Public Disclosure Authorized

Public Disclosure Authorized

Public Disclosure Authorized

87029

April 2014

Bhutan Development Update

Poverty Reduction and Economic Management, South Asia Region

The World Bank

Contents

Summary 3
Recent Economic Developments 4
Official unemployment is relatively low and declining: so why is it an issue? 13
Special Focus 1: Malnutrition and Stunting Demand a Coordinated Response 15
Special Focus 2: Pioneering Cultural Heritage Protection as a National Asset 17

Figure 1:Economic Growth in Bhutan – 4
Figure 2: Inflation and its Contributors 6
Figure 3: Wage Bill of Bhutan 7
Figure 4: Bhutan's Balance of Payments (% of GDP) 9
Figure 5: Credit Growth has Slowed Sharply along with a Construction Squeeze… 10
Figure 6: Construction & Personal Loans drove Credit Growth 11
Figure 7 Unemployment affects mostly youths and urban women 13
Figure 8: Anemia Prevalence in Women (by age) 15

Table 1: Electricity Tariffs in Bhutan are Low 4
Table 2: Cement Production 5
Table 3: Government Budget 7
Table 4: Poverty Dynamics* 12

Box 1: Factors Impacting Macroeconomic Development in 2013 & 2014 5
Box 2: Features of the Economic Stimulus Plan 6
Box 3 : The Chhukha Tariff's Upward Revision 9
Box 4 : Government's Plan for Full Employment 14

Summary

After a policy-engineered slowdown in 2012, which saw GDP growth decline to 4.8 percent, the lowest since 2008, Bhutan's economy is expected to rebound to 6.5 percent this year, supported by hydropower construction and higher electricity and food production, following favorable rains.

The tight fiscal stance introduced in 2012 has been maintained to bring spending in line with lower non-hydro revenues and a slowdown in foreign grant disbursements, but the revenue situation is expected to improve with the commissioning of cement and electricity projects. This may provide space for an increase in public sector compensation to offset recent declines that have occurred in the face of an average 8 percent annual increase in the CPI over the past five years.

Bhutan's external debt, at 85 percent of GDP, remains high, but is likely to fall sharply as assured hydropower revenues begin to flow from projects for which the external loans were taken. However, its narrow exports base and the large rupee-reserves mismatch make the country vulnerable to shortfalls in external earnings and pose a moderate risk. Although gross international reserves rose to US$920.8 million at end-November 2013, only 12 percent was in the Indian Rupee, which is needed for trade settlement and debt service.

Liquidity in the banking system has eased and measures have been taken to improve the monetary transmission mechanism, which should improve the monitoring of liquidity conditions. This is important as negative real loan rates persist, accounting partly for the 30 percent annual increase in nominal credit over the past decade.

Bhutan's success in reducing absolute poverty is noteworthy, with the poverty rate falling from 23 percent in 2007 to 12-13 percent in 2012, improving the lot of the poorest segments of the population rather than merely that of those clustered around the poverty line. A rapid growth of commercial agriculture, expanding rural infrastructure, and beneficial effects from the construction of massive hydropower projects has established a sound platform for further poverty reduction. However, continued out-migration to urban areas and vulnerability of infra-marginal groups, the relative absence of formal social protection institutions, youth unemployment, and the persistence of malnutrition, anemia and stunting point to the need for continued effort at tackling non-income poverty. Further, a better framework for managing Bhutan's cultural assets could improve employment opportunities, especially in rural areas, among poorer segments of the population.

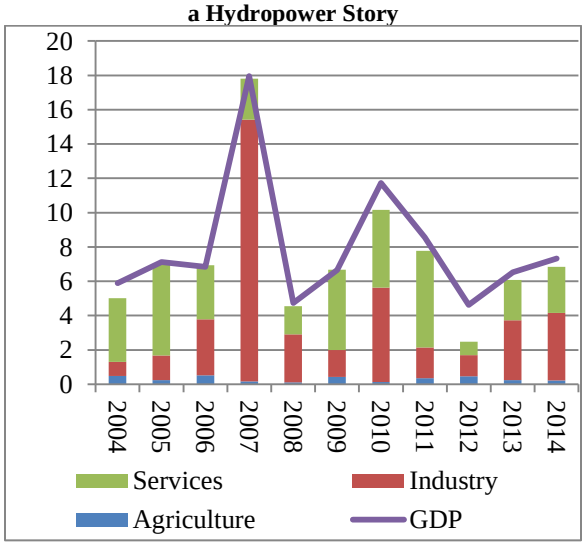
The macroeconomic projections for 2014 set GDP growth at 7.3 percent, stemming from new projects, increased tourism receipts, easier credit conditions and the effects of the Economic Stimulus Plan.

Recent Economic Developments

Growth has been volatile, dependent on hydropower developments and disbursements from India

Economic growth is expected to rebound in 2013.[1] While administrative measures have been maintained throughout 2013, growth is expected to recover to an estimated 6.5 percent supported by hydropower projects under construction, good rainfall (leading to more electricity generation), and better agricultural performance (Figure 1). In 2012, corrective administrative measures to stop the rupee shortage led to a sudden halt in construction and service growth in 2012 which, combined with a poor record in agriculture, contracted growth to 4.6 percent, the lowest level since 2008. In 2013, hydropower has benefited from better rainfall, leading to a 10.7 percent increase in electricity generation.[2]

Figure 1:Economic Growth in Bhutan – a Hydropower Story



Sources: National Statistical Bureau and Macroeconomic Framework Coordination Committee (MFCC)

With reportedly improved paddy production and a record increase in vegetable production, 2013 is expected to see an agricultural rebound. Although it employs more than two-thirds of the population, agriculture has grown sluggishly. The Food & Agriculture Organization expects the paddy harvest in 2013 to increase to 88,000Mt (a 4 percent increase compared to 2012, or 50 percent of domestic consumption), while vegetable production has reached 98 percent of consumption, despite cyclone Phailin damaging crops across the country in the fall of 2013. Increased plantings and higher yields through irrigation, mechanization, and introduction of high-yielding varieties are the factors behind the increase.

Increased industrial electricity tariffs are raising concerns about the profitability of the ferro-alloys industry. The industry is concentrated in steel, iron, and ferro-alloy products, selling mostly to external markets with India the primary destination. Bhutan being a price-taker, the performance of the sector depends largely on internationally determined metal prices the costs of inputs. The impact of the increased electricity tariffs – of about 30 percent from October 2013 to 2016 – should be modest, since the industry will still be price-competitive with those of India, China, South Africa, and Russia – the last two being world leaders in ferro-alloys (Table 1). We estimate, therefore, that the sector should continue to expand despite the higher energy cost.

Table 1: Electricity Tariffs in Bhutan are Low

2014		Electricity tariffs USD/KWH	above Bhutan
China	average	0.13	290%
South Africa	lowest	0.06	100%
	highest	0.17	430%
India	highest	0.16	400%
	lowest	0.05	40%
	West Bengal	0.13	300%
	Delhi	0.08	140%
Bhutan	national	0.03	0%

Source: WB staff calculations (various sources)

The construction sector besides hydropower has slowed significantly with the freeze on housing loans (see Figure 5). Construction in hydropower has been sustained, with four projects under construction at an average annual investment cost of 28 percent of GDP. Delays in construction of Punatshantchu I, following unforeseen geological challenges, have reportedly delayed commissioning of the plant

by a year, to FY17/18. Domestic sales of cement, a good proxy for construction-sector activities, slowed markedly in 2013 (Table 2). Cement production is expected to rebound in 2014, with the Dungsam Cement mega-project starting production.[3]

Table 2: Cement Production

Production in MT	2010	2011	2012	2013
Clinker Production	273,765	244,200	244,130	238,820
variation		*-11%*	*0%*	*-2%*
Cement Production	424,055	384,510	370,469	344,830
variation		*-9%*	*-4%*	*-7%*
Penden Cement Authority Ltd				

Services expansion in 2013 was subdued due to weak tourism growth, delay in the Puna I construction, and tightening of credit in the financial sector. The World Bank estimates that hotel, restaurants and trade/retail will grow at a low 10 percent in 2013. Banking sector activities in 2013 have been subdued, with liquidity drying up in step with the Royal Monetary Authority (RMA)'s restrictions on housing loans. Bhutan was able to draw only 10 percent more tourists last year, leading to a low 1 percent increase in convertible currency revenues – the lowest growth in five years.[4] Bhutan is facing rising competition from destinations such as Myanmar and Sri Lanka. Despite the rise of the dollar in 2013, Americans beat out the Japanese to reemerge as the top market, with 6,927 visitors compared to 4,015 Japanese. For the first time, China became the second-biggest market with 4,764 visitors, indicating a lucrative new tourism trend. Most visitors are Indian, qualified as regional tourism.[5]

The 2014 outlook is positive but macroeconomic pressures on domestic demand will have to be managed. We estimate growth to reach 7.3 percent supported by a combination of favorable factors (on-going construction of four hydropower projects, the commissioning of the Dagachhu project by mid-2014, Dungsam Cement coming on line, the possible lift of the bans on imports and housing credit, disbursement from India to finance the 11th Five-Year Plan (FYP-11, 2013-2018) leading to higher public capital spending, the economic stimulus plan, increased public wages expected in the FY14/15 budget, expansion of tourism with innovative measures).[6] This boost in economic activity could risk a resumption of overheating and macro imbalances. It will be important to tighten monetary and fiscal policies in light of (i) upcoming disbursements in the economic stimulus, (ii) a proposed increase in the public service wage bill, and (iii) proposed relaxation of restrictions over foreign exchange, vehicle imports, and housing loans. Fiscal tightening with consistent monetary policy measures will be needed to avoid a new episode of rupee shortage once the restrictions are lifted.

Box 1: Factors Impacting Macroeconomic Development in 2013 & 2014

2013

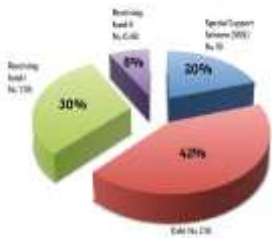
- Delay in Puna I construction (-)
- Good rainfall for agriculture and hydro generation (+)
- Better agricultural performance (rice and vegetables) through plantings & higher yields (+)
- Cyclone Phailin (-)
- Elections delaying budget readiness and public administration spending (-)
- Ongoing construction of four hydro projects worth twice Bhutan's GDP, or US$3.2 billion (+)
- Scheduled increase in electricity tariffs (-)
- Developments in India's inflation and exchange rate (+/-?)

2014

- Dungsam cement starts production early-2014 (+)
- Dagachhu project is commissioned mid-2014 (+)
- Boost in tourism revenues with new measures (+)
- Twenty percent public wage bill hike (+)
- Increase in electricity tariffs (+/-?)
- Four new joint-venture hydropower projects agreed (+)
- Economic stimulus plan introduced (+)
- Developments in India's inflation and exchange rate (+/-?)
- Possible lifting of bans on housing credit and imports of vehicles and furniture (+)
- Possible new fiscal measures to temper domestic demand if bans are lifted

Box 2: Features of the Economic Stimulus Plan

In an effort to address the issue of liquidity shortage and boost lending to productive sectors, the Economic Stimulus Plan (ESP) was formulated with a Rs 5 billion grant from the Indian government. Part of this assistance will be injected through the financial system to improve liquidity and create a revolving fund for collateral-free lending to productive sectors such as cottage and small industries, non-formal rural agri-based activities and youth education and employment. The stated intention is to help increase liquidity of financial institutions, and lending to export promotion, import substitution and employment-generating sectors.



Of the Nu 5 billion, Rs 1.9 billion is being allocated to a SME "revolving fund" to boost primary and secondary sectors and the rural economy in general. Under this allocation, Revolving Fund-I has been established with Rs 1.5 billion to support cottage- and small industries, including manufacturing and production centers. Revolving Fund-II, with the remaining Rs 0.4 billion set aside, will support non-formal activities, individuals and cooperatives, and rural enterprises.

In December 2013, the Bhutan's Prime Minister issued a government order to establish a Business Opportunity and Information Centre (BOIC) under the Ministry of Economic Affairs to administer and implement the Rs 1.9 billion SME Revolving Fund to ensure flows reach the priority sectors.

Of the remaining Rs 3.1 billion of the grant, Rs 2.1 billion will be injected into banks through a subordinated debt, strengthening their ability to lend to the private sector. The money will be injected into the banks based on the permissible limit under the prudential norms of the central bank, which is up to 50 percent of a bank's capital fund. Subordinated debts injected by the government into the banks have a ten-year repayment period but the interest (6 percent) will have to be paid annually.

The remaining Rs 1 billion will set up a Special Support Scheme, with sub-schemes for higher education, senior citizens, and guaranteed employment.

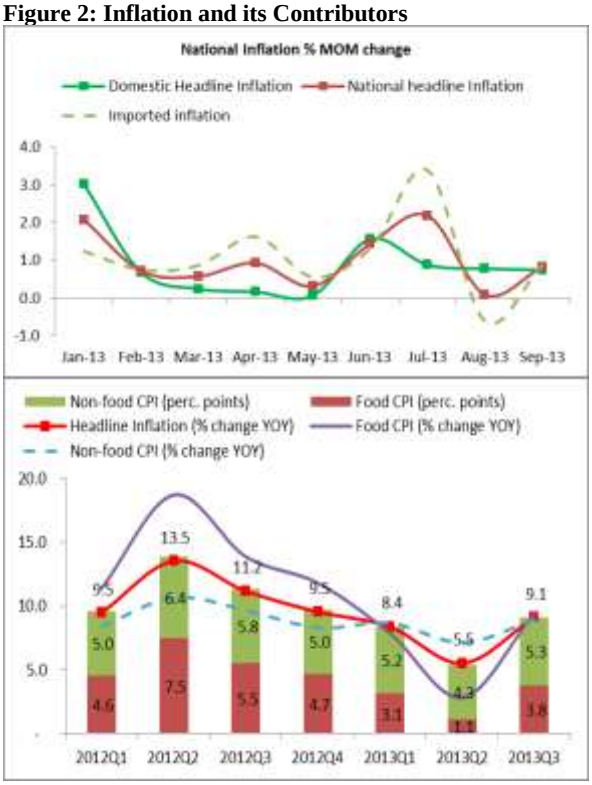
The Bhutanese government has already received Rs 3.7 billion of the Indian government's Rs 5 billion commitment, in three instalments of Rs 1 billion, Rs 1.5 billion, and Rs 1.2 billion.

Rs 4.2 billion will be injected into the economy in the first fiscal year, FY13/14, while the remaining Rs 800 million will be spread over the next four years. The government will release Rs 20M each year. The first tranche of funds, under ESP through a subordinated issue to the financial institutions, is scheduled for early 2014.

Inflation Closely Follows that of India

With 75 percent of Bhutan's imports coming from India and an exchange rate at par with the Indian rupee, Bhutan's consumer inflation is intimately linked to India's inflation. Food and beverages have the heaviest weighting in Bhutan's consumer price index, at 36.9 percentage points, and since most are imported from India, they will continue to have the strongest impact on overall inflation.

Figure 2: Inflation and its Contributors



Source: National Statistical Bureau

Despite the recent easing of inflation in in India during December/January, inflationary pressures will continue through 2014. Structural drivers of inflation in India, including rising food prices, are expected to persist. India's consumer price inflation averaged a rapid 10.1 percent in 2013 on the back of a weak rupee, supply-side shortages, rising demand, and changing consumption patterns (due to higher rural incomes). Any changes in subsidy policy (fuel, power, and fertilizer), or a monsoon shock, could boost inflation significantly.

Consumer price inflation in Bhutan accelerated to 11.3 percent, y-o-y, in the third

quarter of 2013, from 7.3 percent in the second quarter, and will reach around 10 percent in 2013. Inflation in 2014 and beyond will be driven largely by the scheduled rise in electricity tariffs, by up to 30 percent, but its impact on poverty should be modest, given the progressive nature of tariffs.

Tighter public spending kept the fiscal stance in check, despite a sharp decline in revenues

The government continues to rely heavily on foreign grants to finance its expenditure. Grants financed about 36 percent of total spending, or 10 percent of GDP, in FY12/13, 70 percent of it from the government of India. The budget for FY13/14 projected a decline of nearly 9 percent in nominal spending compared with the revised budget for the previous fiscal year. Given the persistent shortage of rupees, the government has tightened expenditures to bring them in line with available resources. Another reason for the spending dip is the slow start of the budget year because of the elections in the summer, change of leadership, and delays in foreign grant disbursements. Grants are expected to more than halve, from 15 percent in FY12/13 to about 6.6 percent of GDP, due to slow initiation of the 11th Five-Year-Plan (FYP).

Domestic revenue is projected to decline to 19.5 percent in FY13/14 from 20.8 percent of GDP in FY12/13 due to lower non-hydro revenues, particularly in the area of business income tax, excise duties and non-tax revenue.[7] Hydro revenue remains stable at 3.7 percent in FY13/14, with no new projects starting generation. The deficit in FY14/15 should ease to 0.7 percent of GDP, as more revenues will kick in with commissioning of the Dungsam cement project, the Dagacchu hydro electricity scheme, and the Chhukha power plant's electricity export tariffs revision (see Box 3).

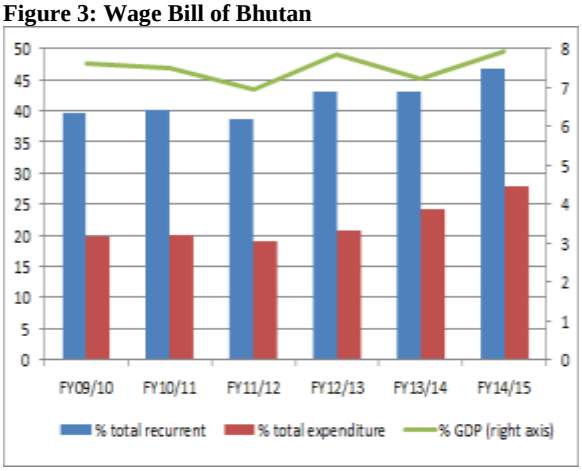
Table 3: Government Budget

As a Percentage of Nominal GDP	2012/13 *Revised*	2013/14 *Budget*	2014/15 *Proj.*
Revenue & Grants	**35.6**	**25.5**	**28.9**
Domestic Revenue	**20.0**	**18.9**	**18.6**
Tax revenue	14.6	13.4	13.7
Non-tax revenue	5.4	5.5	4.9
Grants	**15.0**	**6.6**	**10.3**
Project-tied Grants	12.0	5.2	9.0
Program Grants	3.0	1.4	1.3
Other receipts	0.6	0.0	0.0
Outlay	**36.6**	**30.0**	**29.6**
Total Expenditure	**37.3**	**31.6**	**31.1**
Current	17.7	16.2	17.6
Capital	19.7	15.4	13.4
Net lending (NL)	-0.7	-1.6	-1.5
Primary Balance	1.5	-2.8	0.9
Fiscal Balance	**-1.0**	**-4.5**	**-0.7**
Borrowings	15.9	2.3	4.8
Repayments	15.2	2.3	2.2
Resource Gap (dom. borrowing)	**-0.3**	**-4.5**	**1.9**

Source: Ministry of Finance

An upward revision of public compensations is under discussion for FY14/15. It could match the last three years' inflation to adjust civil servant purchasing power, but will also put pressure on domestic demand. It will be important to put tightening fiscal/monetary measures in place to counter-balance the increase in purchasing power in the public sector. Such measures could incentivize savings over immediate consumption. Taxation measures and strengthened macro-prudential regulations are being considered (see section on monetary and financial development) to replace existing bans on import and housing credit.

Figure 3: Wage Bill of Bhutan



Source: Ministry of Finance

Bhutan: Structure of Public Sector Debt

	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13
Total Public Sector Debt (percent of GDP)	75	66	57	69	72	90
External	71	64	56	66	71	85
Hydropower sector debt	46	41	36	43	46	52
Convertible currency debt	28	25	23	27	28	29
Standby facility with GoI			6	5	6	6
Domestic	4	3	2	3	1	6

Source: Ministry of Finance

Public Debt: is High Level also High Risk?

Bhutan's public and publicly guaranteed external debt increased to 85 percent of GDP by end-FY12/13, adding 14 percentage points of GDP to the previous year. The rise in the external public debt was driven in large part by hydro sector-related external borrowing (52 percent of GDP). Hydropower projects are financed primarily by India with a mix of loans (70 percent) and grants (30 percent). External debt continues to be denominated in Indian rupees (and related to hydropower sector debt), which accounts for 61 percent of total external debt, with convertible currency debt accounting for only 29 percent of GDP. Domestic debt was due entirely to a loan to purchase aircraft for national carrier Druk Air in FY9/10.

Bhutan's rapid hydropower development is projected to lead to a substantial buildup of external debt in the medium-term, with debt ratios breaching most of the country-specific indicative thresholds. Bhutan's debt situation is expected to improve over the long run, reflecting significantly higher electricity exports when hydropower projects come on stream.

Under the baseline scenario, Bhutan pursues a planned expansion of its power generation capacity to about 10,000MW by 2020.[8] Bhutan's external and public debt closely traces the power cycles. External debt is projected to rise to 121 percent of GDP in FY16/17 with disbursements for hydropower sector projects, before declining slightly to 116 percent of GDP in FY17/18 with the completion of the first phase of hydro construction. The stock of external public and publicly guaranteed (PPG) debt is expected to gradually decline in the long term to about 29 percent in 2034 once construction of most of the hydropower projects is completed and debt service commences to pay down the debt stock. As a result, the present value (PV) of PPG external debt-to-GDP gradually declines to only 25 percent over the long term. The commissioning of the hydropower projects (in FY17/18), which also marks the start of the debt repayment, puts the debt ratios on a steady downward trajectory.

Bhutan's risk of external debt distress continues to be moderate.[9] This is based on the commercial viability of the hydropower projects, the risk-sharing agreement with India for hydropower loans, Bhutan's strong track record of project implementation, rapid growth in energy demand from India, committed donor support, and Bhutan's high level of international reserves. Bhutan's concentrated export base, rupee-reserves mismatch with external debt and the trade structure of the country leave it vulnerable to exports and any shortfalls in aid inflows. Additional risks stem from bulky hydro-related debt service payments requiring provisioning of rupee reserves.[10]

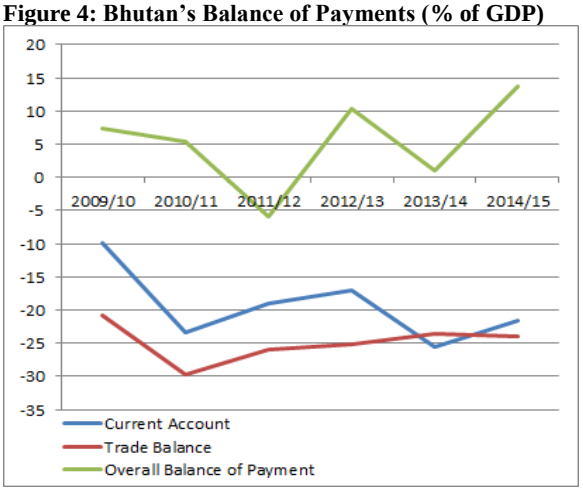
These projects also bring strong economic dividends in the long term, boosting average real GDP growth and exports. Moreover, despite the large increase in the stock of debt, the addition of the new hydropower projects does not create substantial vulnerabilities in debt servicing over the long term. Bhutan's strong track record of project implementation, the commercial viability of the new hydropower projects, the close economic and political ties that Bhutan has with India are all mitigating factors which mitigate the commercial risks of these projects. India has been both the main

provider of financing for hydropower projects and the main consumer of the projects' output.

External Sector: Bhutan's Negative Savings

Export revenues from sales of electricity are expected to improve in step with good rainfalls in 2013. Since no new hydropower projects have become operational since 2006, the fluctuation in export revenues reflects the vagaries of hydrological flows. The monsoon rains in 2013 have been better than the previous year, which is why data show a 12 percent rise in export revenues from sales of electricity in 2013. The potential for future increases remain strong. Exports of minerals and mineral-based products account for more than half of total exports, with hydropower exports comprising a further 45 percent, and manufactured products a tiny 5 percent. India receives almost 90 percent of Bhutanese electricity production. Continued shortages of power in India will ensure strong demand for electricity from Bhutan

Figure 4: Bhutan's Balance of Payments (% of GDP)



Source: Royal Monetary Authority

The tourism sector has turned into an important contributor of export revenues in recent years. Tourism revenues are 20 percent of non-hydro exports. Tourist arrivals and revenues (from convertible currency-paying tourists) expanded at an average of 15 percent per year in the five years to 2013. In 2013, some 44,000 tourists came to Bhutan, earning the country US$62.5 million in convertible currency, a modest increase compared to 2012. A similar number of tourists came overland, mainly from India with light travel requirements but the statistics are not up-to-date for this segment.

Bhutan runs a large and growing current account deficit (estimated at about 20 percent in 2013). It is essentially financed by donor resources, of which India contributes the most through loans and grants to finance hydropower development. Even when excluding self-financed hydropower construction imports of goods and services (around a third of total good and services), the current account deficit would stand at 10 percent of GDP, illustrating a significant national dissaving, and the need for the country to borrow to finance consumption.

Gross international reserves had built up to 13 months of merchandise exports. International reserves amounted US$920.8 million by end-November 2013, 88 percent of which was in convertible foreign exchange, with the rest in Indian rupees.[11] There is, however, a continuing mismatch in the composition of Bhutan's reserves and the structure of its international transactions, as the country primarily needs Indian rupees for trade settlement and debt service.

Box 3 : The Chhukha Tariff's Upward Revision

The export price of Chhukha power has been revised by 25 paisa per unit in February 2014, retroactively to 2013. The new export rate is now fixed at Rs 2.25 per unit from the existing Rs 2 per unit. The increase means that the 336MW Chhukha hydropower project will earn additional revenue of Rs 450 million annually.

Chhukha exports around 1,800 million units of power to India every year. That decision followed a bilateral agreement to review the rate every four years. The next revision is set for January 2018, and is based on increases in operating and maintenance costs, and in the number of hydropower companies in India, and a range of other factors.

Chhukha is Bhutan's oldest hydropower project, commissioned in 1989, and built with funding based 60 percent on loan and 40 percent on grant. The entire loan component has been repaid fully since 2007.

Tight Monetary Conditions are Necessary to Protect the Economy from Overheating and Another Rupee Shortage

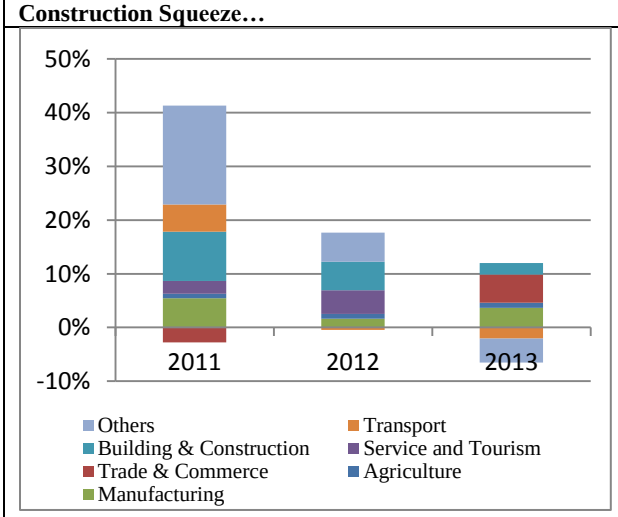
The tight liquidity experienced by the banking system in 2012 eased recently. Excess liquidity characterized the financial system from 2008-mid 2011 due to large build-up of hydropower inflows and grants (and only partial sterilization of these funds by the RMA). The tight liquidity conditions emerged in June 2011 as a result of persistent growth in Indian rupee imports with an equivalent drain on local currency liquidity, a reduction in the overall level of individual deposits, over-dependence on the more volatile and seasonal corporate deposits as a source of funding; and bank-financing of the large, long-term public- and private-sector investment projects (e.g., Dungsam cement project). Since March 2012, in order to address the tight liquidity conditions, the RMA cut the cash reserve ratio (CRR) twice to 5 percent from 17 percent. As result, the banking sector's liquidity improved between Q2 2012 and Q2 2013.

Interest rates have shown little movement previously, despite the absence of explicit controls. Real interest rates have been negative, introducing a strong bias towards investment in real estate. While the reason for interest rate stickiness is unclear, higher and more flexible interest rates may better reflect market conditions and be more aligned with those in India.

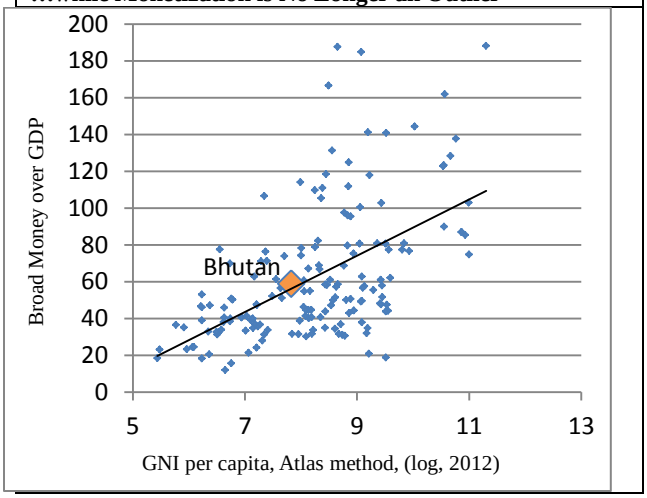
The authorities have made progress towards improving the monetary transmission mechanism. In March 2012, the RMA introduced a Short-Term Liquidity Adjustment Window (RSTLAW) for securitized RMA lending to banks at a newly introduced policy rate which is linked to the RSTLAW facility. To further strengthen the transmission mechanism, the RMA also launched a base rate system (below which lending is not viable for financial institutions) in order to curb credit growth, improve loan pricing transparency, and foster lending discipline. The base rate also serves as a reference benchmark for floating rate loans.

Monetary conditions need to remain sufficiently tight to ward off overheating and manage pressures on rupee reserves. Excess liquidity should be closely monitored and promptly adjusted to prevent credit growth from rebounding strongly. In future, along with the development of a domestic capital market, increased issuance of treasury bills could be used to mop up excess liquidity. Rupee inflows related to hydropower projects and grants should be sterilized in order to curtail excess liquidity in the banking system and dampen credit growth, without the need for administrative or macro-prudential measures.

Figure 5: Credit Growth has Slowed Sharply along with a Construction Squeeze…



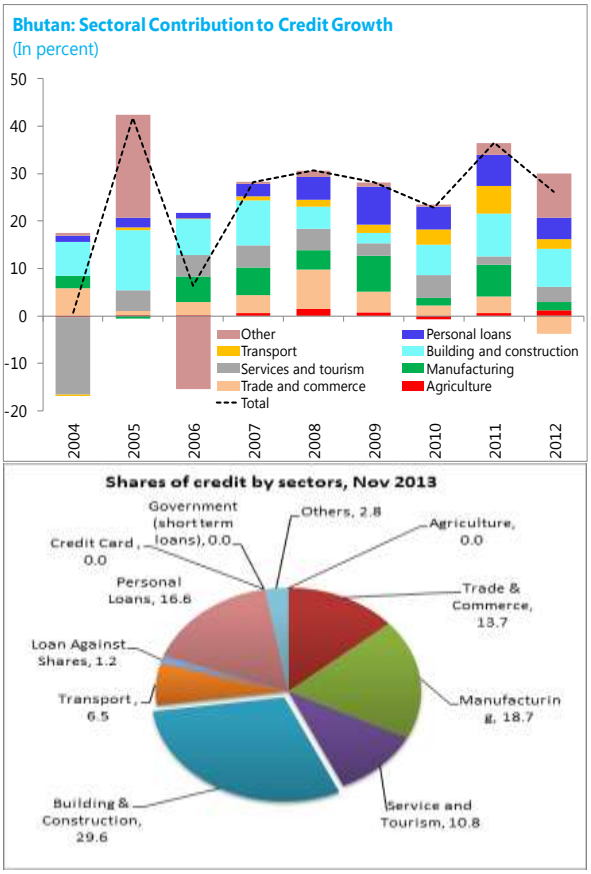
…while Monetization is No Longer an Outlier



The Financial Sector Shows Signs of Vulnerability, with Limited Supervision

The growth in bank credit to the private sector in Bhutan has been remarkable. Private sector credit has grown to an average above 30 percent during FY02-FY11, increasing credit from 11 percent to 49 percent of GDP. This compares with a median of 32 percent for lower middle-income countries (16 percent for low-income countries), while coinciding with the median of 49 percent for South Asia. The rapid expansion stemmed from an initially low base, growth in civil services wages, spillovers from large hydropower projects, loose monetary conditions (including low and often negative interest rates, as mentioned above) and the entry of three new banks in 2010.[12] In addition**,** non-banks also have engaged in lending in the absence of alternative investment opportunities.[13]

Figure 6: Construction & Personal Loans drove Credit Growth



Source: RMA Quarterly Bulletin

Strengthening supervision will be critical in the short to medium term financial sector vulnerabilities have likely accumulated.[14] Banks appear to be well capitalized, with the risk-weighted capital adequacy ratio rising to 19 percent. Non-performing loans reportedly declined to around 8 percent in the last two years, which partly reflects rapid credit growth. But the increase in the loan-to-deposit ratio to above 100 percent raises concerns, given the overall decline in deposits. Financial sector vulnerabilities also arise from growing asset-liability mismatches, with a significant proportion of the deposit base being (short-term, seasonal and volatile) corporate deposits, whereas bank credit is concentrated in loans with longer time horizons to finance investment and projects (as in construction, particularly funding of large infrastructure projects).[15] The concentration of lending in personal and real estate loans raises particular concerns; more than a quarter of the financial sector's portfolio consists of building and construction loans, followed by personal loans which constitute around 16 percent of overall credit outstanding. The recent decline in real estate prices following years of increasing prices may expose weaknesses.

Efforts to deepen the financial sector in a sustainable manner are underway. A comprehensive Financial Sector Development Strategy is underway with a careful sequencing of reforms within a medium-term plan. It will emphasize the importance of balancing further deepening with maintaining financial stability, promoting alternatives to bank financing for the private sector including, and improving information and market infrastructure by steps that included broadening coverage of the credit bureau.

Poverty Declined but Rural Vulnerability Prevails, Magnified by Out-Migration

Poverty reduction in Bhutan has been rapid, broad-based and inclusive between 2007 and 2012. Both consumption based poverty measures and broad-based multi-dimensional poverty indicators show that the percentage of poor was cut by nearly half -from around 23 percent in 2007 to 12-13 percent in 2012. This conclusion is robust to alternative poverty lines. The reduction has been deeper touching the poorest of the poor not just the people just under the poverty line. Evidence from focus group discussions further corroborate that there has been perceptible sense of improvement in living standards in rural Bhutan. Bhutan has almost eliminated extreme poverty ($1.25 purchasing power parity terms, per day per person) within the living memory of a generation.

Table 4: Poverty Dynamics*

First Period & Second Period	Poverty Status (%)
Poor, Poor	8.3
	(0.1)
Poor, Non-poor	10.5
	(0.1)
Non-poor, Poor	4.1
	(0.0)
Non-poor, Non-poor	77.2
	(0.2)
N	6045

* Based on synthetic data for two periods in Bhutan, 2007-2012 (joint probabilities).

Note:

1. Predictions are obtained based on data in the second survey round. We use 500 bootstraps in calculating standard errors.
2. All numbers are weighted using population weights.
3. Household heads' ages are restricted to 25-55 years for the first survey round, adjusted accordingly with the year difference for the second survey round.

The primary drivers of such rapid poverty reduction are various. These appear to be accelerating commercialization of agriculture, rapid development of rural infrastructure (roads, schools, health centers, and electrification), and spillovers from new construction of massive hydroelectric projects. Benefiting from strengthened trade agreements with neighboring India and Bangladesh, signed between 2006 and 2009, Bhutanese farmers are increasingly specializing in commercial production. The value share of fruits, cardamom, and eggs have nearly doubled to 46 percent in just four years to end-2012. Rural infrastructure development has been a thrust area of the 10th Five Year Plan (2008-13). The eight-fold expansion in farm roads has been phenomenal: nearly 4,000kms of farm roads were built, with 500kms in 2006 alone. Besides the these roads, ongoing construction of the Southern East-West Highway (along the India border) has decreased travel times and lowered the cost of transportation of goods. With the emphasis on electrification of all rural areas, 97 percent of the villages are now electrified with the poor having doubled access. Three new massive hydro-electric power projects (Punatsangachhu I and II, and Mangdecchu) with an eight-year construction window were started in 2008-10 costing a little over Nu187 billion (187 percent of GDP in 2012). The immediate benefits to the local economy from construction activities are sizeable because of the hiring of local contractors to provide transportation, food, and rental for the three-fold increase in foreign construction worker numbers (involving nearly one-third of the local population in project-site dzonkhags).

The big reduction in poverty is accompanied by notable vulnerabilities, magnified by out-migration to urban areas. Urbanization is on the rise, with Thimphu capital city drawing the greatest interest of rural migrants. Males and the young are most likely to migrate to urban areas. Females are less mobile because of family responsibilities and the inheritance of land. Young people migrate to study or for economic reasons. The chronically poor constituted two-thirds of all poor people in 2012. For every ten persons who moved out of poverty, four fell into poverty. The absence of formal social protection institutions and targeting mechanisms for the chronically poor could be shackling them in a poverty trap. For example, the poverty incidence of female-headed households is about the same as male-headed households, but they are less

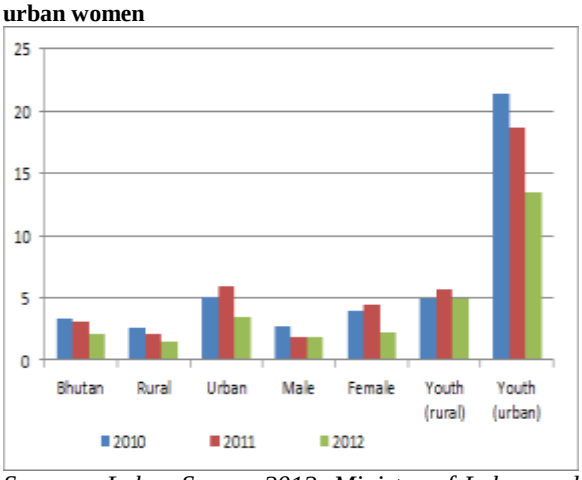
upwardly mobile and have fewer coping resources.

Sustainability of the pace of poverty reduction appears to be good. Rural trade intensification induced by trade agreements with neighboring countries and fortification of road links along the North-South Highways and the Southern East-West highways will continue apace under the 11th Five Year Plan. Ongoing and new hydro-electric projects will continue to stimulate the economy to 2020 and income from projects in production phase will fund public good provision. In the short-term, investment in strengthening irrigation channels, eradication of pests that are destroying the cash crops such as oranges and cardamom, effective ways to fend off wild animals (wild boars, monkeys and elephants) that inflict crop losses, introduction of formal social protection mechanisms and crop-insurance could help reduce poverty further and diminish vulnerability.

Official unemployment is relatively low and declining: so why is it an issue?

While youth unemployment and skills mismatches are perceived as an important concern, reported official unemployment figures are low and on the decline. Unemployment rate has dropped from 4 percent in 2009 to 2.1 percent in 2012, according to the MoLHR Labor survey. Youth unemployment rate has also decreased from 12.9 percent in 2009 to 7.3 percent in 2012. This raises the question of the real nature of the issue. Measurement issues, including the narrow definition of employment and unemployment, the limited information on underemployment, and the low frequency (annual) of the labor survey might be factors that underestimate the unemployment issue in Bhutan.[16]

Figure 7 Unemployment affects mostly youths and urban women



Sources: Labor Survey 2012, Ministry of Labor and Human Resources

Aside from queries about methodology, there are other issues, actual or perceived, that make Bhutanese skeptical of official employment figures. These include:

1) *Underemployment*. This refers to those who work part time, but would work more if they could. The Labor Force Survey does not provide any details about the number of underemployed in the workforce, yet one would expect underemployment to be significant, especially in agriculture, where 60 percent of employed persons are. The farming sector is most vulnerable to high underemployment.

2) *Labor force drop-outs.* Long-term unemployed workers may be discouraged and drop out of the labor force (the people of working age and below retirement age who are actively participating in the work force, or are actively seeking employment), thereby not being accounted for anymore in the labor force.

3) *Aspirational mismatch*. Often we hear in Bhutan about the existence of a mismatch between skills demand (skills needed for the current GDP structure of the economy and growth prospects) and skills supply (people offering their skills

for jobs). Young people would be unwilling to take blue-collar jobs, favoring white-collar occupations. The existence of formal and informal social safety nets such as free health, free education, family ties, would allow the unemployed to be more selective in their job search. In other words, these are the people who might (i) have no job, (ii) be actively looking for a job, but (iii) perhaps are not willing to work immediately, thereby not qualifying as "unemployed". They might also belong to the (under)employed category if, say, they have worked for one hour the week preceding the annual labor survey. Counterintuitively, employment trends in the economy over the last three years actually show a consistent increase in blue-collar occupations (elementary occupations, skilled agriculture workers, plant and machine operators, and assemblers).

4) *Bias towards public-sector jobs* (for better benefits and job safety). Public-sector jobs in Bhutan are the first choice for young graduates. Job safety, opportunity to study further, and good benefits (such as early retirement) are among the factors that cause the bias towards the public sector. Recent trends, however, show a change, with private-sector employment on the rise.

5) *Increasing rural to urban migration* leads to (i) increasing urban unemployment, and (ii) shortages of labor and higher labor costs in rural areas. Agricultural land reportedly is increasingly being left fallow because of rural labor shortages.

Box 4 : Government's Plan for Full Employment

By the government's calculation, the full employment pledge needs to create 82,000 jobs over the five years (to achieve 97.5 percent, according to the FYP-11 and economic development policy of 2010):

- 42,000 people will be employed in five years, as per the regular employment projection baseline (government's human resource development plans)
- 30,000 jobseekers will be sent abroad for employment opportunities, and
- 10,000 jobseekers will be enrolled in various programs in the country.

Overseas Employment:
Three Bhutanese employment agents have been registered to date. Job offers amount to 9 at the Sheraton hotel in Qatar, 2,000 in the US and Saudi Arabia, 50 agricultural jobs and 30 basic agricultural training openings in Israel, and 48 English-teaching posts in Thailand.

Classes X and XII likely to enter the job market:
A six-month training in agriculture would also be available for class XII graduates, and a total of 3,000 youths will be enrolled in the pre-employment program.

Another 3,000 youths would be given entrepreneurship development training. Under this program last year, 49 youths were trained in basic entrepreneurship and 37 youths in comprehensive entrepreneurship.

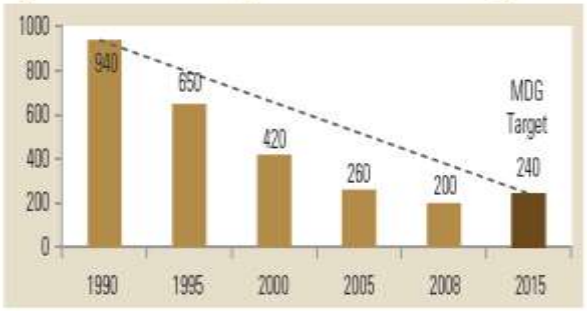
To address the issue of a lack of job skills, a total of 7,142 youths would be enrolled in technical institutes in the country.

The labor ministry will train 3,000 graduates in the next five years under the university graduate internship program. In addition, some 2,000 youths would be given apprenticeship training over the next five years. The ministry trained 832 youths under this program last year.

Special Focus 1: Malnutrition and Stunting Demand a Coordinated Response[17]

Bhutan has made steady progress in recent years in its health indicators, and is now on target to achieve the major health-related Millennium Development Goals (MDGs) of the United Nations. The infant mortality rate decreased to 36 deaths per 1000 live births in 2012 (from 91 in 1990) and the under-five mortality to 45 per1000 live births in 2012 (as against 131 in 1990), both on target to achieve MDG 4. The Maternal Mortality Rate has also decreased rapidly from 940 per 100,000 live births in 1990 to 180-200 deaths per 100,000 live births in 2008. With regard to MDG 1 target 2, Bhutan has managed to reduce underweight rates amongst under -fives by more than half from 38 percent in 1990 to 12.7 percent in 2010.

Figure 1 ▪ Maternal mortality ratio 1990–2008 and 2015 target

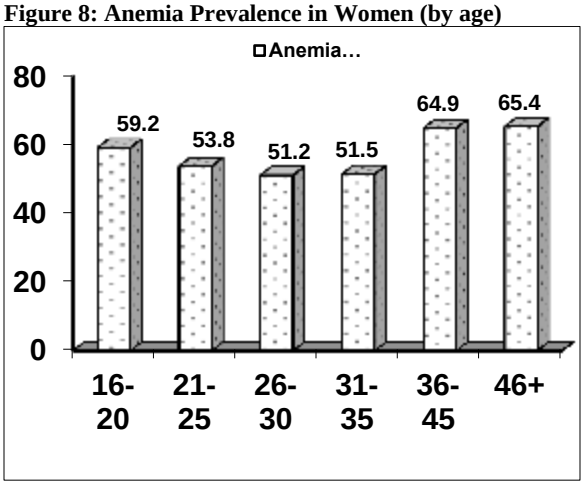


Source: 2010 WHO/UNICEF/UNFPA/World Bank MMR report.

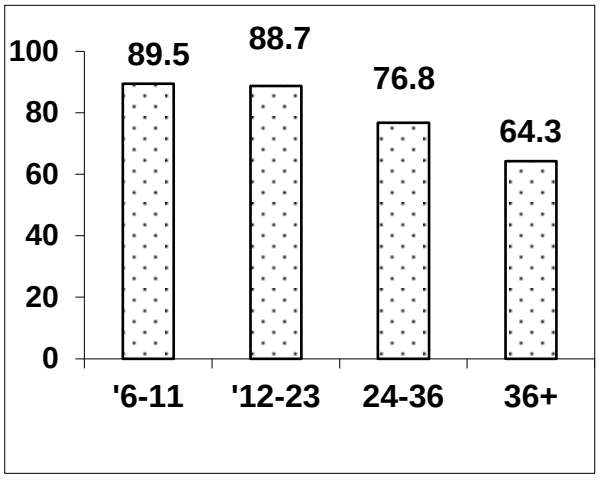
It was against this backdrop that the Bhutan National Nutrition Assessment and Gap Analysis (World Bank, 2014, forthcoming), aimed to generate evidence and create awareness among Bhutanese policymakers, program managers, government officials and development partners to invest in strengthening the public nutrition system in order to address malnutrition in the first 1,000 days, i.e., from conception through the first 24 months after birth. The objectives of the study were to review the size, severity and key determinants of under-nutrition in Bhutan, and the current nutrition and nutrition-related programs in order to identify gaps and opportunities to scaling-up these programs. Quantitative information for the study was gathered as secondary data through a systematic review of sources provided by various government ministries and departments, and an extensive on-line literature search. Both published and unpublished documents were used. In some instances, existing primary data was re-analyzed for further correlations. A primary qualitative study was also undertaken in sampled geographies from three regions of Bhutan: Western, Central, and Eastern. Besides development indicators, socio-cultural contexts in these three regions also vary significantly, usually due to geographical terrain and climatic variations, and differences in religious and cultural practices.

Despite the success on the MDG front, the recently concluded Bhutan National Nutrition Assessment and Gap Analysis finds that two major indicators of under-nutrition remain persistently elevated – stunted growth of children under five years of age, and anemia in women and children. The proportion of Bhutanese children under five years suffering from chronic under-nutrition (i.e., stunting) is 33.5 percent, and anemia affects 54.8 percent of women, and 80.6 percent of children – a prevalence which is among the highest rates in the world. These are alarming figures for two reasons: they have persisted over a long period of time (although stunting has dropped from 40 percent to 30 percent in the past decade, anemia levels have hardly decreased since 1988) and they are even more concerning when inequalities of gender, geography, poverty, and ethnicity are taken into consideration.

Figure 8: Anemia Prevalence in Women (by age)



Source: FNS 2008



Furthermore Bhutan faces an enormous challenge of addressing maternal and child under-nutrition in the context of a nutrition transition. A nutrition transition is epitomized by a shift from traditional diets based on indigenous staples, legumes, and fruits and vegetables, to a more global intake pattern including processed and imported animal source foods and increased amounts of sugar, fats, and salt. As Bhutanese migrate to the cities in search of jobs and education, shift in lifestyles generally accompanies the transition, favoring more sedentary lifestyles cars vs. walking and television vs. traditional forms of recreation. As a result of the nutrition transition, Bhutan is experiencing the double burden of malnutrition, whereby both over-nutrition (overconsumption of energy dense nutrient poor foods that are high in fat, salt and refined sugar combined with low levels of physical activity) and under-nutrition (inadequate consumption of nutrient rich foods, poor hygiene and sanitation, and infections) co-exist in the same communities. The World Health Organization estimates that 53.5 percent of Bhutanese women are now overweight with signs of the double burden of malnutrition reflected in rising cholesterol and fasting blood sugar levels.

Some of the underlying factors can be interpreted as the direct or nutrition specific determinants of under-nutrition in Bhutan: diarrheal diseases, high parasite loads in parts of the country, and a very high prevalence of *Helicobacter pylori* infections, linked to under-nutrition through malabsorption or diversion of nutrients. In addition, sporadic food insecurity affecting some remote areas for up to 3-4 months each year, and a lack of dietary diversity due to poverty, climate, or education lead to decreases in balanced intake of nutrients needed for normal growth. As a cause of stunting, among the most important is the poor nutrition and care of women before and during pregnancy reflected in the profound levels of anemia in women, both pregnant and non-pregnant; this despite 77 percent of women having at least four antenatal care visits and 64.5 percent reporting skilled birth attendance, raises questions about the quality of care provided.

Beyond the factors that directly impact on the nutrition of women and children are other nutrition-sensitive issues specific to Bhutan: the remoteness and inaccessibility of many villages and settlements, some at altitudes that strongly influence crop selection and production; trade dependency on imported foods that makes the country vulnerable to food price fluctuations; ethnic and other cultural variables that influence access to services and alter feeding practices; urban migration which further impinges on the decreasing agrarian work force;; the lack of community awareness about the nutrition problems of stunting and anemia with no understanding of their causes, their significance, or potential actions that could be taken to remedy them; and, related to the latter, a national, district, and community lack of human resources knowledgeable about public nutrition with the requisite skills to educate and motivate changes in community behavior.

As greater knowledge and awareness of public nutrition is needed, existing programs with a potential for impact on public nutrition were reviewed in health, agriculture and forests, education, rural water supply and sanitation. Two findings stood out from the assessment: (i) the enormous extent and relevance of these programs for improving nutrition; and (ii) the enormous opportunity to further strengthen nutrition content in each, an opportunity which is currently not optimally utilized. During the assessment, several training opportunities were identified where content on public nutrition

could be included. Furthermore, it was found that staff from each of these programs does work in the same villages and frequently with the same community workers, and need to better coordinate their visits, to enhance their efficiency and effectiveness.

Conclusions in the report of the assessment highlighted four major areas for consideration: in the individual and the community arena, the need for more emphasis on nutrition and care of women (pregnant and non-pregnant); in the workplace, the need for a significant augmentation of the public nutrition knowledge of the available workforce, along with the need for better job descriptions with defined competencies; in the organizational structure for the government departments, a need for better inter-sectoral coordination driven by a high level mandate where roles and accountabilities can be defined and monitored, and a better nutrition monitoring system that can be used to decide if programs and personnel are succeeding or not; and in the system environment of policies and laws that enable work to be done that will improve nutrition in the country, there is a need for much greater visibility of nutrition as the driving factor behind future national economic and intellectual development.

Special Focus 2: Pioneering Cultural Heritage Protection as a National Asset

Bhutan's Heritage Sites Bill is a significant new approach and tool aimed to redefine the way in which Bhutan values and protects its cultural assets; with far-reaching implications for society. The Bill proposes a major shift in policy by widening Bhutan's definition of cultural preservation beyond protection of monuments and cultural expressions towards stewardship[18] of the very social and cultural fabric and sites which have shaped its society, way of living and landscapes for centuries. To achieve its goals, the Bill proposes a number of policy instruments, including a "landscape approach" to Bhutan's cultural assets management; establishment of a dedicated Heritage Sites Fund; and provisions for designation and adaptive reuse of designated

heritage buildings and cultural sites. It also devolves considerable responsibilities for protection to local owners of heritage sites given their ownership and critical role in transferring Bhutan's values and knowledge to the new generations.

By strengthening its own identity and integrity as a cultural landscape, Bhutan will thus be better equipped to cope with powerful external economic and social pressures in a way that meets its 21st Century aspirations to promote an inclusive development, based on non-material wellbeing, happiness, and cultural tradition. The government's expectation is that the Bill will contribute to: (a) improving the distribution of benefits to heritage villages and cultural sites which tend to be poorer than non-traditional sites; (b) better targeting improvements of living conditions in poor villages and areas; (c) generating new alternative employment opportunities linked to the protection of heritage villages and cultural sites; (d) clarifying roles and responsibilities and improving coordination for cultural heritage preservation in Bhutan; and (e) increasing investments in communal stewardship of Bhutan's (currently undervalued) assets.

For insight into the implications of the Bill – drafting of which commenced in 2010 – a Poverty and Social Impact Analysis (PSIA) was undertaken in 2012 and 2013. The aim of the PSIA was to assess the potential impacts and effectiveness of the draft Bill, in order to inform its further development.[19]

The Bill has been drafted within the context of Bhutan's unique development philosophy, as encapsulated in the Gross National Happiness (GNH) Index. Preservation and promotion of culture is one of the four pillars of GNH and of the Constitution, and is central to the Royal Government of Bhutan's five-year development plans and its Vision 2020. Passed on from generation to generation, Bhutan's cultural preservation strategy includes: (i) a strict civic and cultural code of conduct and etiquette; (ii) the oral transmission of cultural morals from older to younger generations through extended families; (iii) a strong social support system and promotion of communal festivals and ceremonies; and (iv) the protection of its broad national heritage, including preservation of emblematic monuments and support for traditional arts and crafts.

While notable, this strategy has not paid enough attention to the country's majority of non-monumental assets, villages and their immediate surroundings that have supported community life for centuries. These assets are increasingly under threat from a number of unprecedented challenges. Economic liberalization of the country has brought an influx of "modern" influences and more materialistic aspirations, especially among young people. Ways of living, landscapes, and cultural practices, particularly those enshrined in rural communities and that have shaped Bhutan's society for centuries, are being transformed in the quest for new lifestyle and less laborious job opportunities.

The weakening of community vitality and loss of their assets has spurred the government to enact measures to formally steward its cultural assets with an emerging emphasis on living landscapes. Within this context, the draft Heritage Sites Bill tries to strike a delicate balance between preserving the valued cultural traditions of Bhutan and accommodating the understandable new aspirations of its youth. The purpose of the PSIA was to shed light on how well the Bill's provisions could perform that task.

The PSIA assessed the potential implications of the Bill for villages, their owners and households, their geographic areas, and their cultural assets, and for traditional houses in Thimphu.[20] It also investigated the institutional needs, including the capacity, regulations, and financing mechanisms, to ensure effective implementation of the Bill.

- For potential rural heritage villages, the PSIA found that significant cultural value still resided in the homes, artefacts, landscapes, and traditions of these locations. Despite that, the levels of poverty in the sampled villages are nearly 2 to 3 times

greater than the gewogs and dzongkhags to which they belong. Subsistence poverty rates are also twice the amount at the gewog, dzongkhag or national levels. Provision of basic services is uneven. The single main item of expenditure is house renovations. Agriculture is the main source of livelihood, and sale of nonagricultural products and services, though cultural assets, such as crafts, account for little income. Only 37 percent of rural households expressed being happy in comparison to 50 percent in cities. Such "geography of poverty" –low living standards, lack of alternative job opportunities especially for young people, and unhappiness – is contributing to increased out-migration as well as families' breakdown and loss of communities' vitality.

- For traditional houses in Thimphu, the PSIA found that most of those few remaining were isolated (individually or in small groups) as they had been engulfed by unplanned urban expansion. The houses were considered to be of low value and maintenance was often not cost-effective with no incentives for owners to upkeep their traditional properties. Therefore many owners prefer to demolish traditional houses and replace them with concrete blocks of flats as a source of income.

The PSIA findings demonstrate that the Bill may result in positive impacts, especially in the areas of poverty reduction and inclusive development, with resources and people better distributed across Bhutan:

- The Bill comes at a critical time, as modernization is promoting changes in Bhutan that require a rethinking of the way the country has been promoting and safeguarding its cultural assets, and their continuity in the 21st century;

- It is expected to address living areas and landscapes, following the latest thinking and practice in heritage conservation, environmental management and urban/regional planning;

- Also to raise awareness of heritage management and lead to its better integration in poverty reduction and service delivery schemes through the establishment of needed regulations and procedures for coordination and transfer of resources and services to heritage villages across the country, which often have poorer populations than other nontraditional rural and urban communities;

- It is also expected to increase the value of traditional skills and improve the self-esteem of Bhutan's ageing skilled craftspersons (and thus the transfer of such knowledge to younger generations), and to create new employment opportunities and growth sources within a 21st century creative economy. Rural areas will particularly benefit through increased demand for labor in the traditional construction, skilled heritage, and tourism sectors, supported by specialized training and establishment of centers of excellence. This may also contribute to create attractive employment alternatives outside overgrowing Thimphu; and

- The Bill is also expected to clarify roles, responsibilities, and overlapping institutional arrangements for heritage conservation by strengthening the function of the Ministry of Home and Cultural Affairs as the nodal agency and putting in place the necessary coordination platforms and incentives.

The PSIA has also identified three areas that require further attention in the Bill's current draft form to ensure its relevance and successful implementation:

- **Economic burden on communities and individuals.** Owners and caretakers of traditional houses in heritage villages may not have the financial resources or full expertise to carry out the Bill's proposed technical and funding requirements for the maintenance and/or repair of their properties and sites. Those in cities may incur greater absolute costs due their higher opportunity

costs, rising transaction costs, and the growing land values in cities;

- **Increased financial and technical workload for dzongkhags and thromdes.** The Bill's proposal to further decentralize conservation and monitoring responsibilities to local authorities may increase the workload of already understaffed offices. Most local authorities also lack the funding and expertise needed to properly carry out those responsibilities; and

- **Unclear mandates and lack of institutional coordination.** In the absence of a clear and enforced governance framework for cultural preservation in Bhutan, a variety of agencies tend to carry out similar work in an uncoordinated manner, with differing criteria and no standardized methods, leading to fragmented outcomes. Critical instruments such as permits are missing or deficient, and there are no effective mechanisms for the integration of heritage conservation into living communities through service delivery, integrated city and regional planning, adaptive reuse of traditional buildings, and managed growth of communities that steward their culture and landscapes.

In order to realize the positive impacts of the Bill and mitigate the potential adverse impacts, the PSIA offers tailored recommendations and a package of combined incentives. At the core of the recommendations is the importance of engaging key stakeholders, particularly owners, caretakers, local authorities, and concerned agencies, in all key steps envisioned for the identification, inventorying, designation, and stewardship of properties and areas to be designated under the Bill as heritage sites. This is essential to ensure the relevance for concerned communities and households, and thus the achievement of the Bill's objectives and the sustainability of its associated efforts.

Another central recommendation is the value of an incentive-based Bill, rather than traditional command and control mechanisms, in line with its intention to increase people's awareness of and responsibility for the stewardship of the majority of privately owned assets currently unprotected and at risk of being lost due to modernization. To this end, the PSIA offers a group of material and nonmonetary incentives, which combined may lead to improved living standards and job opportunities in heritage sites across Bhutan, and ultimately a more balanced and inclusive development of the country in the 21st Century.

[1] Macroeconomic cycles in Bhutan follow closely developments in the hydropower sector, given the magnitude of these projects compared to the size of the economy. During construction, hydropower, as many industries that produce intermediate goods has a major effect on GDP through construction, transport and services, directly and indirectly through money and spending multiplier effects. What makes hydropower unique in Bhutan is the size of projects relative to the economy. For instance, the four hydro projects under construction represent no less than a total investment of 200 percent of GDP (2012), spread over 7 years. 30 percent of construction cost may be attributed to domestic suppliers, the rest being imported.

[2] RMA monthly bulletin, Feb 2014. Bhutan's hydropower dams are run of the river schemes with no reservoirs, so better rainfalls is the main factor impacting generation from year to year.

[3] As of March 2014, the Nu 10.88 billion (US$175 million) project was reported to operate at half capacity, so the overall impact in 2014 remains to be seen. Full capacity would total Nu 6 billion in total sales, and Nu 4 billion in revenues after debt repayment.

[4] RMA Bulletin February 2014.

[5] Indian National do not require visas and are exempt from the minimum daily tariff of USD 250 per person a day

[6] In February, the Prime Minister announced the "Bhutan-Thailand friendship offer" aimed at attracting residents from Thailand during the leaner months of June, July and August, as an effort towards lean season promotion as well as the new flight from Mumbai to start in the fall of 2014. As a part of the offer, Thai nationals and others with proof of residency in Thailand will not pay the mandatory minimum daily tariff of US$200 per day for the lean season. Instead, they would be levied the daily royalty of US$65, while tour operators would have to compete and come up with attractive packages. In addition, the national airline will offer 50 percent discounts on airfare, while hotels will give up to 50 percent discounts on rates.

[7] From 2013/14 onwards the excise tax retroceded from India to Bhutan will cover one year, instead of two.

[8] The hydropower development policy of Bhutan consists of eleven new hydropower projects, which would quintuple Bhutan's power generation capacity. External financing for non-hydropower sector activities continues to remain predominantly from multilateral and bilateral donors at concessional terms.

[9] On the basis of the recent Joint Bank-Fund Sustainability Assessment, 2014.

[10] Bulky debt service payments may have contributed to rupee shortage in that past, hence the need for good cash/reserves management and projections.

[11] The Constitution requires that foreign exchange reserves should be maintained at 12 months of essential imports.

[12] Five commercial banks dominate the financial system, accounting for nearly 90 percent of total loans in June 2013. The Bank of Bhutan and Bhutan National Bank dominate, holding 82 percent and 76 percent of banking sector credit respectively as of June 2013. Three new commercial banks, namely Druk PNB, T Bank, and Bhutan Development Bank commenced operations in 2010. The share of the three new banks in deposits has risen appreciably from 6 percent since their licensing in 2010 to 18 percent in June 2013, while the share in credit has risen from 17 percent to 24 percent over the same period.

[13] The RMA has since then directed all nonbank financial institutions to suspend all lending activities by June 1, 2014.

[14] Asset classification and provisioning rules were relaxed in March 2012 to address tight liquidity.

[15] Private-sector deposits account for more than 70 percent of total deposits. The remainder consists of deposits of government corporations and public corporations. As of June 2013, 53 percent of total deposits were corporate.

[16] Survey method Bhutan Labor Survey follows the ILO definition of unemployment where a person is considered unemployed when he/she is simultaneously: (i) without work; (ii) available for work; or (iii) seeking for work. A person is considered to be employed if she/he has performed some paid work in cash or in kind at least one hour during the reference period (a week). Unemployed are those who, during the period mentioned, (i) have no job, (ii) are able to work at any time, or (iii) are actively looking for jobs (ILO). Anybody who meets the three conditions at the same time may be called unemployed. Working a minimum of one hour/week excludes the individual from classification as a job seeker.

[17] This brief was compiled by Somil Nagpal, Nkosinathi Mbuya and Preeti Kudesia, drawing upon the draft report of the recently concluded World Bank study authored by Stephen J. Atwood, Somil Nagpal, Nkosinathi Mbuya, and Luc Laviolette, World Bank, 2014 (forthcoming).

[18] Heritage Stewardship encompasses protection, research, documentation, preservation, maintenance and operations as well as management of heritage assets, sites and landscapes.

[19] The Bill is being drafted by the Division for Conservation of Heritage Sites (DCHS), Ministry of Home and Cultural Affairs; the PSIA was conducted by the World Bank in coordination with the DCHS. This note was prepared by Stefania Abakerli, World Bank, and summarizes the main findings of the PSIA study. For further information please contact *sabakerli@worldbank.org*

[20] A sampling baseline survey was undertaken of 56 villages, and 4 sample villages were selected (Drugyel, Korphu, Rinchengang, and Sakteng) across the country. A rapid appraisal of the 27 remaining traditional houses and their residents was also carried out in Thimphu.

Selected Economic Indicators, 2008/09-2013/14

Indicator	2008/09	2009/10	2010/11	2011/12	Provisional 2012/13	Projected 2013/14
Gross domestic product ((US$ million at current prices))	1,213	1,433	1,744	1,815	1,975	2,298
Consumer price index (% change)	3	6.1	8.3	13.5	5.5	8.0
Real annual growth rates (%, calculated at 2000 prices)						
Gross domestic product at market prices	5.7	9.3	10	8.1	5.6%	6.8%

Balance of Payments (US$ millions)	2009	2010	2011	2012	2013	2014
Exports (GNFS)[a]	565.3	673.0	750.0	706.5	709.9	789.3
Merchandise FOB	504.3	597.4	655.2	594.3	582.6	642.0
Imports (GNFS)[a]	786.7	682	933.7	1,301.5	1,258.9	1,288.9
Merchandise FOB	670.5	606.6	843.2	1,184.7	1,126.5	1,125.2
Trade balance	-166.3	-365.2	-436.2	-368.0	-358.0	-377.6
Current account balance	-191.0	-420.8	-464.9	-418.1	-427.1	-499.6
Net private foreign direct investment	44.8	53.3	28.1	22.2	20.0	n.a
Long-term loans (net)	91.7	247.1	332.4	289.8	292.0	n.a.
Official	58.6	178.6	250.8	279.8	316.6	n.a.
Change in reserves[b]	38.4	-63.1	-144.4	78.8	313.6	n.a.

Public finance (as % of GDP at market prices)[c]	actual	actual	actual	actual	estimated	(budget)
Current revenues (without grants)	24.2	23.4	22.0	22.0	20.0	18.9
Current expenditures	19.1	19.3	18.6	18.0	17.7	16.2
Current account surplus (+) or deficit (-)	5.2	4.1	3.4	3.9	2.3	2.7
Capital expenditure	17.0	19.3	18.7	19.6	19.7	15.4
Foreign financing (grants from FY2011)	11.3	16.6	13.3	13.5	15.0	6.6

Monetary indicators	2008/09	2009/10	2010/11	2011/12	2012/13	20013/14
M2/GDP	58.5	68	69.9	58.8	58.2	n.a
Growth of M2 (%)	24.6	30.1	21.2	-1	18.6	n.a
Private sector credit growth /	31.1	38.6	33.2	30.1	7.1	n.a
Total credit growth (%)	21.7	42.3	32.7	51.3	12.8	n.a

Notes: a: GNFS=Good and Non-Factor Services; b: includes use of IMF resources; c: account is for consolidated general government. All statistical information follows Bhutan's fiscal year (from July to June), except Balance of payment data (calendar year)