was signed under the PTA (Project Tied Assistance) provided by GoI included up-gradation of around 510 KM of northern roads from Semtokha in the west to Trashigang in the east<sup>20</sup> Works started by the end of 2014 and the first 65 KM stretch of Northern East-West highway was inaugurated in June 2017.

With the upgradation work, a major stretch of the Northern East-West highway was double-laned with an average width of 7.5 metres (M), catering to a traffic volume of 2,000 - 2,500 vehicles per day<sup>21</sup>. Previously, the highway was a 3.5M single-lane road with an estimated traffic volume of 150 vehicles per day. The East-West highway between Bumthang and Mongar is expected to be completed by the end of 2023. The upgradation project has helped shorten travel time between Thimphu and Trashigang, facilitated easy transport of goods and equipment, enhanced convenient access for tourists or guests, and increased socio-economic well-being of the people.

Improvement and construction of the Southern East-West highway which stretches from Sipsoo in the Southwest to Jomotshangka in the Southeast had also been emphasized. Construction of road links between Gelephu and Panbang, Sarpang and Lhamoizingkha, Deothang and Nganglam, Samrang and Jomotsangkha and others were pursued and completed<sup>22</sup>. According to the State of the Nation Report (2022), the currently missing links are Lhamoizingkha to Sarpang, an estimated road length of 86 KM, and Gelephu to Panbang, an estimated road length of 94.5 KM . Additional missing links that are currently under

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<sup>18</sup> Asian Development Bank. *Technical Assistance Report*. <https://www.adb.org/sites/default/files/project-documents/56001/56001-001-tar-en.pdf>

<sup>19</sup> Government of Bhutan, Ministry of Works and Human Settlement. 2020. Road Classification and Network Information of Bhutan. Thimphu.

<sup>20</sup> Northern East-West Highway Project. Department of Roads, MoWHS.

<sup>21</sup> <https://kuenselonline.com/65-km-of-northern-east-west-highway-inaugurated/>

<sup>22</sup> 11th FYP. GNHCS

construction are the 68 KM Dewathang - Nganglam Highway, Dewathang - Samrang South North Highway, and Samrang - Jomotsangkha SNH<sup>23</sup>.

During the 11th FYP, initiatives such as the construction and maintenance of farm roads had been undertaken. At the end of the plan period, around 5362.79 KM of farm roads were built and 1450.075 KM were maintained<sup>24</sup>. Similarly, 180 GC roads were black-topped and 11 new GC roads were under construction. The construction and maintenance of farm roads were carried out in accordance with the Department of Agriculture's *Guidelines for Farm Road Development*. There was also an emphasis on the construction and upgradation of roads connecting hydropower projects, North-South highway and the management of road assets<sup>25</sup>.

In the 12th FYP, to develop the local economy and facilitate easy transport of farm produce to the markets, the government has been implementing the “*Improvement of Farm Roads Project*” as part of the Economic Contingency Plan 2020. Under this project, about 2,312 numbers of farm roads across the country measuring an approximate length of 9,883 KM will be layered with granular sub-base and construction of drainage<sup>26</sup>. Owing to limited resources, a total of 1,555 KM of 201 farm roads were prioritized out of which 193 have been completed and other 8 nearing completion<sup>27</sup>. For the second phase, 197 farm roads were prioritized for which improvement works on 88 farm roads are being implemented and 109 are being contracted out. Overtime, the quality of these roads will be improved with better materials such as concrete or bitumen.

Building on Bhutan’s pro-environment stand and bolstering the commitment to remain carbon neutral for all times, “*Bhutan Sustainable Low-emission Urban Transport Systems*” project funded by UNDP-GEF and co-financed by the government was started in 2018. The aim of the project was to ensure the transition into low carbon emission transport sector by encouraging the use of EVs. Another project “*Leveraging Nationally Determined Contributions*” (NCDs) is under implementation through the government of Japan’s support and the project supports the procurement of EVs and installation of charging stations. As of 2022, there were a total of 431 electric vehicles including 237 EV taxis<sup>28</sup>. Adequate EV charging infrastructures are also built across the country to encourage higher uptake of EVs by the people.

With support from the United Nations Industrial Development Organization (UNIDO), the first electric bus is piloted in Thimphu Thromde. In terms of public transport, new routes were approved and Global Positioning System (GPS) trackers have been installed in public buses to ensure movement compliance with RSTA rules and regulations.

Strengthening of air transport was also prioritized. The Royal Bhutan Helicopter Services was established in 2015 along with the identification of helipads and emergency landing pads<sup>29</sup>. The helicopter services are used for search and rescue, air medical evacuations, firefighting, movement of cargo, transport of officials and VIPs, and for tourism purposes.

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<sup>23</sup> State of the Nation Report. (2022).

<sup>24</sup> 11th FYP Terminal Review. GNHCS

<sup>25</sup> Eleventh Five Year Plan Volume II: Programme Profile, GNHCS

<sup>26</sup> 12th FYP Mid-Term Review Report. GNHCS

<sup>27</sup> State of the Nation Report. (2022).

<sup>28</sup> State of the Nation Report 2022. Prime Minister’s Office of Bhutan.

<sup>29</sup> 11th Five Year Plan Terminal Review. GNHCS

The transformation of the Paro International Airport and its terminal had been completed in 2021 through the beautification project<sup>30</sup>. Emergency operations center and access gates were opened to ensure a better response to emergencies. Despite setbacks imposed by the COVID-19 pandemic, development and upgradation of domestic airports were emphasized. For instance, resurfacing works and runway extension of Bumthang airport were undertaken to enable the ATRs to fly in from Kolkata, Kathmandu, Bangladesh, and Guwahati. Similarly, the extension of runways at Younphula and Gelephu Airports had been undertaken to enhance air transport infrastructures<sup>31</sup>.

With support from the Asian Development Bank, capacity building in the aviation sector was taken up, including the preparation of a master plan for Gelephu Airport. The feasibility of developing an alternative international airport is explored. Bhutan has also implemented Automatic Dependent Surveillance-Broadcast (ADS-B), an aeronautical surveillance system in order to enhance surveillance of flight movements in the Bhutanese airspace. To improve the existing cargo system, Drukair is also pursuing to convert one A-319 to a dedicated cargo freighter by removing all the passenger seats<sup>32</sup>.

Bhutan had also made progress in terms of the development of dry ports. The construction of Phuentsholing Dry Port, the first mini dry port began in 2017 as a part of the South Asian Subregional Economic Cooperation (SASEC) North Bypass Road Project funded by the Asian Development Bank and was completed in 2022<sup>33</sup>. This has led to a better customs clearance system and improved the facilities for export and import. The establishment of the dry ports at Nganglam, Gelephu, and the largest Mega Dry Port at Pasakha is being pursued in the 12th FYP<sup>34</sup>. With the aim to further promote and strengthen trade, Bhutan had signed a memorandum of understanding with the government of Bangladesh on the use of inland waterways to transport bilateral trade and transit cargoes in 2019<sup>35</sup>.

Despite recording significant progress, transport sector in Bhutan is still constrained by various challenges. Natural disasters such as landslides, intense rainfall, and monsoon floods continue to make roads impliable, especially during the summer season. During winter, travel is hampered by icy roads and heavy snowfall. Oftentimes, road infrastructures are wiped out or damaged by massive falling boulders.

Inadequate professional expertise to undertake studies for rail-based transit systems, ropeways and waterways is another major caveat. Limited resources and huge investment requirements for transport infrastructure development also put stress on the country's limited domestic resources. Although there is a public transport system, transport services are inadequate and unreliable, especially in remote places. With the transition to electric vehicles, challenges lie in huge upfront costs, sustainable operation, and maintenance of quick charging stations. It is also difficult to build people's due to the technology being new.

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<sup>30</sup> State of the Nation Report 2021. Prime Minister's Office of Bhutan.

<sup>31</sup> 12th Plan Mid-Term Review Report. GNHCS.

<sup>32</sup> State of the Nation Report 2022. Prime Minister's Office of Bhutan.

<sup>33</sup> South Asia Subregional Economic Cooperation 2022.

<https://www.sasec.asia/index.php?page=news&nid=1358&url=sasec-mini-dry-port-bhu-completed&enews=97>

<sup>34</sup> 12th Five Year Plan of Bhutan. GNHCS.

<sup>35</sup> MoEA. (2019). *MoEA Newsletter 1(1)*.

In urban areas, increase in the number of vehicles has not been complemented by improvements in road infrastructures, especially parking spaces. Most urban centers increasingly experience traffic congestion and a lack of parking spaces. In the aviation industry, it is arduous as well as time-consuming to train and retain technical staff to perform regulatory and technical works while meeting the standards set by the International Civil Aviation Organization (ICAO). Resource constraints also render development of high-quality and additional airport infrastructure difficult.

Although private sector participation in the development of the transport sector has increased, achieving a vibrant Private-Public Partnership in developing transport infrastructure is far-fetched. This is perhaps due to the fact that the user base is small to justify the huge investment requirements.

## Energy and ICT

Bhutan is endowed with a rich environment and fast-flowing rivers which present an opportunity to harness clean energy. As such, hydropower is regarded as one of the five jewels of the Bhutanese economy and its development has remained the cornerstone of the country's socio-economic development. Hydropower is the predominant source of energy as well as a significant revenue source.

As of 2021, the sector's contribution to GDP accounted for 15.64% constituting about 30 % of national revenue.<sup>36</sup> Bhutan currently has a total installed capacity of 2,334 MW. Four hydropower projects totaling 2,938 MW are at various stages of construction and upon completion, the country will have a total installed capacity of 5,264 MW with a total firm power of 909.35 MW. According to the Power System Master Plan 2040, the total estimated potential is 36,900 MW, with an annual production potential of 154,000 GWh of energy. In recent years, there has also been an increased emphasis on the development of small hydropower projects. DGPC has initiated the construction of three small hydropower projects in June 2022 and feasibility studies are underway for another four small hydropower projects.

The Sustainable Hydropower Development Policy 2021 which superseded the hydropower policy 2008 seeks to achieve energy security by prioritizing the development of reservoir and pumped storage hydropower projects. The policy will focus on trilateral cooperation at the regional and sub-regional levels for hydropower development in the country<sup>37</sup>.

Recognizing the need to diversify energy sources, attention has been placed on tapping alternative sources of energy, especially renewable energy sources such as wind and solar. The Alternative Renewable Energy Policy has been adopted with the target of generating 20 MW from various technologies by 2025. Bhutan Renewable Energy Master Plan has also been prepared and it shows the potential to produce 12 GW of solar and 760 MW of wind energy.

The country undertook pilot projects to install solar power plants and harness wind energy. The 180 KW grid-tied solar power plant at Rubesa, which is the first utility grid-tied solar plant was commissioned in September 2021<sup>38</sup>. The 17.38 MW Sephu Solar Power Project

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<sup>36</sup> Statistical Yearbook 2022. NSB.

<sup>37</sup> Sustainable Hydropower Development Policy 2021, MoEA

<sup>38</sup> State of the Nation Report 2021. PMO



supported by the ADB and 80KW solar plant at Aja-Ney, Mongar was implemented. The desk assessments of seven solar projects totaling 308 MW were submitted to ADB for the purpose of carrying out feasibility studies and financing.

To reduce state expenditure on electricity subsidy, assist households to enjoy sustainable energy supply, and enhance livelihoods, the piloting of a 3 KW distributed small-scale solar PV system has been undertaken in 304 rural households<sup>39</sup>. Inroads to exploring the viability of hydrogen use in industry and transport was studied with the onset of initial works toward development of a national hydrogen roadmap. This is explored with the primary aim of reducing dependency on fossil fuels in the transport sector and upend Bhutan's carbon neutral commitments.

In 2022, 99.71% of households in Bhutan had access to electricity with 100 % in urban areas and 99.5% in rural areas<sup>40</sup>. In order to encourage the use of renewable energy, electricity subsidies have been provided by the government in line with the Electricity Tariff Policy of Bhutan. Rural households, community temples, and micro trade activities are provided with 100 units of free electricity a month. Since the revision of the electricity tariff policy in 2019, the government has been providing fully subsidized 200 units of electricity per month for rural highland communities such as Laya, Lingshi, Merak, and Sakteng<sup>41</sup>.

National Energy Efficiency and Conservation Policy was passed in 2019 to ensure energy efficiency and promote conservation. It focuses on enhancing efficient use of energy and reducing the energy intensity of the economy in four main sectors such as building, industry, transport and appliances<sup>42</sup>. In line with this policy, the government introduced the energy efficiency roadmap which laid the foundation for assessing energy efficiency and conservation measures<sup>43</sup>.

To enhance the realization of SDG Goal 7: *Affordable and Clean Energy*, a roadmap called Energy Transition Pathway for the 2030 Agenda: SDG 7 Road Map for Bhutan was launched with the aim to achieve 90% access to clean cooking, 43.2% of total energy consumption as renewable energy, and 70% of total vehicles to be electric vehicles. Other policy interventions included the development of Climate Change Policy, and Sustainable Consumption, and Production Strategy.

Acknowledging the importance of telecommunications and broadband in the socio-economic progress of the country, the Bhutan Telecommunications and Broadband Policy was approved in 2014. Since then, the development of telecommunications and broadband services, infrastructures, and facilities has been steered by this policy. It has mainly focused on the objectives of achieving universal connectivity, enhancing the regulatory provisions and frameworks, and promoting private sector investment by smoothening business environments. This will bring about an efficient market and make broadband and telecom services more accessible and affordable.

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<sup>39</sup> State of the Nation Report 2022. PMO

<sup>40</sup> Bhutan Living Standard Survey 2022. National Statistics Bureau.

<sup>41</sup> Tariff Review Report 2019. Bhutan Electricity Authority.

<sup>42</sup> National Energy Efficiency and Conservation Policy 2019. MoEA

<sup>43</sup> Energy Transition Pathway for the 2030 Agenda:SDG 7 Roadmap for Bhutan. (2022). ESCAP:United Nations.

As of now, all 20 Districts and 205 blocks of Bhutan have access to cellular connectivity; internet and broadband penetration in all 20 Districts is up to 75% and Government to Citizen services consist of more than 100 numbers of public services made online through electronic and mobile platforms.

Additionally, an electronic-government interoperability framework and an enterprise architecture to enable the efficient sharing of information were developed in 2014. Bhutan established its first Tech Park with support from multilateral donors and public-private partnership has been promoted with the objective of employment generation and promoting knowledge-based society. The park also serves as the innovation hub for startup businesses. To foster innovation and ICT-enabled growth, Bhutan is investing in Start-Up innovation camps and has established a Business Start-Up Center in the capital.

Despite the progress made in harnessing renewable energy, challenges remain. The impact of climate change on the hydropower sector would likely create dire impacts for Bhutan. Successfully ensuring access to affordable, reliable, sustainable, and climate-resilient infrastructure through scaling existing initiatives will require significant investment in terms of human resources and technology transfer. The government will put continuous efforts to improve the investment climate through review of relevant policies and regulatory frameworks to attract financing.

The manufacturing sector in Bhutan is locked into relatively low-value-added products. Furthermore, with a population of only 768,577, the small size of the domestic market offers limited opportunities to harness greater economies of scale for production. Capacity constraints and negligible investment in the areas of science, technology, research, and innovation are major constraints facing the Bhutanese economy.

### **Priority Area 3: International trade and trade facilitation**

Despite the country's small domestic market and limited export basket, promoting international trade and enhancing trade facilitation is crucial for Bhutan. Strengthening export capacity and improving the quality of exports have been regarded as important means to realize the greater goals of sustainable development. Accordingly, Bhutan has made concerted efforts that were spelled out in the national five-year plans.

In the 11th FYP, emphasis was placed on export promotion and market access, bolstering trade policy and enhancing regulatory framework, and development and strengthening of intellectual property. Interventions geared towards resolving trade issues, promoting market access, and honing trade capabilities were undertaken through the establishment of trade information system, the conduct of market studies, and the agreement of various trade cooperations<sup>44</sup>. Building on the progress achieved in the 11th FYP, further focus was given to enhancing trade in the 12th FYP. The erstwhile Ministry of Economic Affairs continued the task to facilitate partake of Bhutanese exporters in international trade avenues, market studies, and Bhutan's membership in the international export and trade facilitation initiatives<sup>45</sup>.

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<sup>44</sup> 11th Five Year Plan of Bhutan. GNHCS.

<sup>45</sup> 12th Five Year Plan of Bhutan. GNHCS.

The construction of various dry ports were also undertaken. A mini dry port was constructed in Phuntsholing and dry port constructions are also ongoing at Pasakha, Gelephu, and Nganglam. The construction of a mega dry port in Pasakha has been pursued since 2021 and it is expected to be complete by the end of 2024 while two other dry ports are at their initial stages. These dry ports are expected to minimize logistical challenges such as cargo shipment, long transit times, trade processing, and high freight costs<sup>46</sup>. A Trade Information Portal (TIP) has been developed and launched in 2020 to provide information on trade requirements, procedures, statistics, destinations, tariff and non-tariff measures, preferential treatments and market analysis tools<sup>47</sup>. To promote Bhutanese industries and products in the international market, the Brand Bhutan has been developed with development of implementation tools such as the Brand Guidelines and Brand Implementation and Governance Plan<sup>48</sup>.

Acknowledging the importance of modernizing and digitizing customs procedures in trade facilitation, Bhutan Electronics Management System has been developed and is currently being piloted. This electronics customs management system will be implemented across the country in the fourth quarter of 2023 and ensure individual and business entities make electronic declarations. The system is aimed to ensure an honest and transparent environment, ensure efficient assessment and collection of duties and taxes besides facilitating legitimate trade and commerce<sup>49</sup>. The development of the national single window (NSW) has also been identified as a critical aspect for trade facilitation in the National Export Strategy 2022. It is a platform that will enable traders to submit their documents and access all the relevant trade information through a single electronic gateway<sup>50</sup>.

To work towards creating a more conducive business ecosystem, the government handed over the Private Sector Development Committee (PSDC) to the Bhutan Chamber for Commerce and Industry (BCCI) in 2019<sup>51</sup>. Through collective efforts, possible measures were taken to promote business entities such as infrastructure development, skills enhancement, and efficient taxation. The BCCI is an apex body that serves as an “Engine of Growth” for private sector development. In order to promote innovation through dialogue and deliberation, Bhutan Economic Forum for Innovative Transformation was established in 2017. BEFIT was convened in 2019 with the theme “*Catalyzing Cottage and Small Industries to drive Bhutan’s Economic Diversification.*” Its focus has been on making a stable and sustainable business environment and complements the work of the National Transport and Trade Facilitation Committee (NTTFC).

The promotion of trade should also be complemented by enabling a regulatory environment such as laws, regulations, acts, and policies. The Economic Development Policy of Bhutan 2010 was revised and the Economic Development Policy 2016 was adopted with the intent to build vibrant, dynamic and progressive economy<sup>52</sup>. The policy guides the development of

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<sup>46</sup> Kuensel. (2021). Construction of mega dry port in Pasakha begins. Retrieved from <https://kuenselonline.com/construction-of-mega-dry-port-in-pasakha-begins>

<sup>47</sup> Trade portal website ([www.bhutantradeportal.bt](http://www.bhutantradeportal.bt))

<sup>48</sup> National Export Strategy 2022.

<sup>49</sup> The e CMS is a web-based that is accessible to businesses wishing to conduct international trade that will consist, inter alia of customs agents (brokers), importers, exporters, freight forwarders and private citizens via the internet.

<sup>50</sup> National Export Strategy 2022.

<sup>51</sup> Kuensel. (2019). <http://www.bbs.bt/news/?p=118559>

<sup>52</sup> Economic Development Policy 2016.

trade, both domestic and international alike and half of its policy provisions are dedicated to external trade facilitation<sup>53</sup>. The Goods and Services Tax (GST) Act was enacted in 2020 although its implementation is awaited with full operationalization of Bhutan Integrated Tax System (BITS).

To further participation of Bhutanese traders in the international market, the Department of Trade facilitates in-country trade fairs and ensures traders participate in international trade events so that they can establish trade networks and expand the export market. One of the most recent events in which Bhutan participated is the World Expo held in Dubai in 2021 where 192 countries took part to exhibit their arts, culture, and merchandise. Led by the Ministry of Economic Affairs, Bhutan exhibited under the theme “*Bhutan-Land of Happiness and Opportunities*”<sup>54</sup>

Bhutan’s trade volume has increased over the decades. As of 2022, the total export including electricity amounted to Nu 56.871 billion<sup>55</sup>, which was an increase of Nu 21.291 billion as compared to the total export in 2014. Similarly, the overall import increased to Nu 118.792 billion from Nu 56.88 billion<sup>56</sup> imports in 2014. Due to the rising amount of imports and fuelled by inflationary pressure, the balance of trade has invariably witnessed a deficit and it has been increasing over the years. Bhutan’s export composition has been mainly dominated by mineral products such as ferro-silico-manganese, dolomite, and gypsum. Other export items that feature in the top ten are boulders, cement, and concrete aggregates including pebbles which are mostly exported raw. Although exports to countries other than India (CoTI) had risen from 3.78 billion in 2014 to 7.697 billion in 2022, India still remains the predominant market with more than 80% of the Bhutanese products (including electricity) being exported to the country.

With regard to the World Trade Organization (WTO), Bhutan is still not a member. Bhutan reached an advanced stage of the WTO accession process in 2008 but the accession could not be realized due to reservations including the possible impact on the pursuit of Gross National Happiness. Currently, Bhutan is studying and deliberating on WTO accession especially whether Bhutan should accede before its graduation from the least-developed countries status. As part of the accession process, Working Party Meetings are held. It is important to note that Bhutan has been a WTO observer since 1998. As an LDC, Bhutan has been receiving market access to the preferential schemes of WTO-developed country members.

Bhutan made remarkable progress in cross-border trading. Out of 183 economies, Bhutan ranked 30th in Trading Across Border in 2020 according to the World Bank<sup>57</sup>. Nonetheless, the same report showed that Bhutan’s performance in the Logistics Performance Index is low at 139th of 160 economies in 2018.

Despite various initiatives that were embraced to promote export and facilitate international trade, there still remain challenges in terms of product certification, trade infrastructure, and high transit cost among others. Certification agencies such as BAFRA and Bhutan Standards Bureau (BSB) are confronted with inadequate capacity to fulfill all the export requirements.

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<sup>53</sup> National Export Strategy 2022.

<sup>54</sup> Report on Bhutan’s Participation in World Expo 2020. Tourism Council of Bhutan.

<sup>55</sup> Bhutan Trade Statistics 2022. Ministry of Finance.

<sup>56</sup> Bhutan Trade Statistics 2014. Ministry of Finance.

<sup>57</sup> Logistics Performance Indicator. The World Bank Group.

The agencies also lack Mutual Recognition Agreements (MRA) with counterpart agencies in the export markets for which reason BSB's plan to effect MRA with trading partners, especially with India, Bangladesh, and Nepal could be expedited.

Inadequacy of trade infrastructures such as warehousing and storage facilities, access points for consignments, reliable online custom clearance and management impact the optimum realization of export potential. Exporters still experience hurdles in getting their export documents processed by the approving agencies since the existing infrastructures are unable to meet the rising demand for the export processing of goods. Besides, the digital system is at times inoperational due to internet outages or is overwhelmed by the high number of applicants.

High transportation costs associated with the export of goods is also of concern to exporters. Given the rugged topography, transportation of goods is expensive. Besides, an absence of cargo flights makes export of goods to international markets costly. Subsidizing freight rates would play a significant role in boosting exports especially agro and CSI products. Bhutan's export is also challenged by the small economies of scale. Most of the production happens at a CSI level due to limited market opportunities.

There is also minimal value addition in the goods exported by Bhutan. Most agricultural and mineral goods are exported in primary form whereas the goods from the industrial sector are exported in the intermediate state. Emphasis should be on upgrading the value chain with focus on exporting finished products for higher economic returns.

#### **Priority Area 4: Regional integration and cooperation**

Regional integration and cooperation have been essential to the pursuit of Bhutan's developmental gains. Participation in bilateral and regional integration has provided an opportunity to expand the regional market and enhance collaboration in myriad areas of socio-economic development such as regional trade, transport, communications, energy networks and others.

Bhutan has been a member of the South Asian Association for Regional Cooperation (SAARC) since its establishment on 8th December, 1985 with the signing of the SAARC<sup>58</sup> Charter in Dhaka. As spelled out in the SAARC Charter, the member states have been endeavoring towards fulfilling the key objectives of promoting active collaboration in social, economic, cultural and scientific fields, strengthening cooperation in addressing the matters of shared interests and enhancing cooperation with international organizations for the common welfare of the South Asian people. The member states signed the South Asian Free Trade Area (SAFTA) on 6th January, 2004 during the 12th SAARC Summit and it came into force 1st January, 2006 superseding the previously existing SAARC Preferential Trading Agreement (SAPTA).

SAFTA agreement recognizes and promotes economic cooperation among the member states through solving tariff and non-tariff trade barriers with focus on tariff reduction in trade in goods. It is mainly implemented through the main instruments of the Trade Liberalization

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<sup>58</sup> SAARC comprises eight member states namely Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka.

Programme (TLP), Rules of Origin, Special and Differential (S&D) Treatment of LDCs, Safeguard Measure and Suspension of Agreement, and Institutional Arrangement<sup>59</sup>. Under the TLP instrument of SAFTA, one important aspect is the reduction of the customs duty on import of goods from member states to 0-5% in seven years by non LDCs (India, Pakistan, Sri Lanka) and in ten years by the rest of the LDC countries from the date of SAFTA implementation. Accordingly, Bhutan has successfully reduced the tariff to 0-5% with start from 1st January, 2016<sup>60</sup>. Bhutan has also maintained the products list which is subject to tariff reduction accounts for 240 tariff lines.

Trade among SAARC countries has been crucial to Bhutan's development but this has mainly resulted from trade outside of the SAFTA agreement. Trade among the states in the region is considerably low when compared to trade in other regions. Bhutan's trade with India constitutes the largest share among the SAARC members followed by trade with Bangladesh, Nepal and Sri Lanka. Despite the reduction in tariff and economic cooperation agreed under the SAFTA agreement, Bhutan is yet to pick up trade with countries such as Afghanistan, Maldives, and Pakistan.

Bhutan's trade performance with SAARC members in the most recent year is provided in the table below.

#### **Bhutan's Trade Performance with SAARC Members in 2022**

(Note: Value of export and import less than or equal to Nu. 2,000,000 is excluded)

<b>(Value in Nu. Million)</b>					
<b>Sl.No</b>	<b>Country</b>	<b>Import (A)</b>	<b>Export (B)</b>	<b>Total Trade(A+B)</b>	<b>Balance of payment(B-A)</b>
1	Afghanistan	0	0	0	0
2	Bangladesh	918	4,665	5,583	3,747
3	India	85,093	26,698	111,791	(58,395)
4	Maldives	0	0	0	0
5	Nepal	484	462	946	(22)

<sup>59</sup> Agreement on South Asian Free Trade Area (SAFTA). <https://www.sarc-sec.org/index.php/resources/agreements-conventions/36-agreement-on-south-asian-free-trade-area-safta/file>

<sup>60</sup> Bhutan's Domestic and External Trade. 2019. Ministry of Economic Affairs.

<b>(Value in Nu. Million)</b>					
<b>Sl.No</b>	<b>Country</b>	<b>Import (A)</b>	<b>Export (B)</b>	<b>Total Trade(A+B)</b>	<b>Balance of payment(B-A)</b>
6	Pakistan	0	0	0	0
7	Sri Lanka	130	0	130	(130)
<b>Total</b>		<b>86,622</b>	<b>31,363</b>	<b>118,450</b>	<b>(54,800)</b>

Source: *Bhutan Trade Statistics 2022, Dept. of Revenue and Customs, Ministry of Finance*

Bhutan has also been a member of the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) since 2004. The regional organization is currently composed of seven member states namely Bangladesh, Bhutan, India, Nepal, Sri Lanka, Myanmar and Thailand. It serves as a bridge for collaboration between the South and the South East Asian countries and its main objective is to build an alliance in harnessing accelerated growth through mutual cooperation in shared interests by using regional resources and leveraging on the geographical advantages<sup>61</sup>.

Bhutan's trade is dominated by India and Bangladesh since the two countries are also BIMSTEC member states. Another BIMSTEC member but not a SAARC member with which Bhutan engages in trade is Thailand. Thailand is the third in terms of country-wise import ranking with a total of Nu 3,322 million value of imports in 2022<sup>62</sup>. Bhutan's trade with other BIMSTEC members is limited to some countries not having trade at all. Nevertheless, Bhutan remains steadfast in upholding the commitment to stimulate and enhance trade with the member states and promote other outsider's participation in bolstering the goals pursued by the organization. As a member, Bhutan participated in all the discussions, meetings, and events and upheld the commitments within the BIMSTEC framework. Given the limited resources, it has become increasingly imperative for Bhutan to attract investment from foreign sources. The successive governments of Bhutan have been improving investment climate by easing the business and regulatory environment. As of 2022, India was the top source of investment in the Asian region with 51% share followed by Singapore with 15% and Thailand with 10%<sup>63</sup>.

In addition to regional corporation frameworks and commitments, Bhutan's trade with the neighboring countries is driven predominantly by bilateral trade agreements. India has been the leading development partner of Bhutan and mutually beneficial economic ties have been the cornerstone of Bhutan-India relations. Bhutan and India have been enjoying free trade

<sup>61</sup> BIMSTEC Charter. <https://bimstec.org/bimstec-charter/>

<sup>62</sup> Bhutan Trade Statistics 2022. Ministry of Finance.

<sup>63</sup> FDI Annual Report 2022. Ministry of Economic Affairs.

since the onset of diplomatic ties in 1949. The formal Agreement on Trade and Commerce signed in 1972 have undergone five revisions as in 1983, 1990, 1995, 2006 and 2016. The existing “*Agreement on Trade, Commerce and Transit between the Royal Government of India and the Government of the Republic of India*” renewed in 2016 seeks to further strengthen the age-old ties and enhance bilateral trade and economic cooperation for mutual benefit and development of the two countries<sup>64</sup>.

The most important aspect of the Free Trade Agreement (FTA) is the provision of free trade and the granting of transit rights for Bhutan’s trade with the third countries. With the transit rights, a wide range of Bhutanese goods could reach the rest of the countries without having to pay duties to the Indian government thereby expanding Bhutan’s trade. Bhutan’s main exports to India include electricity, dolomite, ferro-silicon, cardamom, semi-finished iron and non-alloy steel pebbles, portland cement, gypsum and others. The main imports from India include diesel, petroleum, motor vehicles, ferrous products, oil, edibles and others. According to Bhutan Trade Statistics 2022, trade with India (including electricity) accounted for Nu 134,266 million from the overall trade value of Nu 175,663 million.

Given the liberal trade and geographical proximity, India will continue to remain the greatest and most essential trading partner for Bhutan. Bhutan remains committed towards the continued strengthening of trade with India through mutually addressing trade, commerce, and transit challenges.

Besides, Bhutan benefits from the trade agreements signed with the Government of the People’s Republic of Bangladesh. The 1980 Agreement on Trade signed between the two nations have undergone several revisions, one of which was done in December 2014. Under the 2014 revised “*Agreement on Trade between the Royal Government of Bhutan and the People’s Republic of Bangladesh*”, Bhutan granted duty free access to 90 products listed in the exportables from Bangladesh to Bhutan. On the other hand, Bangladesh granted duty free access to 18 products from Bhutan and rest of products listed in the exportables from Bhutan to Bangladesh have been given the Most Favored Nation (MFN) treatment.

In 2017, the two nations signed the “*Memorandum of Understanding on the Use of Inland Waterways for Transportation of Bilateral Trade and Transit Cargoes Between the Royal Government of Bhutan and the Government of the People’s Republic of Bangladesh*”. This MoU provided for Bhutanese export and import goods between maritime ports of Bangladesh and destinations in Bhutan through the waterways and riverine routes of Bangladesh<sup>65</sup>. The first consignment using the inland waterways of Bangladesh arrived in Bhutan in 2019<sup>66</sup>

Building on the previously existing agreements and MoU, Bhutan and Bangladesh signed the Preferential Trade Agreement (PTA) on 6th December 2020 against the backdrop of the 50th Anniversary of Bhutan’s recognition of Bangladesh. As spelled out in the “*Preferential Trade Agreement Between the People’s Republic of Bangladesh and the Royal Government of Bhutan*”, the

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<sup>64</sup> Agreement on Trade, Commerce and Transit between the Royal Government of Bhutan and the Government of the Republic of India. <http://www.moenr.gov.bt/wp-content/uploads/2017/07/2016-En-Agreement-on-Trade-and-Commerce.pdf>

<sup>65</sup> MoU on Use of Inland Waterways for Transportation of Bilateral Goods and Transit Cargoes Between the Royal Government of Bhutan and the Government of the People’s Republic of Bangladesh.

<sup>66</sup> The Executive Report-One Year in Office. Cabinet.



objectives include establishing a preferential trading agreement, facilitating, promoting, and diversifying bilateral trade, and eliminating trade barriers. With the endorsement of PTA, Bhutan has been enjoying duty free export of 16 additional products to the already existing 18 products and 10 more products from Bangladesh have been given duty-free export to Bhutan<sup>67</sup>.

Aside from India and Bangladesh, Bhutan has a notable trade with Thailand especially in terms of import. Thailand has been a major source of import for Bhutan with it being positioned 4th in the country wise import ranking in 2021 and 3rd in 2022 according to Bhutan Trade Statistics 2021 and Bhutan Trade Statistics 2022 respectively. The two countries share a trade and economic cooperation agreement as of now. To further bolster the trade and economic cooperation, the two countries agreed to study and sign a bilateral trade agreement during the Joint Trade Committee Meeting (JTCM) held in Thailand in April 2022<sup>68</sup>. Authorities in Thailand also initiated the pest risk analysis for Bhutanese potatoes, apples and mandarin so that they can import it.

Besides, under the duty-free quota-free (DFQF) scheme guaranteed to the LDCs, Bhutan enjoys market access to Thailand for a wide range of agricultural and non-agricultural items. Bhutan is expecting to export honey, quinoa, asparagus, buckwheat, lemongrass oil, cardamom, ginger, turmeric, cordyceps and mushroom after meeting the sanitary and phytosanitary requirements. With imminent LDC graduation, Bhutan recognizes the importance of expediting the bilateral trade agreement with Thailand. The trade agreement will contribute to making Bhutanese products competitive Thailand's markets and will incentivize Bhutanese exporters.

Nepal is also an important trading partner of Bhutan. As discussed earlier, the country is a market destination for Bhutanese products as well as a source of import for Bhutan. Trade with the country is carried out based on economic and trade cooperation under the umbrella of the BIMSTEC Framework. Despite the significant trade flows, Bhutan and Nepal are yet to sign a bilateral trade agreement towards which end the discussion has already begun during the fourth bilateral trade talk between the two countries in June 2022<sup>69</sup>.

## **Priority Area 5: Structural economic transformation**

As a small developing nation, achieving economic growth and transformation has been accorded the highest priority in Bhutan. The successive governments have developed policies, strategies and plans aimed at building macroeconomic stability, diversifying the economic base and achieving progressive, balanced and sustainable development.

The 11th FYP has placed emphasis on sustaining economic growth as one of its priority areas. Under sustained economic growth, attention had been on sustaining the annual GDP growth of more than 10%, increasing the percentage of domestic financing to the total

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<sup>67</sup> Preferential Trade Agreement Between the People's Republic of Bangladesh and the Royal Government of Bhutan. Parliament of Bhutan.

<sup>68</sup> Dolkar, D. (2022). Bhutan and Thailand to have a bilateral trade. *Kuensel*. <https://kuenselonline.com/bhutan-and-thailand-to-have-bilateral-trade/>

<sup>69</sup> South Asia Regional Economic Cooperation. (2022). *Bhutan and Nepal prepare to sign a bilateral trade agreement*.

expenditure of over 85%, maintaining an average fiscal deficit of less than 3%, and controlling the inflation rate below 8%<sup>70</sup>. With the goal to further diversify the economy, there was a target on increasing the non-electricity export by the end of the plan period. To trigger rural economic growth by enhancing the access to finance, the government established Rural Enterprise Development Corporation Limited (REDCL) offices in all the districts to provide collateral-free loans to the rural entrepreneurs<sup>71</sup>. To foster the growth of CSIs, the Priority Sector Lending (PSL) scheme was also launched and the Royal Monetary Authority formulated the Priority Sector Lending Guidelines to provide wider access to finance<sup>72</sup>.

The government revised the Economic Development Policy 2010 and adopted the Economic Development Policy 2016. This policy embraced the promotion of “Five Jewels” (hydropower, CSI, agriculture, tourism, and mining) of Bhutan, Brand Bhutan, diversification of export base and harnessing alternative sources of energy as the key strategies<sup>73</sup>. It also recommended policy reforms to address constraints to business growth and drive the private sector as an engine of growth by creating an enabling environment for investment.

As discussed earlier, Bhutan has a comparative advantage in hydropower and its development has been perceived as having one of the greatest opportunities for economic transformation. With the continuous generation of hydropower which has been complemented by commensurate growth of industries and nationwide electrification, Bhutanese people have reaped immense benefits. Even the most far-flung remote settlements are supplied with clean and reliable electricity for cooking and heating purposes. Over the years, there has been a drastic rise in the domestic demand for electricity which may surpass the firm generation capacity. Acknowledging this matter, the Hydropower Development Policy 2008 of Bhutan was amended and the new Bhutan Sustainable Hydropower Development Policy (SHDP) 2021 was put in place since 2021.

The revised SHDP endeavors to enhance energy security in Bhutan and develop value chains based on clean energy <sup>74</sup>. According to the “*Bhutan Sustainable Hydropower Development Policy 2021*”, the objectives of the policy are to provide universal access to sustainable energy, enhance cross-border electricity trade, mobilize funds, develop clean and smart technologies, strengthen national and institutional arrangements, promote Bhutanese people’s participation, make Bhutan a knowledge hub for hydropower development and develop energy storage business such as hydrogen fuel, green ammonia, and other emerging technologies.

CSI development was also pursued considering its huge potential to diversify the economic growth. The 12th FYP emphasized the importance of promoting high value-added CSI and enhancing job creation in the sector. A dedicated flagship programme “*Startup & Small and Cottage Industries Development Flagship Programme*” has been implemented and the key domains were on easing the regulatory environment, promoting the culture of

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<sup>70</sup> 11th FYP. GNHC.

<sup>71</sup> State of the Nation Report 2016. Parliament of Bhutan.

<sup>72</sup> Annual Report 2016/2-17. Royal Monetary Authority of Bhutan.

<sup>73</sup> Economic Development Policy of Bhutan 2016. Royal Government of Bhutan.

<sup>74</sup> Launch of Sustainable Hydropower Development Policy 2021. Ministry of Economic Affairs

entrepreneurship, enhancing access to finance and incentive, developing human capital, and market access<sup>75</sup>. Under this program, 700 CSIs have been supported, three Business Incubation Centers were established in three colleges, and a dedicated CSI market outlet was opened in Thimphu to promote Made and Grown in Bhutan products<sup>76</sup>. Building on past initiatives to develop CSIs, the Cottage and Small Industries Policy 2019 has been passed to meet the demands of changing business environment<sup>77</sup>. Since access to finance was a key constraint to business growth in this sector, the National CSI Bank and Credit Guarantee Schemes were introduced to ensure business continuity and sustainability especially in wake of COVID-19. CSIs accounted for 95% of the total number of industries in Bhutan generating more than 90,000 employment<sup>78</sup>.

Agriculture sector is the main source of livelihood for the Bhutanese people. Today, 48.7% of Bhutanese are dependent on agriculture and its GDP contribution in 2021 stood at Nu 36,036.73 translating into 19.19% share of economy<sup>79</sup>. Today, Bhutan has achieved 100% self-sufficiency in eggs, 84.66% in dairy, 84% in vegetables, 72.27% in maize. 34.71% in rice and 34.18% in meat<sup>80</sup>

Acknowledging its importance, various initiatives have been undertaken such as sustainable land management, product certification, infrastructural development, and enhancing marketing and export. To address the shortage of irrigation water, smart irrigation systems were adopted such as drip irrigation, automated drip system, drip and sprinkler system, dryland irrigation system and automated drip and irrigation system. In 2021 alone, 289 acres of land were supplied with smart irrigation systems<sup>81</sup>.

Emphasis on transition from subsistence farming to commercial farming was placed a few decades ago. The 11th FYP recognized “*Transition from subsistence agriculture to commercial agriculture*” as one of the strategies to upscale agricultural development. Accordingly, the adoption of modern technologies and farm mechanization were emphasized. The Farm Machinery Corporation Limited (FMCL) was incorporated as SOE in 2016 under the Company Act of the Kingdom of Bhutan 2000. In accordance with its mandates of hiring, selling, and repairing farm machinery and enabling contract farming, it has provided farm machinery to farmers and farm enterprises. According to the 12th FYP Mid-Term Review Report (2021), 40,708 acres were brought under assured irrigation and 31,746 acres were brought under farm mechanization in the 12th FYP alone.

Initiatives include addressing human-wildlife conflict through electric fencing. A cumulative of 3,596.5 KM of electric fencing was installed across the country as of 2021<sup>82</sup>. In recent years, the government approved the construction of chain link fencing worth Nu.500 million to further the efforts in reducing farm loss to wildlife. Other initiatives included the development of market infrastructures such as cold storages and farm roads, sustainable

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<sup>75</sup> 12th Five Year Plan of Bhutan. GNHCS.

<sup>76</sup> 12th Five Year Plan Mid-Term Review Report. GNHCS.

<sup>77</sup> Cottage and Small Industries Policy 2019. Ministry of Economic Affairs.

<sup>78</sup> Annual Report 2020-2021. Department of Cottage and Small Industries, Ministry of Economic Affairs.

<sup>79</sup> National Accounts Statistics 2022. National Statistics Bureau of Bhutan.

<sup>80</sup> State of the Nation Report 2022. Prime Minister’s Office of Bhutan.

<sup>81</sup> State of the Nation Report 2022. Prime Minister’s Office of Bhutan.

<sup>82</sup> 12th FYP Mid-Term Review Report. GNHCS.

forest and resources management, product certification, and livestock development enterprises. One notable program is the National Organic Flagship Programme which is currently under implementation in the 12th FYP.

Since agriculture is a climate sensitive sector, the Sector Adaptation Plan of Action (SAPA) 2016 was formulated to enhance biodiversity, forest and food security against the increasing events of natural disasters and climate change. The government also launched the Agriculture Land Development Guidelines (ALDG) in 2017 to minimize risks of land degradation and strengthen land management<sup>83</sup>. In order to alleviate poverty and enhance food production by providing land to the landless, the National Land Commission Secretariat initiated National Rehabilitation Programme (NRP) which benefitted more than 4,600 households<sup>84</sup>.

Tourism sector is one of the major sources of revenue for Bhutan. Bhutan's gross receipt in 2019 was Nu 225.87 million and the total tourist arrivals were 315,559 visitors<sup>85</sup>. However, the onset of COVID-19 had a huge impact on the sector reducing tourist arrival by 91% and gross receipts by 92%<sup>86</sup> in 2020 and it came to a complete halt with the closure of the international border. Bhutan formally reopened the tourism sector on 23rd September 2022.

Recognizing its importance, various transformation initiatives were implemented to enrich the tourism sector. The Tourism Council of Bhutan (TCB) adopted "*Taking Tourism to The Top by 2023*" as an organizational motto. These aspirations embraced two dimensions, firstly to make Bhutan one of the top tourist destinations and secondly to make the tourism sector a key economic sector<sup>87</sup>. Bhutan's tourism policy since the beginning of the sector in early 1970s has been that of "*High Value and Low Impact*." This policy has served to assure that tourism in Bhutan is socially and culturally acceptable, environmentally friendly, and economically viable.

The government of Bhutan adopted the Tourism Levy Act of Bhutan in 2020. With its adoption, there has been an imposition of concessional sustainable development fees for regional leisure tourists or visitors from India, Bangladesh, and Maldives. The act came into force on 1st July, 2020 and hence SDF of Nu 1200 per tourist per night has been imposed on the regional tourists<sup>88</sup>. Previously, regional tourists were exempted from bearing any SDF whilst an international tourist paid an SDF of USD 65 per night which was covered in the Minimum Daily Package Rate (MDPR) of USD 250 per tourist per night during peak seasons and USD 200 during lean seasons.

Taking lessons from the disruption caused by COVID-19 pandemic, the Disaster Management and Contingency Plan for the Tourism Sector (DMCP) has been developed by the TCB in 2021 in consultation with the relevant stakeholders. The objective of the plan is to minimize the future risks of disruption and address vulnerabilities to natural and manmade disasters that could undermine business competitiveness and sustainable

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<sup>83</sup> Agriculture Land Development Guidelines, 2017, Department of Agriculture, Ministry of Agriculture and Forest, Royal Government of Bhutan (<http://www.nssc.gov.bt/>)

<sup>84</sup> <https://www.nlcs.gov.bt>

<sup>85</sup> Bhutan Tourism Monitor 2019. Tourism Council of Bhutan.

<sup>86</sup> Annual Report 2020/2021. Tourism Council of Bhutan.

<sup>87</sup> Dradhul, D. (2019). Tourism Policy-the Way Forward. *The Druk Journal* 5(3),7-10

<sup>88</sup> Tourism Levy Act of Bhutan 2020. Parliament of Bhutan.

development of the tourism sector<sup>89</sup>. The plan syncs well with the Tourism Policy of the Kingdom of Bhutan 2021 and the Disaster Management Act of Bhutan 2013 which places requirements on sectors to frame contingency plans to tackle disasters. It provided an overview of the tourism sector, detailed the development of the tourism disaster management system, discussed the hazard, vulnerability, and capacity assessment, contained action plans, and presented the contingency plan and standard operating procedures.

In line with the reforms in the tourism sector, the government also passed the Tourism Levy Act of Bhutan 2022 and the act came into force on 20th June, 2022. The objectives of the act are aligned to further promoting Bhutan as an exclusive high-end tourist destination and deliver quality services to the visitors. One of the transformative provisions of the act has been the increment of SDF for international tourists from USD 65 to USD 200 per tourist per night<sup>90</sup>. However, the act empowers TCB to grant a concessional levy subject to conditions prescribed in the rule such as exemption to children of five years and below, 50% concession to children between 6-12 years and other exemptions deemed necessary.

Other changes in tourism include the introduction of domestic tourism through the launching of *Druk Kora*<sup>91</sup> and *Druk Neykor*<sup>92</sup>, digitization of tourists sites and destinations, development of infrastructures and professionalization of tourism employees. Bhutan also changed the previously existing destination brand “Happiness is a Place” and launched a new brand “Bhutan Believe” in 2022 which will also serve as a national brand. The new brand is reflective of the essence that makes Bhutan remarkable to the world, targets visitors who will become our brand ambassadors, and aspires provision of authentic worthy services and products to the visitors. The Sustainable Tourism Development Flagship Programme is currently under implementation in the 12th FYP with the aim to increase tourism’s GDP contribution and enhance rural livelihood balanced regional development.

Although Bhutan has achieved significant economic growth with an annual average economic growth rate of 7%<sup>93</sup>, it still is plagued with various challenges. The economy is largely undiversified with high dependence on a few sectors such as hydropower, agriculture, and forestry. This makes the Bhutanese economy vulnerable and highly sensitive to external shocks.

Bhutan also records an increasing trade deficit over the years with a significant volume of imports and a low volume of exports. The trade deficit in the FY 2021-2022 has reached Nu 59.6 billion translating to a trade deficit of 31% of GDP<sup>94</sup>. The quality of the trade deficit is worrisome given the fact that a majority of imports are finished goods and the exports are predominantly low-value-added goods or raw materials. While the demand for imports is rising, Bhutanese products face the issue of competitiveness in the regional and international

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<sup>89</sup> Disaster Management and Contingency Plan for the Tourism Sector. (2021). Tourism Council of Bhutan.

<sup>90</sup> Tourism Levy Act of Bhutan 2022. Parliament of Bhutan.

<sup>91</sup> Druk Kora with the slogan Bhutanese Exploring Bhutan is a reference platform for exploring tour packages within Bhutan.

<sup>92</sup> Is a packaged nationwide pilgrimage tourism product that connects sacred sites in Bhutan.

<sup>93</sup> National Accounts Statistics from year 1988–2018. Government of Bhutan. National Statistics Bureau.

<sup>94</sup> Macroeconomic Situation Report-First Quarter Update 2022-23. Department of Macro Fiscal and Development Finance, Ministry of Finance.

markets due to economies of scale, high transportation costs, and the developing logistics sector.

Because of the limited domestic resource mobilization, most developmental activities are financed through development grants and borrowings. The need to finance developmental activities through loans has resulted in a high accumulation of debt. As of 30 September 2022, the total public debt stock stood at Nu 256,993.907 million accounting for 124.5% of the GDP and external debt comprised 119%<sup>95</sup>. From the external debt, hydropower constituted 78.9% due to which the debt stress is deemed moderate as the hydropower loans are self-liquidating<sup>96</sup>. Grants on the other hand have seen a decreasing trend in recent years mainly on account of the serious economic impacts caused by the pandemic and the receding global economic outputs.

Despite the efforts to promote the private sector, the private sector is still at a nascent development stage. Its growth is inhibited by various factors such as limited access to finance, lack of human capital, inadequate business services and limited market access. Against the undeveloped private sector and limited job opportunities in the public sector, Bhutan is faced with a high unemployment rate especially among the youths. As of 2022, Bhutan unemployment rate was 5.9% and its youth unemployment rate stood at an ever high of 28.6%<sup>97</sup>.

Challenges also exist in the fields of education and health sector. Although the adult literacy rate has increased from 63%<sup>98</sup> in 2012 to 70.2%<sup>99</sup> in 2022, the education system suffers from the dearth of qualified teachers. The inadequacy of teaching professionals is further intensified by the high attrition rate among the teachers. Schools especially in the rural areas also continue to experience a shortage of quality infrastructures and low adoption of modern teaching facilities. These have direct consequences on the learning outcomes of the students. Similarly, Bhutan's health sector suffers from the shortage of doctors and nurses. According to the Annual Health Bulletin 2022, the number of doctors per 10,000 population in 2021 is 354 which is way below the WHO requirement of one doctor per 1,000 population<sup>100</sup>. Similarly, the nurse density per 10,000 population is 21.07 which is one of the lowest in Southeast Asia<sup>101</sup>.

Bearing in mind Bhutan's fragile and mountainous ecosystem with cornerstones of our economy being climate-sensitive hydropower and agriculture sector, Bhutan is unlikely to escape the threats and losses caused by climate change. Natural disasters such as landslides, earthquakes, floods, and forest fires continue to impede Bhutan's development gains. The melting of glaciers which are sources of hydropower and drying up of upstream river sources are becoming great concerns. As well, a single earthquake or a major glacial lake outburst flood could perhaps irrevocably damage Bhutan's economy.

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<sup>95</sup> Public Debt Situation Report- For the Quarter Ended 2022. Development Coordination and Debt Management Division, Department of Macro-Fiscal and Development Finance.

<sup>96</sup> Macroeconomic Situation Report-First Quarter Update 2022-23. Department of Macro Fiscal and Development Finance, Ministry of Finance.

<sup>97</sup> 2022 Labour Force Survey Report. National Statistics Bureau.

<sup>98</sup> Bhutan Living Standard Survey 2012. National Statistics Bureau.

<sup>99</sup> Bhutan Living Standard Survey 2022. National Statistics Bureau.

<sup>100</sup> Annual Health Bulletin 2022. Ministry of Health, Royal Government of Bhutan.

<sup>101</sup> Annual Health Bulletin 2022. Ministry of Health, Royal Government of Bhutan.

## Priority Area 6: Means of implementation

### 6.1 Domestic resources mobilization

Bhutan's socio-economic development which is steered through the national FYPs has been primarily financed through development assistance and domestic resources. To upscale domestic financing capabilities, the government has been embracing various means such as broadening the tax base, prudent fiscal management, private sector participation, and issuance of bonds and priority investment in economically viable sectors. The 11th FYP recognized the importance of domestic resource mobilization as highlighted in its overall objective of achieving "*Self Reliance and Inclusive Green Socio-economic Development.*" In the context of the plan's objective, self-reliance is interpreted as "the ability to meet all our national development needs as articulated in the 5-year plans by 2020<sup>102</sup>." The 11th Plan's *NKRA 1: Sustained Economic Growth* had "*Percentage of domestic financing to total expenditure enhanced*" as one of the KPIs. The focus under this KPI was to increase the domestic financing to total expenditure from the baseline of 65% to more than 85% by the end of the plan period (2017/2018).

The 12th FYP which is under implementation pursues the goal of covering at least 80% of the total expenditure by domestic revenue<sup>103</sup>. In order to strengthen the domestic resource mobilization, a midterm revenue strategy has been adopted which focuses on measures such as maintaining the tax-to-GDP ratio above 12%. Towards this end, the importance of replacing the sales tax regime with a modern GST was recognized. Building on the preparatory works to initiate GST towards the end of the 11th FYP, the GST Act has been passed which has laid the legal basis to introduce GST. Other interventions to increase the domestic resource mobilization include the rationalization of recurrent expenditure, reviewing and revision of existing tax exemptions, introduction of new taxes, fostering private sector participation and improving the efficiency and effectiveness of the capital investment.

Despite the initial domestic resource projection of Nu 217,000 million in the 12th FYP, the impact of COVID-19 has affected the resource mobilization target. According to the 12th Five Year Plan Mid-Term Terminal Review Report (2021), the domestic revenue is projected to decline by about 18% amounting to Nu 178,000 million from the initial projection. Given the decline in domestic revenue, efforts to contain the aftermath of COVID-19 and stimulate economic growth have been undertaken by prioritizing fewer priority activities such as construction of office or staff quarters, training, awareness, workshops, professional services, travel, etc. As of today, Bhutan has achieved to finance 64% of its total expenditure through domestic revenue and the tax-to-GDP ratio is well on track at 12.7<sup>104</sup>.

### 6.2. Official Development Assistance (ODA)

Bhutan is largely reliant on external assistance including bilateral and multilateral assistance to finance and sustain the country's developmental activities. ODA constituted more than 55% and 54% of the total capital expenditure in the 11th FYP and the 12th FYP respectively. From the development partners, India has been the greatest source of external grants as well as

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<sup>102</sup> 11th Five Year Plan of Bhutan. GNHCS.

<sup>103</sup> 12th Five Year Plan of Bhutan. GNHCS.

<sup>104</sup> 12th Five Year Plan Mid-Term Review Report. GNHCS.

loans with more than 50% of external grants provided by India. In the 12th FYP alone, India committed a grant of 45 billion for the implementation of project-tied assistance (PTA) projects, high-impact community development projects, and program grant support to Bhutan. An additional 4 billion was committed towards a transitional trade support facility to develop trade infrastructure and trade governance mechanisms in Bhutan.

Other significant sources of grants include EU, Japan, World Bank, ADB and UN agencies. Besides the external grant, the Royal Government has also received interest-free loans from the World Bank and concessional loans from ADB. To maximize the benefits from the grants and loans, Bhutan has ensured sound governance and prudent investment practices in accordance with international finance commitments.

As Bhutan is set to graduate from LDC, Bhutan will need the continuous support and assistance of its development partners to ensure that the loss of certain support measures does not impede Bhutan's development or overturn its development gains. Since the domestic resource mobilization in terms of financing capital expenditure is still low, overseas development assistance will be inevitable to sustain Bhutan's economic growth, especially with the aspiration to become a developed nation.

### **6.3. Foreign direct investment**

Foreign direct investment (FDI) remains a crucial source of finance for a developing nation like Bhutan. As of 2022, Bhutan has a total of 101 FDI projects with a major share of the FDI being in the hotel and IT sectors with 36% and 22% respectively<sup>105</sup>. From the regions, Asia constitutes the highest source of FDI with 67% followed by Europe with 16% and America with 10%. From within Asia, India remains the source of investment in Bhutan with 51% followed by Singapore (15%) and Thailand (10%).

In terms of employment, FDI projects in Bhutan directly employ a total of 4,601 Bhutanese as of 2022. Considering the approved FDI companies awaiting their commercial operation and the number of expatriate employees in the operating companies, the employment figure reaches to more than 5,200. In its efforts to develop the FDI pool, the Royal Government has been introducing policy reforms, creating a public information and credit register and simplifying the procedures necessary for doing business and its establishment.

Bhutan revised the previously existing FDI Policy 2014 and adopted the new FDI Policy 2019 and FDI Rules and Regulations 2019. The new policy takes cognizance of the changes in the investment and business environment and is geared towards making the policy more relevant and investor friendly. It also focuses on encouraging investment, especially in the priority areas that will ultimately contribute to the development of a green and sustainable economy, promotion of socially responsible, ecologically friendly, culturally and sensitive industries,

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<sup>105</sup> FDI Annual Report. (2022). Invest Bhutan Division, Department of Industry, Ministry of Economic Affairs.



promotion of Brand Bhutan, creation of a knowledge society and enhance economic diversification through export promotion and import substitution<sup>106</sup>. The key interventions include the adoption of new technology, skills acquisition, and enhanced market access by inviting FDI joint ventures with local partners in production and manufacturing industries and in service sectors.

Despite making significant efforts to attract foreign direct investment by introducing policy reforms and offering incentives, Bhutan struggles to draw major global investors. The net inflow of FDI in Bhutan is reported to be significantly below the average level of South Asian countries, LDCs, and Asian Countries. Further efforts are still required to improve the ease of doing business and create a favorable investment climate by investing heavily in infrastructure, energy, transportation, and G2B services.

#### **6.4. Private sector participation**

Bhutan understands the significance of private sector development as a catalyst for economic growth and a means of creating job opportunities. According to the National Statistics Bureau of Bhutan, the private sector in Bhutan has over 24,500 establishments<sup>107</sup>. Over the years, the private sector's presence and contribution have expanded into multiple sectors such as education, health, financial services, communications, and technology from a concentration on agro, forest, and mineral-based industries.

The private sector has been playing a vital role in the human capital development of Bhutan. About 6% of students go to private schools with the proportion being higher at the higher levels of education. 23% of the students go to private institutes at the higher secondary level and the percentage of students pursuing their tertiary education from private colleges comprise 27%<sup>108</sup>. There are also around 58 private ECCD centres across Bhutan catering to the early learning needs of the children<sup>109</sup>. With further consolidation and increasing emphasis to open up the private sector in education, the role of private institutes in imparting education to Bhutanese children will increase in the coming years. There are also a considerable number of private training institutes that provide a myriad of skills development and training programs to the Bhutanese people starting from driving to IT skills, culinary arts to hospitality services, coaching classes to entrepreneurship workshops, etc.

The private sector has played a significant role in improving the transport and communication facilities in the country. Bhutan Airlines since 2011 has been complementing the air transport services provided by Druk Air and extended an alternative air service for passenger and goods transport beyond Bhutan. Similarly, Tashi Infocomm, a private mobile company, has been providing telecommunications services alongside Bhutan Telecom. The private sector

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<sup>106</sup> Foreign Direct Investment Policy 2019. Ministry of Economic Affairs, Royal Government of Bhutan.

<sup>107</sup> Statistical Yearbook of Bhutan 2020. National Statistics Bureau.

<sup>108</sup> Bhutan Living Standard Survey Report 2022. National Statistics Bureau.

<sup>109</sup> Statistical Yearbook of Bhutan 2022. National Statistics Bureau.

also contributed to the transportation needs of the country. According to the Road Safety and Transport Authority, there are more than 6,000 taxis as of June 2022 besides the presence of buses offering transportation services to every part of the country. Private entities have also been carrying out a bulk of the surface transport, especially road construction and maintenance works.

The private sector has also contributed significantly to employment generation. Second to agriculture, the employment share in the private business accounts for 28.7%, and private limited company's employment share is 3%<sup>110</sup>. Excluding those employed in the agriculture sector, the private sector employs approximately 90,000 individuals. Given the small public sector and the compact and efficient civil service, the private sector remains the major source of employment for Bhutanese people. The sector also served to diversify the economic base through the establishment of new businesses mainly cottage, small and medium industries. The existing and new industries have introduced new products and services for export purposes as well as for import substitution. This has directly contributed to diversifying the limited export basket. Value addition in the products and services have also been bolstered by the private enterprises.

The private sector also served to generate sources of finance for socio-economic development purposes. Local entrepreneurs have attracted FDI and fund support for developing new products and services. Through consumption and tax payment, the sector has significantly contributed to the government's revenue thereby enabling the government to invest in socio-economic development or sustain the development gains. Through various contributions, the private sector indeed has been serving as the strategic partner of the government in implementing the priority areas of the VPOA.

However, the expansion of private sector businesses has been hindered by various factors including a limited domestic market, high costs associated with trade, and imperfections in the investment climate<sup>111</sup>. The GDP contribution from the private sector is around 40% which is way below the 60 to 70% expected of an emerging economy. A majority of the private sector is concentrated in wholesale and retail trade, and hospitality and are single proprietorship. Most of the private sector also depends on the import of raw materials which negatively influences Bhutan's trade balance and the value addition is still insignificant. There are opportunities for innovation and value addition with a focus on developing more export-oriented industries.

Some of the common challenges encountered by the private sector include lack of market access, access to adequate finance, lack of talent and skilled human capital, and difficulty in terms of the regulatory and business environment.

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<sup>110</sup> Labour Force Survey Report 2022. National Statistical Bureau.

<sup>111</sup> Investment Climate Assessment of Bhutan 2017. Asian Development Bank.

## **V. Monitoring of implementation and review**

To achieve the desired outcomes and outputs at the end of the plan period, the FYP of Bhutan employs a results-based management strategy through NKRA, Agency KRAs, and LG KRAs, along with their corresponding KPIs and programs. On a yearly basis, these KRAs are prioritized and transformed into annual performance agreements (APA) that are signed between the Prime Minister and the implementing agencies, including LGs, with the aim of focusing on performance and results achievement. The APA framework lays out yearly targets with key indicators, activities, and budgets, emphasizing accountability.

The implementation and progress of the APA are regularly monitored, reviewed, evaluated, and provided with technical support for problem-solving through the government's planning, budgeting, accounting, monitoring, and evaluation systems. This is done through a coordinated effort led by the Prime Minister, involving multiple sectors and agencies. The same mechanism is also used to monitor and review the progress of the VPoA as it is usually integrated into the national and sectoral plans.

The national plans also undergo mid-term reviews to take stock of the progress, make mid-course corrections, and strengthen the implementation of the priority areas. The mid-term review provides an opportunity to recognize the challenges restraining the achievements of the development indicators and embrace solutions to ensure the achievement of the risky targets. At the end of the plan period, the terminal review is undertaken which reviews the achievement of the plan targets and achievements made. It also takes cognizance of the activities that will spill over into the next plan. This mid-term review and the terminal review of the plan serve as the mechanisms to monitor and review the implementation of international commitments related to SDG, LDC, and LLDCs.

## **V. Towards the Next LLDC Programme of Action**

Being a landlocked least developed country, Bhutan faces numerous challenges with regard to structural economic impediments and inherent geographical limitations. Bhutan is a small economy characterized by limited domestic resources and high dependence on grants and borrowings. The economy is largely undiversified which is predominantly driven by a few climate-vulnerable sectors such as agriculture and hydropower. Due to high reliance on imports and limited exports, the country is experiencing increasing trade deficit which is further aggravated by global inflation in food and fuel prices.

Furthermore, the landlocked status continues to remain a challenge in accessing international markets and participation in global trade and investment opportunities. Climate change and natural disasters pose grave threats to the country's progress toward sustainable development goals. While glacial lake outburst floods, landslides, and earthquakes continue to destroy our vital infrastructures, the melting of glaciers and drying up of water sources pose serious threats to the country's economy especially to hydropower and agriculture sectors. Limited productive capacity, underdeveloped infrastructure, low innovation, limited adoption of

science and technology, and underdeveloped private sector are other challenges that impact Bhutan's advancement.

In cognizance of the aforementioned challenges, the next program of actions must primarily focus on expanding the productive capacity of the LLDC economies. Productive capacity is the basis on which countries can achieve meaningful structural transformation and a diversified economy.

Science, technology, and innovation play a vital role in achieving broader development objectives. The next development agenda should prioritize tackling the inadequate capacity of LDCs to leverage the advantages of science and technology, as well as the development of digital and technological infrastructure.

With the decreasing trend of grants and phasing out of certain benefits in lieu of Bhutan's imminent LDC graduation, the focus should also be in terms of identifying and mobilizing innovative sources of finance. Interventions to enhance national capacity to access complex international financing mechanisms will be crucial.

Support in formulating strategies and programs to expedite the process of structural transformation suited to each country's developmental context will also be crucial. In this regard, targeted assistance in developing domestic enterprises and their competitive advantage should be featured in the next LLDC development agenda.

A special and dedicated focus should also be on addressing the issues of climate change and environmental degradation. How to build resilience, mitigate and adapt to natural disasters and also ensure sustainable management of natural resources must be taken into account. Building capabilities in tackling climate change must necessarily have an emphasis on enhancing access to climate finance besides technology and know-how transfer.

There should also be a focus on improving the capacity of countries to fully recover from the impacts of COVID-19 as well as build preparedness to minimize the impact of future shocks and crises.

At the regional and global level, emphasis should be on reinvigorated partnerships to sustain the development gains and further extend the existing support measures. Targeted support in terms of human capital development particularly in health, education, and ICT would become indispensable.

The continuous support of the development partners and the UN system would be crucial in sustaining the development progress achieved by LLDCs. While focusing on new support measures, equal efforts must be piled on sustaining what has already been achieved by the respective countries.