

BTI 2014 | Bhutan Country Report

	scale	score	rank	trend
Status Index	1-10	5.70	# 63 of 129	
Political Transformation	1-10	6.40	# 54 of 129	↑
Economic Transformation	1-10	5.00	# 80 of 129	↗
Management Index	1-10	6.27	# 23 of 129	

This report is part of the Bertelsmann Stiftung's Transformation Index (BTI) 2014. It covers the period from 31 January 2011 to 31 January 2013. The BTI assesses the transformation toward democracy and a market economy as well as the quality of political management in 129 countries. More on the BTI at <http://www.bti-project.org>.

Please cite as follows: Bertelsmann Stiftung, BTI 2014 – Bhutan Country Report. Gütersloh: Bertelsmann Stiftung, 2014.

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Key Indicators

Population	M	0.7	HDI	0.538	GDP p.c.	\$	6699.4
Pop. growth ¹	% p.a.	1.7	HDI rank of 187	140	Gini Index		38.7
Life expectancy	years	67.5	UN Education Index	0.356	Poverty ³	%	12.6
Urban population	%	36.3	Gender inequality ²	0.464	Aid per capita	\$	99.5

Sources: The World Bank, World Development Indicators 2013 | UNDP, Human Development Report 2013. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$2 a day.

Executive Summary

In early 2013, the first elected national government of Bhutan completed its term; as the review period closed, the country's citizens were preparing to go to the polls for a second time. The democratic institutions established under the 2008 constitution have performed fairly well given their recent creation and the very small size of the opposition party in the National Assembly. The government has maintained a credible track record in producing legislation, while the National Council, the elected upper house, has been effective in playing a monitoring role and producing constructive criticism. The Anti-Corruption Commission has also done a good job in educating the public about the issue of corruption generally, as well as in investigating and prosecuting specific corruption cases, most notably one involving the speaker of the National Assembly and the minister for home affairs.

In the lead-up to the second elections, it is apparent that the idea of democracy and its institutional form in Bhutan are becoming more familiar and widely accepted. Indications include the increase in the number of candidates for the nonpartisan National Council, the increase in the number of political parties contesting the National Assembly elections from two to five, and the considerable media coverage of election matters. Bhutan appears to be making progress in terms of democratic consolidation. A major deficiency of the system is that only one opposition party is allowed in the National Assembly.

Socioeconomic development has continued its positive trend. Economic growth has been sustained at an average of 8.5% per year, secondary-school and university enrollment ratios have risen, health indicators have improved, more roads have been built for the rural population, and environmental concerns have begun to figure prominently in policy decisions. The overarching developmental philosophy of Gross National Happiness has been embraced by all political parties, as has the implementing framework of five-year plans. The government's effectiveness in utilizing donor funding for development has been acknowledged by the Asian Development Bank.

However, poverty remains a significant problem in rural areas, and agricultural production levels are stagnant.

The state has played a prominent part in all these developmental activities, despite reasserting the important role of the private sector in generating wealth and jobs. Doing business in Bhutan is difficult, and a variety of impediments prevent the emergence of a fully functioning market economy. Distance from markets, the country's landlocked location, difficulty in obtaining credit, a shortage of rupees (used as an alternate currency), inadequate investment protection regulations and the high costs of trading across borders are among the problems facing entrepreneurs in Bhutan. However, the number of tourist visits has continued to rise.

The government is running a small fiscal deficit, and public debt has risen to the fairly high level of 50% of GDP. It is expected to continue rising to 60%, driven largely by major hydropower programs that remain under construction, but to improve markedly thereafter. Financing for these projects comes from India, as do 75% of the country's imports. Similarly, 75% of Bhutan's exports go to India. This emphasizes the high level of dependence on India although the government has continued its efforts to integrate more fully with the region as a whole through active participation in the South Asia Association for Regional Cooperation (SAARC) and other regional initiatives.

History and Characteristics of Transformation

Bhutan underwent a major and generally peaceful transformation from direct royal rule to a constitutional monarchy over the course of 10 years. In June 1998, direct royal rule was ended by royal decree (kasho), and a cabinet of ministers was appointed. This initial step toward institutional reform was followed in September 2001 by the announcement that a written constitution would be prepared on orders of the king. On 25 March 2005, the draft constitution was publicly released. In a series of presentations and meetings with ordinary Bhutanese men and women throughout the kingdom and abroad, the king and his government presented the draft constitution to the people. On 18 July 2008, the constitution was formally enacted.

The constitution established a parliamentary system providing citizens with the right to form political parties for the first time in Bhutanese political history. It established the basis for a governing party, elected by simple majority, and an opposition party. The National Assembly subsequently debated and enacted a range of legislative measures associated with the formation of political parties, the conduct of elections and the creation of an Anti-Corruption Commission.

A major concern among policymakers was to educate the Bhutanese population about parliamentary elections and processes. Therefore, during April and May 2007, mock elections were held with fictional political parties to help educate the voters.

Elections for the newly created National Council were held in December 2007 and January 2008. These paved the way for the main elections in March 2008. The first elections were contested

between two newly formed political parties – the Bhutan Peace and Prosperity Party (Druk Phuensum Tshogpa, DPT) and the People’s Democracy Party (PDP).

A third party, the Bhutan People United Party (BPUP) was disqualified from competing in the elections when its registration was annulled by the Election Commission. The BPUP had declared itself to be a party for the downtrodden (nyamchung). Under Article 15 (4) (b) of the constitution, membership of a political party may not be based on “region, sex, language, religion or social origin.” Accordingly, the BPUP was held to be in breach of this article. In addition, the Election Commission declared that the BPUP’s charter “had no clear ideology, vision and mission, indicating the lack of leadership with capability to envision goals and objectives of the group.”

In the first-past-the-pole elections of March 2008, the PDP gained only two seats, while the DPT won virtual total control of the National Assembly. However, though attaining only two seats, the PDP did receive a reasonable number of votes. Therefore, while the election results reflected a range of concerns expressed by many ordinary Bhutanese about the future of their country, the nature and long-term impact of the political reforms, and the role of the monarchy, it is important to recognize that the apparent rejection of the PDP must be placed in wider context.

Although Thimphu, the capital, is developing rapidly, the country remains dominated by agriculture and a rural society. Education has been accelerating a rural-urban migration that began in the 1980s and has been intensifying since the mid-1990s. This has led to the rapid development of Thimphu. Until the early 21st century, the Royal Civil Service offered employment for school and college graduates. Since 2000 – 2001, the number of graduates has outstripped the number of posts available. There is growing concern over the limited private sector’s ability to provide employment alternatives. Recent reports from Thimphu suggest that new social problems are emerging, including the impact of urban life on the structure of Bhutanese families and the increasing social pressures associated with insufficient employment opportunities. Therefore, although Bhutan continues to make improvements in the provision of education, and adult literacy is increasing, new, primarily urban-focused policy concerns are emerging.

The so-called southern question, relating to Lhotshampa refugees who fled or were expelled from Bhutan in the early 1990s, remains unresolved. Although the governments of Bhutan and Nepal agreed to a joint program aimed at verifying the status of refugees, the verification process ceased following attacks on Bhutanese officials in December 2003. The resettlement of refugees in the United States, Canada and Norway has been undertaken, and although this provides an opportunity for the refugees to rebuild their lives, it has also provided new platforms for the refugees to criticize Bhutanese authorities.

Bhutan borders on two giant countries, India and China, but only has formal relations with one, India. While Bhutan is extensively and inextricably tied to India economically, financially and strategically it has been active in developing other relations with South Asian countries and was a founding member of the South Asian Association for Regional Cooperation (SAARC), the South Asia Preferential Trade Area (SAPTA) and the South Asia Free Trade Area (SAFTA).

The BTI combines text analysis and numerical assessments. The score for each question is provided below its respective title. The scale ranges from 1 (worst) to 10 (best).

Transformation Status

I. Political Transformation

1 | Stateness

Question
Score

The state has a monopoly on the use of force throughout the country. Despite the presence of ethnic diversity, ethnicity is not currently used as a basis for political mobilization. The Royal Bhutan Army includes the Royal Bodyguard and Royal Bhutan Police, which has a nationwide presence. An estimated 1% of GDP is used for military expenditure. No ideologically driven armed groups or criminal organizations operate in Bhutan. Relations with neighboring India are very close and cooperative. Cooperation extends to the armed forces in order to keep Indian insurgents from using Bhutan as a sanctuary. In 2003 there was a joint military operation to drive these insurgents out of Bhutan, and the continued Indian military presence in Bhutan is to ensure that the events are not repeated. Bhutan has no formal diplomatic ties with its giant northern neighbor, China, and there is still an unresolved border dispute between the two countries. However, the Bhutanese and Chinese heads of government met in 2012, and both reported favorably on that meeting.

Monopoly on the
use of force
8

The concept of Bhutan as a nation-state is widely accepted in the country by all its component ethnic groups. Before and since the departure of thousands of ethnic Nepali in the late 1980s and early 1990s, the government has vigorously promoted the concept of the Bhutanese nation-state, such that it has acquired legitimacy among all groups.

State identity
6

Access to citizenship is determined by the 1985 Citizenship Act. The rules are strict. Persons whose parents are both Bhutanese qualify for citizenship, as do those domiciled in the country before 31 December 1958. Otherwise, applicants for citizenship should demonstrate proof of at least 15 years (public servants) or 20 years (others) of residence, as well as proficiency in the national language. Some external organizations have commented on the “very strict criteria” facing “ethnic Nepali Bhutanese” when trying to obtain citizenship and security clearances. The fact that a

substantial number of the Lhotshampa are Hindus also makes citizenship a question of religion.

The constitution declares that religion is separate from politics and that religious institutions and personalities must remain above politics. Thus, the state is officially secular. Certainly, there is no political activity by the Buddhist establishment in a country where Buddhism is the dominant religion (75% of the population). Furthermore, the personnel of religious institutions are prohibited from standing in elections or voting. However, the constitution does state that preserving the country's Buddhist religious heritage is important and that society is "rooted in Buddhism." The national flag and emblem also draw from Buddhist symbolism. Thus, while there is no state religion in Bhutan, Buddhism comes close to occupying such a position. The state continues to provide some financial support for monasteries and religious activities. The law has been influenced by Buddhism, but the rule of law applies in the country and legal institutions are entirely separate from religious institutions. There is religious freedom in Bhutan, but missionaries are banned and there are restrictions on the construction of religious buildings other than those associated with Buddhism.

No interference of
religious dogmas
7

Bhutan has a generally well-functioning system of public administration involving central ministries in the capital and decentralized ministry offices in the districts (dzongkhags). The system has traditionally been bureaucratic in character, with considerable attention paid to hierarchy, process and seniority. In recent years, some efforts to modernize the civil service using foreign aid and technical assistance have been made. However, many traditional features remain.

Basic
administration
7

With a relatively small and underdeveloped private sector, especially in rural areas, the state has taken most of the responsibility for service delivery. Basic services are provided throughout the country, and the coverage and quality of these services has been steadily improving. Universal primary education has been achieved, life expectancy has risen from 52.4 years in 2000 to 66.7 years in 2010, and 97% of the population has access to an improved water source. Poverty levels were recorded at 23% of the population in a 2007 survey, but the prime minister announced in March 2013 that this had been reduced to 12%.

2 | Political Participation

Bhutan's first (and as of the time of writing, only) national elections were held in 2008. The European Union Election Observation Mission noted an "enthusiastic voter turnout" that brought 79.4% of the electorate to the polls, an election process that "generally met international standards for democratic elections," and a legal framework that provided a "solid basis to conduct elections." The mission did note some restrictions on candidates (e.g., they have to hold university degrees), some

Free and fair
elections
8

limitations on the freedom of association, and the exclusion of NGOs from supplying election information or advice. The Election Commission proved to be effective and impartial, and there were no disputes over the outcome of the elections. Rules for parties' and candidates' media access were enforced by the Election Commission and provided for equal access. Despite the difficult mountainous terrain and often poor infrastructure, the Election Commission organized good voter access to polling stations, enabling people to cast votes even in the remotest villages. The voter registration process was transparent and fair. The election for the National Assembly, the lower house, resulted in a landslide for one of the two parties contesting the election – 45 seats to two – raising questions as to the effectiveness of the opposition.

The second elections for the National Council and National Assembly were to be held in 2013. By March 2013, it was already evident that the contests had attracted more candidates and parties than during the first ballot. For the National Council, where no party affiliation is allowed, there were up to five candidates in some constituencies, as compared to 2007, when the election had to be postponed in some constituencies to find even one candidate. There is a seat for each of the 20 districts, but the king still selects an additional five persons. For the National Assembly, five parties are contesting the election in 2013 as compared to two in 2008. This media was full of election coverage beginning in the second half of 2012, with a general equality of media access. Bhutan also has nonpartisan elections at the block (gewog) level.

Bhutan's political elite is small, and has demonstrated consistent loyalty to state and king. The military has no record of challenging the state, while the clergy do not participate in politics. In short, there are no active domestic veto players. However, there are two potential veto players, one domestic and one external. The potential domestic veto player is the king. He is part of the parliament and has the power of assent for bills of parliament. He may return bills with recommendations for amendments, but must abide by the final decision of both houses. The king and the institution of monarchy are held in very high esteem in Bhutan, and the two houses of parliament are highly unlikely to make proposals with which the king would strongly disagree. There is thus an anticipatory element to policymaking in Bhutan. The potential external veto player is India. It provides considerable financial aid to Bhutan and accounts for 75% of all trade. There are Indian troops based on Bhutanese soil. The Bhutanese government is likely to avoid actions expected to annoy India. However, neither the king nor the Indian government has taken any action that could be interpreted as veto behavior. There are two potential policy influencers in the form of the Buddhist hierarchy and the emergent class of wealthy entrepreneurs. The former might be able to mobilize against any perceived threat to their situation, while the latter may already be able to contribute to policy debates on economic matters of direct consequence to them.

Effective power to govern

7

The constitution guarantees freedom of assembly and freedom of association, but in practice there are some restrictions. Citizens can join political parties that have been approved by the Election Commission. In 2008, only two parties were approved to participate in the first national election, but five received approval in advance of polling in 2013. Parties established by ethnic Nepali refugees are regarded as illegal and operate only outside the country. Protests are permitted but must be approved by the government. However, protests rarely if ever occur, especially as they are portrayed as a non-Bhutanese mode of behavior. Freedom of association has the proviso that it is only for groups “not harmful to the peace and unity of the country.” Thus, NGOs that might work on refugee, human rights or other sensitive issues are not allowed to operate. All NGOs must register with the government. There are no trade unions, because of the rural subsistence-agricultural nature of much of Bhutan’s economy, the relative absence of large organizations and lack of government support for unions.

Association /
assembly rights
6

The constitution guarantees the freedoms of opinion and expression as well as the right to information. However, there is no freedom of information act, press council or broadcasting code. The media are not officially censored, and the number of media organizations has grown considerably in number since democratization in 2008. According to Freedom House, there were seven newspapers, six radio stations, one television channel and four Internet service providers in early 2011. In the post-democratization period, there have been increasing numbers of articles exposing corruption or questioning government actions. However, there still seems to be significant self-censorship, and media outlets are well aware of the Security Act 1992 that prohibits expression deemed to undermine the security and sovereignty of the country. With small circulations, the print media is highly dependent on government advertising, and there has been some concern that this financial clout could be used to influence newspaper content. In Reporters Without Borders’ 2012 global report, Bhutan slipped 12 places to rank 82, although it is not clear what caused this fall. Bhutan still ranks well above all other South Asian nations in terms of press freedom and has risen from a very low ranking of 157th place in 2003, before democratization.

Freedom of
expression
7

3 | Rule of Law

The constitution clearly sets out a separation of powers. The executive, legislature and judiciary are formally independent of each other. However, the domination of the first National Assembly by the DPT, by a ratio of 45 seats to two seats, raises questions about the institution’s ability to counter executive power. The nonpartisan National Council has provided a critical forum. The monarchy still exercises formal authority as part of the parliament but also wields considerable informal power. Prior to democratization, the judiciary was frequently viewed as an extension of the government machinery and/or a tool to support the interests of the powerful. The

Separation of
powers
7

Supreme Court demonstrated independence in 2010 ruling against the government in a case brought by the opposition. In March 2013, a district court found the National Assembly speaker and the minister of home affairs guilty in a case brought by the Anti-Corruption Commission.

Under Article 21(1) of the constitution, the Bhutanese judiciary is independent and charged with upholding the rule of law. The Supreme Court sits at the top of the court hierarchy. Below it are the High Court in the capital Thimphu, dzongkhag courts in each of the country's 20 districts, and dungkhad courts in 15 sub-districts. The decisions of the lower courts can be appealed upward and each level of the court system maintains its independence.

Independent
judiciary

7

There has been investment in upgrading the skills and knowledge of judicial officials through foreign technical assistance and with the establishment of the National Legal Institute. This organization arranges continuing judicial and legal education, including outreach programs to schools and supporting television programs. The Supreme Court has so far managed to act as guardian and interpreter of the constitution, and has developed credibility both domestically and internationally. The penetration of modern legal institutions into the affairs of rural communities remains in some cases minimal.

The Anti-Corruption Commission has worked well since commencing operations in 2006. In its first six years of operation, the Commission dealt with 2,500 complaints, undertook 80 investigations and had a conviction rate of 92%. It has a broad mandate to investigate, prevent and provide education on the subject of corruption. The commission also administers the on-line asset declaration system that is compulsory for all public officials. In March 2013, it secured a guilty verdict against the speaker of the National Assembly and the home minister in connection with an "administrative" offence concerning land allocations committed before their election to office.

Prosecution of
office abuse

8

The fundamental civil rights of Bhutanese citizens are set out in Article 7 of the constitution. These include the freedoms of speech, opinion, expression, movement and religion, the right to vote, and equality of access to public services and before the law. There is no capital punishment. There are no reports of disappearances or arbitrary killings, and prisons have been judged as satisfactory by civil society organizations. Regulations against arbitrary arrests and detention are generally observed.

Civil rights

6

The police have sometimes been taken to task over human rights violations, and there have been allegations, especially by external ethnic Nepali organizations, that the Nepali Lhotshampa population has been subject to discrimination and human rights abuses. While freedom of religion is guaranteed in the constitution, missionaries are banned, as is the construction of religious buildings for Hindus and Christians.

Bhutan is a signatory to the Convention on the Elimination of All Forms of Discrimination Against Women and other international agreements. NGOs report little overt discrimination against women, and say that women have equal access to public services. However, media reports in 2013 reported a rise in the incidence of domestic violence and sexual assaults. It is difficult to ascertain whether this indicates a disturbing rise in such violence or if there is greater confidence in the law enforcement agencies. The National Commission for Women and Children is responsible for implementing the country's obligations to international agreements on women and children, and NGOs within the country focus on issues related to these groups.

4 | Stability of Democratic Institutions

The National Assembly has successfully produced legislation, although the overwhelming domination of the DPT has meant that the opposition has been very weak. However, the opposition's performance has in fact been more significant than might have been expected with only two members. The National Council has been an effective counterweight to the National Assembly in its role scrutinizing legislation. Both parties, the National Council and the king have explicitly expressed their commitment to the goals of the national development philosophy and strategy, which is based on the Gross National Happiness concept. It is difficult to ascertain the degree to which the king's informal power and universal respect constrains the operation of democratic institutions; however, he has declared his commitment to the values associated with a constitutional monarchy.

The Election Commission is seen to be politically neutral, while the judiciary has been strengthened through the appointment of younger judges with modern legal training. This has given the judiciary a better understanding of the rule of law in a democratic system, and of the role of the judiciary in it. The Supreme Court has demonstrated its commitment to its role as guardian of the constitution.

The legitimacy of Bhutan's democratic institutions has been established since the first national elections in 2007 – 2008. There are no active veto players. However, during the period under review, political power was concentrated in the governing DPT. The run-up to the 2013 elections showed greatly increased competition for political office, although the electoral system involves a primary election for the National Assembly that will leave only two of the five parties to compete in the ensuing general election. This political engineering is designed to prevent the occurrence of potentially unstable coalition governments. There are few interest groups in the Bhutanese political landscape, and those that exist are weak in comparison to the state.

Performance of
democratic
institutions

7

Commitment to
democratic
institutions

7

5 | Political and Social Integration

With only one national election having taken place before the end of the review period, it is difficult to determine the stability and rootedness of the political party system. Parties have small memberships, and Bhutanese commentators believe that the success of the DPT derived from the popular appeal of its leader. The policy platforms of the two competing parties differed little. The policies of the five parties preparing for the 2013 elections had by the close of the review period revealed little by which to differentiate them, and perceptions of leadership may continue to be the main influence on voting behavior. Thus, while the number of parties has increased, the distinctions between them have not. Political parties only contest seats in the National Assembly. The National Council is explicitly nonpartisan in character, and parties cannot participate in local-level elections.

Party system
4

There are few interest groups in Bhutan, and those that exist are of only marginal importance in a country where the state has such a commanding presence. There is some influence from business organizations such as the Association of Bhutanese Tour Operators and the Bhutan Chamber of Commerce and Industry, but the state still dominates in terms of policymaking and implementation. NGOs have been developing, but remain few in number and focused on the environment and women and children's affairs. Some NGOs, such as the National Women's Association of Bhutan and the Royal Society for the Protection of Nature, receive royal patronage. There are no trade unions, and the only political mobilization of ethnic interests occurs outside the national boundaries, in refugee camps located in Nepal.

Interest groups
3

The only opinion poll survey data available derives from the 2010 Gross National Happiness survey. In that survey, 92% of respondents indicated an intention to vote in the next election which the survey reporters interpret as a commitment to democracy. However, it could equally be a recognition of civic duty. The questions on political freedoms found 61.7% of respondents acknowledging the existence of "sufficient" political freedom. However, there was a significant share in the "don't know" category, an indication that democratic concepts have not yet been fully understood and internalized by citizens. From this limited data it is impossible to provide an accurate estimation of citizens' level of support for democratic norms and procedures. Traditionally, decision-making focuses on building consensus through mediation. This occurs in both the policy process and the operation of the judiciary. The traditional acquiescence of society to the state and its acceptance of the state's legitimacy may have been transferred to the new democratic institutions, with the latter simply being regarded as the latest manifestation of the state. Personal contact shows that there has been increased discussion of politics and policy matters, while Internet activity in these fields by individual citizens has increased.

Approval of
democracy
n/a

Traditional rural Bhutanese society had a variety of civil society organizations. These were locally based, often around the monasteries, and focused on community functions such as mutual support, water management and religious festivals. Some of these survive today, especially around the monasteries, although urban-rural migration and modernization have led to the disappearance of some of these organizations, or at least hampered their work. Kinship networks retain an importance even in urban areas, and are characterized by close interactions and the provision of help in times of crisis. However, traditional rural-community solidarity has not been replaced by new autonomous organizations in urban areas. There are a few NGOs and sports clubs, but modern forms of voluntary association remain few in number. The 2010 Gross National Happiness survey revealed that 46% of respondents trusted most of their neighbors. A strong sense of belonging was reported by 71% of respondents. These figures indicate that levels of trust are being maintained, although one suspects that they are lower in the rapidly growing urban areas.

Social capital
5

II. Economic Transformation

6 | Level of Socioeconomic Development

Bhutan has made steady progress in improving the welfare of its population and in growing the economy. The country's Human Development Index (HDI) score improved from 0.525 in 2010 to 0.538 in 2012, placing Bhutan in the UNDP's middle human development category, ranked at 140th place out of 185 countries. Life expectancy at birth rose from 55 years in 1993 to 67.6 in 2012. There is now universal primary education, and secondary-school and tertiary enrollment ratios are rising. However, the adult illiteracy rate remains quite high, at approximately 50%. Bhutan is ranked 92nd on the UNDP gender inequality index, well above its overall HDI placing. The economy has performed well and has a long-term average growth rate of 8.5%, a level that is expected to be maintained. However, the UNDP's 2010 Multidimensional Poverty Index shows 27.2% of the population to be living below the poverty line. Using the national poverty line measurement, the proportion of people living in poverty is still high, at 23.2%, although this figure dates to 2008. In March 2013, the prime minister announced that only 12% of the population remained below the poverty line, but the statistics had not been published as of the time of writing. If these figures are correct, then this will represent a remarkable achievement in poverty alleviation. Poverty is concentrated in the rural areas where approximately 65% of the population resides, with many earning their living from subsistence-based agriculture. However, there is little growth in the agriculture sector. Hydropower and tourism largely account for the country's strong economic growth rates. Urbanization has been proceeding rapidly, notably in the national capital, and problems are

Question
Score

Socioeconomic
barriers
4

emerging in areas such as housing provision, environmental deterioration and unemployment.

Economic indicators		2009	2010	2011	2012
GDP	\$ M	1264.7	1585.3	1833.7	1779.6
GDP growth	%	6.7	11.7	8.5	9.4
Inflation (CPI)	%	4.4	7.0	8.8	10.9
Unemployment	%	4.0	3.3	3.1	-
Foreign direct investment	% of GDP	0.5	1.2	0.9	-
Export growth	%	-0.8	-1.3	-0.9	-
Import growth	%	8.7	12.3	-2.5	-
Current account balance	\$ M	-20.2	-142.2	-354.9	-
Public debt	% of GDP	67.7	54.4	65.1	72.1
External debt	\$ M	761.3	907.4	1035.3	-
Total debt service	\$ M	75.5	84.2	84.7	-
Cash surplus or deficit	% of GDP	0.5	-	-	-
Tax revenue	% of GDP	9.2	-	-	-
Government consumption	% of GDP	21.4	20.0	20.8	-
Public expnd. on edu.	% of GDP	4.6	4.0	4.7	-
Public expnd. on health	% of GDP	3.9	3.6	3.4	-
R&D expenditure	% of GDP	-	-	-	-
Military expenditure	% of GDP	-	-	-	-

Sources: The World Bank, World Development Indicators 2013 | International Monetary Fund (IMF), World Economic Outlook 2013 | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database 2013.

7 | Organization of the Market and Competition

Agriculture remains the major source of income and employment for the majority of Bhutan's population. Although 59.3% of the labor force was in agriculture in 2011, agriculture accounted for only 14.4% of GDP. There is still a strong subsistence character to much agricultural production. The state plays a major role in the

Market-based
competition
3

economy through state-owned enterprises (SOEs), which account for 50% of tax revenue. Hydropower accounts for 85% of that revenue. There is government involvement in pricing in such items as gasoline, bus fares, propane and even meat. The private non-agricultural sector is small, with few large companies, as is the informal sector. Market-based competition has been developing but is still at a rudimentary level in what remains a very small economy. The country has difficulty in attracting private sector investment due to its landlocked location, small domestic market, distance from global and regional markets, weak economies of scale, narrow economic base, and vulnerability to natural disasters.

The state has played a dominant role in modernizing Bhutan. In the absence of a significant private sector, it has established many enterprises. Some of these have been privatized and others corporatized, but a substantial state-owned enterprise sector that includes monopolies in areas such as television, electricity and postal services remains. There are few large private-sector corporations. There are no laws on anticompetitive practices, monopolies and cartels, but a Consumer Protection Act was passed in 2012. This has given a slight boost to competition in the economy as government price regulation to some degree helps to prevent the development of monopolies.

Anti-monopoly
policy
3

Bhutan is not a member of the WTO, but enjoys observer status. The country was described by the United Nations Conference on Trade and Development (UNCTAD) in 2011 as having a “fair degree of openness” in terms of tariffs and quantitative restrictions. The bulk of Bhutan’s imports are from countries with which Bhutan enjoys free trade or preferential trade, notably India. Indeed, almost all goods travel overland through India to get to Bhutan. The bulk of exports are to countries where duty-free arrangements or preferential treatment prevail, notably India. However, Bhutan was ranked 172nd in 2013 in the World Bank’s index assessing the ease of trading across borders. This very low ranking reflects the transaction costs of trade in both Bhutan and India, including documentary requirements, customs procedures and other non-tariff barriers. As for exports, the main item is electricity, a commodity that cannot be freely traded. It is exported exclusively to India, and prices are subject to bilateral negotiations.

Liberalization of
foreign trade
4

Until 2010, state banks held a monopoly in Bhutan. Since that time, two private banks have begun to operate, but the sector remains underdeveloped. There have been high rates of credit growth in recent years, and a slight increase in the share of non-performing loans (3.1% in 2011 to 5.9% in 2012). Despite the growth in availability of credit, the World Bank ranked Bhutan at 129th place worldwide for “getting credit” in 2013, below the regional average. A shortage of Indian rupees in 2012 led to restrictions on rupee credits for borrowers, especially in the construction industry. The rupee shortage continued through 2013.

Banking system
4

8 | Currency and Price Stability

The Bhutanese currency (the ngultrum) is pegged to the Indian rupee and is a source of vulnerability, as the country's inflation rate moves in tandem with that of India. Inflation in 2012 was the highest ever at 10.9%, an increase of 2.06% over 2011. In addition to imported Indian inflation, the rupee shortage in Bhutan meant fewer imports from India and a consequent scarcity of goods that placed further upward pressure on prices. The shortage of Indian rupees partly stems from the constitutional provision that a "minimum foreign currency reserve that is adequate to meet the cost of not less than one year's essential import must be maintained" (Article 14 (7)).

Anti-inflation /
forex policy

4

Bhutan's total public debt totaled 50% of GDP in 2011. Although this is fairly high, it is regarded as sustainable. It has grown because of investment in hydropower, infrastructure, education and health. The amount of debt does constrain the government's fiscal flexibility, and has raised concerns about fiscal deficits and inflation. Debt is projected to rise to 60% of GDP in 2014 – 2019, while economic growth is projected to be 9% per year over the same period. Debt is expected to decline substantially once hydropower projects are completed and exports of electricity to India commence. Bhutan has a trade deficit, but the balance of payments is overall positive thanks to external grants and loans.

Macrostability

7

9 | Private Property

The constitution guarantees Bhutanese citizens the right to hold property. A full cadastral survey was completed in 2003 and enabled the clear definition of land holdings. There are well-maintained records of land holdings and ownership. The Land Act of 2007 provides comprehensive coverage of the regulation and administration of land. There are few large landowners, and foreign ownership of land is not permitted. The World Bank ranked Bhutan 85th worldwide in terms of the ease of registering property in 2013, well above its overall doing business ranking of 148th place.

Property rights

6

While the private sector is portrayed as the engine of growth in Bhutan, it remains small and underdeveloped. Corporatized state-owned enterprises are the biggest businesses in the country, and dominate fields including power generation and distribution, postal services, airlines, banking and television. Bhutan's first private hospital opened in June 2012. There are only a few private schools. In the World Bank's 2013 doing business survey, Bhutan received consistently low rankings for many of the items examined, particularly getting credit (129th place), protecting investment (150), dealing with construction permits (124) and resolving insolvency

Private enterprise

5

(85). However, the country received better rankings for starting a business (94), registering property (85) and enforcing contracts (37).

10 | Welfare Regime

The state does not provide welfare benefits to citizens. Public servants, the military, employees of state-owned enterprises and some private sector employees do have access to pension programs, but the rural population and those in small-scale enterprises do not. The most important social safety net in both rural and urban areas is the family. Obligations to look after kin are strong but may be weakening as urbanization continues. Local religious institutions provide some assistance to individuals and communities, while NGOs and external organizations sometimes provide temporary relief for particular categories of the needy.

Social safety nets
3

Bhutan is ranked 92nd of 185 on the UNDP gender inequality index. Males (36.8%) are still overrepresented compared to females (26.6%) in the population over 25 years of age holding at least a secondary education, but the gap is narrowing. Universal primary education has been achieved, and roughly equal numbers of girls and boys are enrolled. Leadership positions are still dominated by men, with only four of the National Assembly's 47 members being women. Six members of the 25-person National Council are women. However, two of the five parties contesting the 2013 elections have women leaders. In the civil service, women accounted for 32.05% of employees in December 2011, but are underrepresented in the upper ranks. The workforce participation rate for women is rising, at 65.8% compared to 76.5% for males.

Equal opportunity
5

11 | Economic Performance

Quantitative indicators show Bhutan's economy to be performing reasonably well. Growth has been strong, with an average yearly rate of 8.7% between 2005 and 2010. This trend was maintained in 2011 with an 8.4% growth rate. Gross national income per capita (on a PPP basis) has been steadily rising, from \$4,550 in 2008 to \$5,570 in 2011. Foreign direct investment has proved hard to attract, with only \$19 million reported for 2010. Not included in this figure, however, is the substantial Indian investment in Bhutan's hydropower plants as well as Indian-funded and -directed infrastructure projects. There was a trade deficit in 2010 – 2011 of \$433.9 million, largely due to the import of capital goods for power projects and housing construction. Due to the substantial inflow of grants and loans, the overall balance of payments was positive, at \$82 million. Current expenditure in 2010 – 2011 was \$271.6 million, while capital expenditure was \$272.5 million. The fiscal deficit in 2010 – 2011 was \$30.8 million. Tax revenues amounted to \$213.7 million, non-tax revenue was \$108.1 million and grants totaled \$193.5 million. Public debt rose to

Output strength
7

approximately 50% of GDP and is expected to rise to about 60% during the course of construction of major hydropower projects. Inflation, mostly imported from India, was 9.1% in 2010, 8.5% in 2011 and 10.9% in 2012. The unemployment rate was 3.1% in 2011, rising slightly to 4% in 2012. Youth unemployment dropped from 9.3% to 7.3% in 2012.

12 | Sustainability

The constitution declares that it is “a fundamental duty of every citizen to contribute to protection of the natural environment, conservation of the rich biodiversity of Bhutan and prevention of all forms of economic degradation.” The importance of the environment in Bhutan is also emphasized in the national development philosophy of Gross National Happiness (GNH), and features strongly in the five-year development plans. Bhutan was ranked at 40th place in the 2010 Environmental Performance Index produced by Yale University, but was not included in the 2012 version. Bhutan is on target to achieve the seventh Millennium Development Goal, relating to the environment. As 72% of its land area is still forested, Bhutan would be a beneficiary of carbon emission trading. However, environmental problems do exist, relating to solid waste disposal, the impact of road construction, the loss of prime agricultural land to urbanization, illegal logging, the overexploitation of non-timber forest resources, high levels of fuel-wood consumption, and livestock practices that exceed the land’s carrying capacity in some areas. Climate change has also contributed to dangers such as glacial-lake bursts and flash flooding. The causes of such calamities lie beyond Bhutan’s control, as they relate to global changes.

Environmental
policy
7

Considerable improvements in the availability of education have been made in recent years. Universal primary education has been achieved, and secondary education enrollment ratios have risen considerably in recent years. Middle-secondary enrollments increased in total from 48,716 in 2007 to 50,102 in 2011, while those in higher secondary doubled from 14,963 in 2007 to 28,799 in 2011. The gross enrollment ratio for secondary schools was 70% in 2011. Tertiary enrolments are also climbing, with the Royal University of Bhutan increasing student numbers from 3,550 in 2007 to 6,315 in 2011. However, the gross enrollment ratio for tertiary education remains low, at just 8.8%. Many students attend colleges and universities in India. The adult literacy rate of 52.8% is also low, and the share of the population with at least a secondary education was just 34.4% in 2011. These figures reflect the comparatively recent development of mass education in the country. The amount spent on education is equivalent to about 4% of GDP. The quality of education is the current policy concern. There is a recognized need to improve quality in order make the economy more competitive and public services more efficient.

Education policy /
R&D
4

Through the 2012 Bhutan Education City Act, the government has set up a public-private partnership (PPP) program to establish an education hub in Bhutan involving leading colleges and universities from throughout the world. Another PPP has been formed to build an information-technology park that aims to attract high-tech companies to the country. To date, R&D activities have been very few and largely confined to agriculture.

Transformation Management

I. Level of Difficulty

Bhutan is a landlocked country with a small market spread widely across the country's difficult terrain. Road infrastructure has improved, but it still takes considerable time to travel between the population centers. Landslides are a hazard in the rainy season, while roads can be blocked by snow in winter. Earthquakes have sometimes caused considerable damage to roads. Domestic air services, begun only in 2012, remain very few and beyond the financial reach of most of the population. International air services have grown so as to cope with the increase in tourist numbers and the rising number of Bhutanese travelling abroad. Despite liberalization, there is still only a single international carrier, a state-owned enterprise.

Structural
constraints

6

Bhutan has a history of organizations that can be classified as traditional forms of civil society. These undertook functions such as ensuring livelihood security, managing water rights or preparing festivities. They were based in local communities, and were sometimes associated with monasteries. Many still exist today, but are finding it difficult to continue operating as in the past due to rural-urban migration and the consequent depopulation in remote areas. Modern forms of civil society such as NGOs and professional associations are a recent innovation in Bhutan. They are governed by the Civil Society Organizations Authority (CSOA), which operates under the terms of the Civil Society Organizations Act 2007. The purpose of the act and authority was to provide a stronger legal and regulatory framework for civil society organizations. The development of this modern civil society has been gradual. In 2013, the CSOA website listed 30 organizations. They included organizations for women, youth, the disabled and senior citizens, as well nature- and industry-oriented associations in areas such as handicrafts or tourism.

Civil society
traditions

9

Bhutan is largely free of social, ethnic and religious conflicts. The ethnic tensions and conflicts of the early 1990s have abated following the departure of a substantial proportion of the country's residents. Citizenship requirements have been clarified and appear to be widely accepted, although some Lhotshampas still have no more than resident status. Many of the refugees in Nepal have been resettled to third countries, and their political activities and organizations have little or no effect in Bhutan. There are no religious conflicts. Buddhism is perceived to be the religious foundation of the country, and while religious freedom is guaranteed in the

Conflict intensity

4

constitution, the missionary activity of other religions is banned and new religious buildings not allowed. There is no political mobilization on a class basis. Decision-making is generally consensual in nature and overt conflict is avoided. A strong state is accepted as legitimate and is expected.

II. Management Performance

14 | Steering Capability

The state has a guiding philosophy of national development based around the concept of Gross National Happiness (GNH), the idea of which was originated by the fourth king and to which all political parties and other domestic political actors adhere. All policies must conform to the requirements of GNH, which is built on four pillars: sustainable and equitable socioeconomic development; conservation of the environment; preservation and promotion of culture; and good governance. There is a longstanding utilization of five-year plans to give strategic direction to national development in the context of GNH. The period of the 10th Five Year Plan 2008 – 2013 is ending, and the 11th Five Year Plan 2013 – 2018 is commencing. The Commission for Gross National Happiness, the equivalent of a planning ministry in other countries, looks after the formulation, coordination and administration of the five-year plans and is a capable organization. Planning occurs in a bottom-up process from the block or gewog level, but the commission has the final say on the content of the plans. The advent of democratization has not disturbed continuity in the national development strategy or the use of medium-term planning frameworks. As of the time of writing, the parties campaigning for the 2013 election had not indicated any intention to change the situation. However, the increased costs of plan funding are becoming a challenge for the government, while some of the outputs, most notably, the growing numbers of educated youth, are creating new policy problems for government to address.

Little or no disagreement was reported from within the cabinet during the period under review, while the opposition in the National Assembly has been numerically weak – just two opposition legislators as compared to 45 government-party members. This situation is to be expected in a country where consensus is valued highly and conflictual politics are avoided. The opposition has questioned government actions, but the most effective scrutiny has come from the nonpartisan National Council. As the electoral rules only permit two parties to be present in the National Assembly, the numerically superior party will form the government and will always be able to outvote the opposition. This will of course assist the government in implementing its

Question
Score

Prioritization
6

Implementation
7

policies, although it does not rule out rigorous scrutiny from the National Council. The main constraint to implementation will come from rising costs.

The civil service is responsible for the implementation of policies, and has demonstrated effectiveness in this regard. The steady improvement in welfare indicators can be largely ascribed to the civil service, which assumes most responsibilities for education, health, infrastructure, agriculture and most other services. It is characteristically bureaucratic in its organization and processes, and maintains a decentralized staff presence in individual districts. There are skill deficits in some areas of civil service operation. Efforts to modernize the civil service have met with moderate success. Remote areas present great challenges for government employees in terms of the implementation of policies.

Bhutan has demonstrated a capacity to learn from its own experiences and from those of other countries, and appreciates the need to learn. Through multilateral organizations such as the UNDP, the United Nations Children's Fund (UNICEF), the World Bank and the Asian Development Bank, and a small group of bilateral donors and northern NGOs, the government has been able to access international experts who have provided policy advice, program design assistance and the demonstration of good practices elsewhere. However, this technical assistance is not always of the best or most appropriate quality, with an adequate depth of understanding of the Bhutanese situation. This raises the possibility of misguided policy transfer.

Bhutanese government officials travel overseas to boost their own knowledge and understanding of particular issues and practices that fall within their areas of influence and concern. A considerable number of students relative to the country's population have gone overseas for training or education; goals have ranged from vocational skills to postgraduate coursework, with higher degrees by students in research-based fields recently becoming more common. Australia's University of Canberra now offers public administration and management programs at the master's level in Thimphu, in association with the Royal Institute of Management. These developments reflect a clear policy goal of increasing the skills and knowledge of public servants, SOE employees and others in order to make Bhutan a knowledge-based society and a hub for innovation and education in South Asia. However, the achievement of these aims is still a long way off.

The most remarkable item of policy learning has been the untroubled transition from a longstanding authoritarian political regime to a constitutional monarchy with well-functioning new institutions determining policy, and where debate is both encouraged and allowed. The transition has been smooth, and reflects the country's ability to adapt imported institutions so as to fit the Bhutanese context.

Policy learning

6

15 | Resource Efficiency

Bhutan's public administration system has been traditionally bureaucratic, focusing on hierarchy, seniority and process. While the country has yet to develop a results-oriented bureaucracy, the traditional model has worked reasonably well to produce the outputs and outcomes desired by the government. The civil service functions on the basis of upward accountability, resulting in low levels of corruption.

Efficient use of
assets

7

The civil service is governed by the Civil Service Act 2010, which sets out details of all human resource management activities from recruitment to duties, remuneration, promotions and discipline. The act is administered through the more detailed Bhutan Civil Services Rules and Regulations, and centralizes human-resource management authority in the Royal Civil Service Commission (RCSC). This organization administers human resource functions for all civil service organizations, and runs the entry exams for the civil service. Entry is open only to university-level graduates through nationwide common exams.

Bhutan has a record of good and professional budget management, as well as of balancing the state budget, although there was a small budget deficit in 2010 – 2011. At 50% of GDP, public debt is quite high, and is predicted to rise further to 60%. The trend will be reversed once the hydropower projects under construction are completed and electricity exports begin flowing to India. Bhutan relies on India for considerable budgetary support, especially for capital works.

The relatively small scale of government, the preference for consensual decision-making and the guiding frameworks of five year plans have led to a significant degree of policy coherence. The Commission for Gross National Happiness plays a major role in coordinating and managing policy. However, government organizations still work according to clearly delineated functional responsibilities that may sometimes hamper more whole-of-government approaches. There is an administrative decentralization within the country's 20 districts. Appointed officials posted there work with locally elected officials to produce plans at the district and block levels, which feed into the overall national plans of action. Despite this decentralization, there is still a strong centralized feel to government decision-making and to the administration of government officials. Hierarchy is still a major organizational principle in Bhutan.

Policy
coordination

7

The government of Bhutan has a good record in containing corruption. The incidence of corruption is lower than in neighboring South Asian countries. Several factors explain this. First, smaller governments such as that of Bhutan are easier to monitor and audit. Second, there has been a concerted effort by the government over several years to raise the standards of accounting and auditing to international levels. Third, the Accounting and Auditing Standards Board of Bhutan was introduced in 2010,

Anti-corruption
policy

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with the aim of assisting in raising Bhutanese standards in these activities. Fourth, the idea of service to the state and king is ingrained in the civil service and acts to prevent corruption. Finally, the Anti-Corruption Commission (ACC) established in 2006 has been a notable force in promoting the anti-corruption message and in investigating and prosecuting corrupt officials. In March 2013, the ACC secured guilty verdicts for a case against the speaker of the National Assembly and the minister for home affairs dating back to years before their election to office.

16 | Consensus-Building

The 2013 national elections will be a test of whether democracy has taken root in Bhutan. Early signs are promising, with five political parties contesting the elections in 2013 as opposed to two in 2008, and National Council seats attracting far more candidates than in 2008. There is more discussion of politics and policy issues among the educated, but the degree to which democratic ideas have penetrated rural areas, where most people live, remains unclear. The Gross National Happiness survey of 2010 revealed a poor understanding of the constitution. Only 1.6% claimed “good knowledge” of the constitution. However, rural people have experience of local-level democracy in block-level elections and participatory planning processes.

Consensus on goals
6

The market economy is proving more difficult to establish. Traditionally, the state has played the most dominant role in developmental activities. Despite policy pronouncements about the importance of the private sector in creating wealth and employment, the state has continued this role through the civil service and government enterprises. Restrictions on doing business, such as difficulties in obtaining credit, hindrances associated with permits and the costs of trading across borders hamper the creation of a market economy. Knowledge of the intricacies of a market economy is not widely distributed among the population, and most enterprises are simple and very small-scale.

Democratization is currently supported or accepted by all, either because it is the preferred mode of governance or because it was introduced by the fourth king and upheld by the fifth king. High levels of respect for and deference to the monarchy still characterize Bhutan. The monarchy is the only potential domestic veto player in Bhutan. India is the only potential external veto player, and it supports democratization in Bhutan as long as it does not threaten the state’s stability or India’s strategic interests. Thus, India’s support is contingent on Bhutan’s relationship with China. Any significant move toward a relationship with China could precipitate action by India. The only vocal opposition to Bhutan’s government is to be found among exiled populations. Such opposition groups have no impact on politics inside Bhutan.

Anti-democratic
actors
7

The only challenge to government authority came in the early 1990s from among the Lhotshampa population in the south of the country; however, many of these individuals were expelled or left for refugee camps in Nepal. Radical organizations continue to exist among the exiles, but have no effect on political life in Bhutan. There are other ethnic groups in Bhutan, but there are no conflicts based on these identities. The east of the country is much less developed than the west in terms of infrastructure, urbanization, education and the economy, but this has not been a source of dispute or conflict. Finally, there is no evidence of class-based conflict in Bhutan, although considerable socioeconomic disparities are evident. The 2010 Gross National Happiness survey revealed that the overall level of happiness was low – 49% for men and 33% for women – but that there was very little interregional difference in this regard. There is no evidence to suggest that the distribution of happiness is giving rise to societal conflicts.

Cleavage /
conflict
management
7

Traditional civil society in Bhutan was community based and dealt with local matters such as water rights, human security and festivities. Modern civil society in the form of NGOs and professional associations is new to Bhutan. The constitution states that the “state shall endeavor to create a civil society.” The Civil Society Organizations Act 2007 distinguishes public and mutual-benefit organizations as well as foreign CSOs. There is no reference to traditional organizations. Few organizations – only about 30 as of the time of writing – have been registered under the act. They may be consulted by government in their areas of specialization such as women’s affairs, youth or the environment, or because they comprise a professional association. However, their impact on policy may have more to do with their sponsorship than their organizational capacity. At least two NGOs enjoy royal patronage. NGOs have been banned from activities directly relating to politics, and so must pursue any agenda with care. There are no trade unions. Within many areas of policymaking, there are no active NGOs. Thus, the overall impact of civil society on the policy process is very small and selective.

Civil society
participation
4

Explicit opposition to the Bhutanese government and political regime has come entirely from the Lhotshampa exile communities. Since the departure of an estimated 105,000 persons from the south of the country in the early 1990s, following anti-government activities and a democratization movement, a variety of organizations, often based in refugee camps in Nepal, have strongly criticized the Bhutanese government. Despite a series of meetings between the Bhutan and Nepal governments, no agreement has been reached regarding resettlement of any of these refugees back in Bhutan. Rather, the international community has offered many thousands of resettlement places to the refugees, most of whom have indicated a desire to be resettled in third countries. There is no process of reconciliation.

Reconciliation
3

17 | International Cooperation

Bhutan's government is strongly dependent on international support, and seeks to align it with the achievement of targets set under the country's five-year plans. India remains the major supplier of financial and other support to Bhutan. It has supplied financial assistance for the current five year plan, additional support earmarked mainly for hydropower facility construction, and a loan. Overall, India provides 74% of the county's total external assistance. Other aid suppliers include the major international financial institutions, the World Bank and the Asian Development Bank, as well as some U.N. agencies including UNDP and UNICEF. Bhutan has been selective in choosing donors so as to avoid overdependence on one major donor, with the notable exception of India. Bilateral donors include Japan, Norway, Denmark, Austria, Australia and Switzerland, all of which maintain small programs in Bhutan. The government of Bhutan is also pursuing the achievement of the Millennium Development Goals (MDGs) under the umbrella of its five-year plans. Aid is effectively channeled into activities that are specified in the five-year plans, and which contribute to the achievement of the MDGs.

Effective use of support

9

The government of Bhutan has demonstrated a capacity to undertake effective and realistic planning and to achieve targets set. It is considered a very reliable partner by the donor community. As evidence of this perception, the Asian Development Bank rated Bhutan the best-performing country in 2012 in terms of the efficient implementation of projects and the effective utilization of funds. Bhutan's only lingering credibility problem relates to the 100,000 refugees who fled the country in the 1990s and who are still being resettled to third countries today or remain in refugee camps in Nepal.

Credibility

9

In 1985, Bhutan was a founding member of the South Asian Association for Regional Cooperation (SAARC), and the country has played an active role in its affairs ever since. It has hosted a variety of SAARC conferences and events, and in 2011 held the organization's chair. The SAARC Development Fund and the SAARC Forestry Center are based in Thimphu. Bhutan signed the South Asian Free Trade Agreement (SAFTA) in 2004. This seeks zero customs duties between members by 2016, although an extra three years was originally allowed for Bhutan. The government of Bhutan has signed agreements on narcotics, terrorism and human trafficking with its regional partners. It has also joined the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC-EC), which includes India, Nepal, Bangladesh, Sri Lanka, Myanmar and Thailand. However, Bhutan's major cooperative efforts are focused on India. Approximately 75% of Bhutan's imports and exports derive from trade with India. It is financially dependent on India, and there are Indian military personnel based in Bhutan.

Regional cooperation

7

Strategic Outlook

While Bhutan appears to many observers to be a Shangri La devoted to the pursuit of happiness, it does have problems, some of which could be exacerbated if environmental conditions change.

Located between the two most populous countries in the world, Bhutan has to date resisted the temptation (or rather has had no choice) to play these two superpowers against one other, and has rather remained closely tied to and dependent on India. Bhutan has been India's closest ally in U.N. voting; overland transport and travel to and from Bhutan is exclusively over Indian territory; three-quarters of Bhutan's foreign trade is with India; the Bhutanese currency, the ngultrum, is tied to the Indian rupee at an exchange rate of 1:1; and the rupee is legal tender in Bhutan. India is tapping Bhutan's hydropower potential, and is funding and building additional power plants. Indian officers are training the Bhutanese army, and there have been joint efforts to flush out Indian insurgents. Critics say that Bhutan is actually run by India House, the Indian High Commission in Thimphu. This leaves hardly any room for independent maneuvering on the part of Bhutan. India ensured that the Nepalese refugees from Bhutan did not settle in the Indian border region, but moved them on to Nepal. With five million Nepalese-speaking people in India's northeast, however, India could easily stir agitation among the remaining Bhutanese of Nepalese origin in Bhutan (the number of whom is highly disputed). Bhutan has given up its policy of restricting tourism, and plans to raise the number of foreign tourist arrivals in Bhutan from the present 30,000 per year to 100,000. Thus, Bhutan has to attract middle-income tourists that are more price- (and economic-crisis) sensitive. Other initiatives for economic diversification, including the education city and the information technology hub, have yet to prove their worth.

Internally, the top-down approach to democracy has been smooth and successful to date. But the growing number of first- and second-generation educated urbanites must find jobs outside agriculture and the government sector. Creating such jobs is problematic. The welfare system is becoming more expensive for the government, and hence more financially unsustainable. Bhutan's public and external debt levels are not yet alarming. Whether investments in infrastructure and human capital are being well made will be evident only once the new power plants come online, and when today's students are able to find employment.