NATIONAL BUDGET

FINANCIAL YEAR 2002-2003

MINISTRY OF FINANCE
JUNE 2002

Introduction

The Ministry of Finance has the privilege to present the budget for the financial year 2002-2003 and the report on the financial year 2001-2002 budget, to the honorable members of the National Assembly.

The coming financial year is significant as it marks the successful conclusion of the Eighth Five Year Plan and the start of the Ninth Five Year Plan. Despite the continuing security threat posed by the ULFA and Bodo militants in our territory, we were able to implement most of the development activities according to the plan. We continue to be blessed and protected by our guardian deities and benefit immensely from the wise leadership of His Majesty the King.

As in the past, this Budget will focus mainly on improving living standards of our rural population through targeted investments in sectors that directly benefit and improve the welfare of our rural population. Concurrent policy emphasis will also be given to the development of the private sector in order to generate employment, improve economic productivity and strengthen our economy.

The Eighth Five Year Plan: Brief Financial Review

I would like to take this opportunity to present a brief financial review of the Eighth Plan to the honourable members. Although the original Eighth Plan outlay was Nu. 30 billion, the actual plan expenditures was around Nu. 40 billion. This increase on the outlay by over 33% can be attributed to equal increases on both the current and the capital expenditure.

On the capital expenditures side, the increase was mainly on account of the low-income housing-project at Thimphu and Phuentsholing, the Tashichho Dzong-Babesa expressway, flood damage restoration works, Taktsang reconstruction, Punakha Dzong renovation as well as increases in spending on other social and physical infrastructure works. The current expenditure increase was largely a result of the pay revision, establishment of new offices, teaching allowance, revision of the DSA and TA for civil servants, enhancement of the national workforce wage, and the increase in salary of the Gups, amongst others.

On the resources side, I am pleased to report that despite the significant increase in expenditures, the Royal Government was able to contain the overall resource gap at Nu. 303.790 million. This was possible because of a major increase in the domestic revenues by Nu. 7,579.938 million, or 60% over the projected amount of Nu. 13,000 million, and successful external resource mobilization. Concessional borrowings from the international financial institutions financed about 5% of the plan.

I am pleased to inform the National Assembly that the successful implementation of the significantly scaled-up Eighth Five Year Plan is indicative of our increased absorptive capacity and effective resource mobilization. The success of the past development plans have strengthened the foundation for greater growth and progress in terms of social and physical infrastructure and our development philosophy based on the concept of Gross National Happiness has ensured a sustainable and balanced development approach with due regard for our culture and environment.

The Ninth Plan: Brief Financial Overview

As honorable members are well aware, the coming financial year marks the first year of the Ninth Plan. With a total outlay projected at Nu. 70 billion - comprised equally of current and capital expenditures - the Ninth Plan represents a considerable increase over our previous plan and is indicative of the growing needs and absorptive capacity of the economy.

The main priorities of the Ninth Plan include: the development of rural infrastructure, qualitative improvement in health and education services, greater decentralization and private sector development. Accordingly, the construction of highways, feeder and farm roads, bridges, expansion of rural electrification and rural telecommunication will comprise a bulk of the plan activities.

The Royal Government is targeting a higher GDP growth rate of about 7-8% during the Ninth Plan. Such a level of growth is necessary to maintain our development momentum as well as to create jobs in the economy for the young entrants in the job market. Towards this end, it is important to continue the thrust on the development of a dynamic private sector. Accordingly, the Ministry of Finance is pleased to highlight the "pro-private-sector-growth" orientation of this budget with numerous tax incentives as stated in the section on Tax Initiatives.

On the resources side, the Royal Government will continue to ensure that domestic revenues continue to meet the recurrent expenditure. I am happy to inform the honorable members that - as per current understanding and commitments - our development partners will continue to assist us in meeting a large portion of the capital expenditures. In particular, I would like to highlight that the Government of India, will continue to be Bhutan's largest development partner and maintain the past levels of assistance of about 30% of the total plan outlay. The Royal Government remains grateful for the continued support and good will extended by all our development partners.

As mentioned earlier by the Honourable Head of Government, the Ninth Plan will be based on full-fledged Gewog level planning in keeping with His Majesty the King's aspirations of empowering the people in the decision making process. The Gewogs will enjoy substantial autonomy and independence in the planning and execution of development activities directly related to them, including the right to retain and use rural taxes. We are confident that further decentralization and enhanced role for Gewogs will add yet another valuable dimension to our development approach and achievement of gross national happiness.

In addition to the decentralization process already underway, the Ninth Plan with its focus on rural development programs and private sector growth should pave the way for continued socio-economic progress and further improve the well-being of our people. I am confident that the Ninth Plan will also be as successful as the past plans and that our country will grow from strength to strength.

Economic Performance (Financial Year 2001-2002)

Bhutan continued to enjoy favorable macroeconomic conditions in the past year with GDP growth rate of over 6%. While the agriculture sector still accounts for the largest share of GDP, the main source of growth was the constructions and energy sector. The average inflation in Bhutan was around 3.5%, tracking the record low levels of inflation in India. This is one of the lowest inflation rates that we have experienced so far. The exchange rate has also remained more stable compared to the recent past. Large inflows of aid continue to more than make up for our trade imbalances and as a result, our Balance of Payments continues to be positive. The foreign reserves now stands at USD 300 million which is sufficient to cover around 17 months of imports. The total debt to GDP ratio stands at around 53% and the debt service ratio is under 4 %. As honorable members are well aware, our debts are concessional in nature and have been availed to finance the power projects and critical social infrastructure for which grant financing was not adequate.

The Ministry of Finance would also like to highlight that we continue to attain the government objective of meeting at least the current expenditure from domestic revenues. Furthermore, as seen in the Eighth Plan the Royal Government is also increasingly meeting capital investments from its own internal resources. This trend is expected to continue once the hydropower projects are fully commissioned, taking us closer to achieving our objective of national self-reliance.

Review of Financial Year 2001-2002

The Ministry of Finance is pleased to report yet another successful Financial Year. We were able to contain expenditure while making significant gains on the resources side, thus reducing the resource gap by over 40%. The revised budget increased by around 4% as shown in the summary presented below.

Summary: Financial Year 2001-2002 Budget

Nu. in millions

Expenditure Outlay	Approved	Revised
1. Current Expenditure	4,611.099	4,664.330
2. Capital Expenditure	5,202.574	5,447.136
3. Net Lending	2.050	72.541
4. Repayment	231.421	231.421
Total	10,047.144	10,415.428

Sources of Finance	Projected	Revised
1. Domestic Revenue	4,613.271	4,943.823
2. Other Receipts	527.317	527.317
3. Grants		
a. GoI Program Grant	800.000	800.000
b. GoI Project Grant	540.343	765.310
c. Grants from Other Sources	1,578.088	1,751.622
4. Financing		
a. Project-tied Loans	941.024	1,019.038
b. Resource Gap	1,047.101	608.318
Total	10,047.144	10,415.428

The Ministry of Finance would like to inform that most of this increase was largely due to increases in capital expenditures. Increase on account of current expenditures was only a little over one percent, reflecting our success in implementing stringent expenditure controlling measures and improved monitoring to ensure reduction of wasteful expenditures.

On the resources side, I am pleased to report an all round success in mobilizing both internal and external resources. The increase in resources, in the past year, can be attributed to higher than expected grants disbursements of around Nu. 398.401 million, and increased domestic revenue of around Nu. 330.522 million. Consequently the resource gap, projected initially at around 10% was finally down to 6%. The remaining resource gap of Nu. 608.318 million was met through domestic borrowings, which also helped to absorb some of the liquidity in the financial system.

Financial Year 2002-2003

The budget outlay for financial year 2002-2003, the first year of the Ninth Plan, is Nu. 11,184.643 million. While this accounts for around 16% of the Ninth Plan outlay, it represents an increase of around 7% only over the revised budget of the past year. This clearly indicates that if our expenditure growth keeps with past trends, then the Ninth Plan outlay of Nu. 70 billion is not as ambitious as it may seem.

Summary: Financial Year 2002-2003 Budget

Nu. in millions

Expenditure Outlay	Amount	Percent
1. Current Expenditure	4,597.266	41.10
2. Capital Expenditure	6,318.764	56.49
3. Net Lending	28.296	0.25
4. Repayment	240.317	2.15
Total	**11,184.643**	100.00

Sources of Finance	Projected	Percent
1. Domestic Revenue	5,100.215	45.60
2. Other Receipts	18.333	0.16
3. Grants		
a. GoI Program Grant	2,000.000	17.88
b. GoI Project Grant	765.413	6.84
c. Grants from Other Sources	1,648.254	14.74
4. Financing		
a. Project-tied Loans	1,152.428	10.32
b. Resource Gap	500.000	4.48
Total	**11,184.643**	100.00

I would like to inform the honorable members that a large part of the budget increase for the coming year is made up of capital expenditures, particularly due to the spillover of donor assisted projects and other major activities scheduled for completion in the coming financial year. The current expenditure is expected to decrease slightly as a direct impact of the corporatization of the utility functions of the Department of Power from July 2002.

Our expenditures are also rising on account of increased demand on the numerous free or highly subsidized services provided to the people including subsidies on the sale of agro-machineries, medical treatment outside Bhutan and electricity. In addition, we also continue to receive generous subsidies on LPG cooking gas and kerosene from the Government of India. The Ministry of Finance would like to highlight that such subsidies are not sustainable but are being provided at high costs considering its social benefits to our people.

On the resources side, domestic revenues are expected to increase by a little over 3 percent over the revised revenue estimates for financial year 2001-2002. It is projected to cover around 45% of the total budget, while grants and concessional borrowings are expected to cover around 50%. A resource gap of around 5% is presently foreseen, but the Ministry of Finance would like to highlight that if the projected donor support does not materialize this could increase significantly.

Furthermore, the Ministry of Finance would like to inform the honourable members that in the event of an armed confrontation with the ULFA and Bodo militants, the Royal Government will have to divert considerable amount of resources to meet the humanitarian needs of the people directly affected by such a conflict. This will undoubtedly pose additional burden on the national budget.

The Ministry of Finance will continue to monitor these budget figures and to ensure that all resources are utilized efficiently and effectively. As in the past, efforts will be continued to curtail wasteful expenditures.

Sector Allocation

The sectoral allocation of the national budget is an indicator of the national development priorities. As in the past, major investment programs will focus on sectors that have direct impact on improving the livelihood of the people living in the rural areas.

The allocations are as summarized below

Sector Allocation: Financial Year 2002-2003 Budget

Nu. in Millions

Sector	Amount	Percent
Health and Education	2,863.538	25.60
Agriculture	1,242.622	11.11
Human Settlements	693.395	6.20
Communications	211.619	1.89
Roads	1,260.149	11.27
Energy (excluding mega projects)	1,068.555	9.55
General Public Services	2,696.867	24.11
National Debt Service	372.218	3.33
Others	775.680	6.94
Total	**11,184.643**	**100.00**

Social Sector

Since the inception of planned economic development, the Royal Government has been spending well over a quarter of its budget on the social sector. This is in keeping with the national policy of enhancing the people's well-being and fostering human resource development. Global experiences also show that investments in education and health yield great benefits and it is recognized as the single most important means to empower people and overcome poverty.

As a result of the past concerted efforts, our social and economic indicators have shown rapid improvement and this bodes well for our future as a healthy and well-educated population is the most valuable asset of any country. Despite such achievements, continuous efforts will be made to enhance access to education particularly in the rural areas. Considering the importance of this sector, the Royal Government has resorted to availing loans from the international financial institutions where grant assistance has not been adequate - particularly for financing educational infrastructure.

Efforts are also being made in the health sector to reach adequate medical facilities to our people in the rural areas. Taking advantage of the expansion of telecommunication facilities, new initiatives such as telemedicine are being experimented to enhance the outreach of medical expertise to remote areas.

Agriculture

Despite major structural changes to the Bhutanese economy in the past few decades, the agriculture sector continues to provide livelihood to the majority of the people in the rural areas. With an allocation of about 11% of the budget, the Royal Government will continue its emphasis to improve agricultural productivity and diversify agricultural production to include other high value agriculture/horticultural and animal husbandry products.

In order to enhance agricultural productivity, increase rural income and make agriculture an attractive employment option, the Royal Government will actively intervene to assist in providing training in farm technologies, business skills and other technical support services. As mentioned earlier, major emphasis will be given to the development of rural infrastructure in the form of farm and feeder roads in order to improve access to markets.

I am happy to report that the Second Eastern Zone Agricultural Project covering six Eastern Dzongkhags, and the Wang Watershed Management project covering four Western Dzongkhags are progressing well.

Human Settlements

As in all developing societies, urbanization is a reality in Bhutan today with over 21 percent of the population residing in urban areas. In order to ensure balanced regional development, the Royal Government will continue its emphasis on the development of Dzongkhag towns all over the country. We are confident that the development of such urban centers will help to stimulate business activities, generate employment and provide a market for the farmers in addition to addressing the issues related to rural-urban migration to the larger towns. The Royal Government will finance high priority investments such as the provision of basic infrastructure including road access, electricity, telecommunications, water supply and sanitation facilities and other public amenities.

In addition to the development of Dzongkhag towns, priority will also be accorded to ensure proper development of Thimphu, the national capital where people from all over the country reside or transit through. The population growth rate of Thimphu currently estimated at 5-7 percent, is one of the highest in the world. As rural-urban migration cannot be fully stopped, it is important to ensure that the major urban centers in Bhutan have adequate infrastructure and social facilities to ensure better quality of lives for the people.

Communications

To achieve greater efficiency and effectiveness in the delivery of social services to the remote areas, facilitate private sector development and address the numerous poverty related issues, the Royal Government will continue to place emphasis on expanding rural access and improving the existing road networks. The thrust of the Ninth Plan rural development strategy is also on the construction of farm and feeder roads as these benefit rural people directly. Furthermore, the Royal Government will continue to ensure that the national highways are open during all seasons and also work on widening and shortening of the roads.

The expansion of the rural telecommunications network will also continue in the coming year. In addition, the Royal Government is studying the possibility of introducing mobile phone technology to improve telecommunications. The promotion of information technology around the country will also take place side by side with the expansion of the telecommunications network. To start with, the emphasis will be on IT in education and e-governance as these are areas that have direct benefit to the public at large.

As the Honorable members may already be aware, the communications sector will receive a large proportion of the capital budget allocation in the Ninth Plan.

Energy

In view of Bhutan's vast hydropower potential, continuous efforts are being made to harness this resource. I would like to inform the honorable members that the works on the 1020 MW Tala Hydropower Project is progressing well and is scheduled for completion by 2005.

The upper stage of the 25 MW Basochhu Hydropower plant was completed last October boosting the national electricity output to 440 MW. I am also pleased to inform the floor that works have already started on the 40 MW Basochhu lower stage. This project is estimated to cost Nu. 1,659 million and is also scheduled to complete by 2005.

The power from the Basochhu project will initially be distributed to the five Western Dzongkhags, but upon completion of the project, supply will be extended to the Southern Dzongkhags of Dagana, Tsirang and Sarpang. The Royal Government will eventually link the Basochhu power supply with Kurichhu power at Gelephu to form an integrated national power transmission grid.

I am also happy to report to the Honorable members that three generating units of the Kurichhu Hydro Power Project are fully commissioned, and the fourth is nearing completion. With an installed generating capacity of 60 MW, we can now be confident that this project will supply reliable and sufficient electricity to the ten Dzongkhags of Eastern and Central Bhutan, and bring about tremendous social and economic benefit to our people.

In order to deliver the benefits of hydropower to the rural people, concurrent rural electrification efforts are also underway. During the Eighth Plan, over 6,000 rural households have been electrified. The goal of the Ninth Plan is to electrify 15,000 rural households. We are confident that the availability of electricity will help private sector development, employment generation and provision of adequate health and education services to the rural population.

Domestic Revenue

The domestic revenue is projected at Nu. 5,100.215 million for the coming Financial Year marking a 3% increase over the revised revenue estimates for the past year. The relatively nominal increase in the coming year is a result of the revenues foregone on account of the corporatization of the Department of Power, which was the second largest source of revenue after Chukha Hydropower Corporation.

The domestic revenue forecast for the coming year is summarized below.

Summary: National Revenue Forecast for Financial Year 2002-2003

Nu. in millions

Source of Revenue	Amount	Percent
A. Tax Revenue	**3,086.624**	**60.52**
1. Direct Tax	1,811.485	35.52
Corporate Income Tax	1,090.135	21.37
Business Income Tax	254.488	4.99
Health Contribution	23.556	0.46
Royalty	325.059	6.37
Rural Tax	8.247	0.16
Personal Income Tax	110.000	2.16
2. Indirect Tax	1,275.139	25.00
Bhutan Sales Tax	522.734	10.25
Export Tax	13.794	0.27
Excise Duty	530.374	10.40
Motor Vehicle Tax	72.659	1.42
Import Duty	93.490	1.83
Business & Prof. Licenses	22.212	0.44
Other Tax Revenue	19.876	0.39
B. Non-Tax Revenue	**2,013.591**	**39.48**
Admin. Fees and Charges	86.920	1.70
Capital Revenue	46.109	0.90
Revenue from Govt. Depts.	45.597	0.89
Dividend	1,343.314	26.34
Transfer of Profits	490.071	9.61
Other Non-Tax Revenue	1.580	0.03
Total	**5,100.215**	100.00

I would like to highlight that according to our projections, the tax revenues will surpass non-tax revenues for the first time marking a significant shift from the past. The domestic revenue to GDP ratio is projected to be around 20 % and the ratio of tax revenue to GDP is projected to be around 12 %. The contributions from Corporate Income Tax (CIT) along with the Non-tax Revenue continue to be the main sources of domestic revenue. The contributions of the Business Income Tax (BIT) are still nominal at around 5% of the total revenue, reflecting the weak growth in the private sector.

Although a vast majority of the Bhutanese live in the rural areas, rural taxes still constitute less than one percent of the total revenue. The Bhutanese people continue to enjoy one of the lowest tax rates in the world while enjoying free access to education and health services as well as other highly subsidized services as mentioned earlier. The Royal Government is confident that such targeted intervention - with generous social sector investments combined with a low rural tax rate - will enable our rural population to improve their living standards and ensure equal access to health and education facilities for themselves as well as their children.

In order to enhance national self-reliance, the Ministry of Finance will continue to explore means to expand and broaden our tax base. I am happy to report to the Assembly that the Personal Income Tax (PIT), as a means to widen the tax base, is already being implemented. In order to familiarize the public about the PIT, over sixty nation-wide workshops have been held concurrent with publicity through the print media, radio and television. The feedback that we have received has been very encouraging, and we would like to thank the honourable members and the public for their support.

Although the projected revenue from the PIT at Nu. 110 million for the coming fiscal year may appear modest, I would like to remind the honourable members that there are numerous social benefits of such a tax that cannot be monetised. We are confident that the PIT will, in the long run, reduce income disparities and instill a sense of participation and responsibility in the minds of the people, both crucial factors in the process of nation building and national security.

External Assistance

The Ministry of Finance is pleased to inform the honorable members of the excellent cooperation with our donors who continue to meet the bulk of our capital requirements. The Royal Government remains grateful for the continued support and good will of all our development partners. In particular, we would like to thank the Government of India, our friend and neighbor for their friendship and generous support, which accounts for more than half of the total external assistance. We would also like to take this opportunity to assure our development partners that their assistance will continue to be utilized and accounted for properly.

I am also happy to highlight to the assembly that we are increasingly meeting more of our capital requirements from our own internal resources. However, given the large requirements of the Ninth Plan as reported earlier, considerable external assistance will still be required. While the international aid climate has, in general, not been very favorable for the developing countries in the recent past, given our good relations as well as successful implementation record, we are optimistic about the targeted level of assistance in the Ninth Plan.

Borrowings

Bhutan's total outstanding debt of Nu. 12,611.154 million (comprised of convertible currency loan of USD 120.740 million and Rupee loan of Rs. 6,696.078 million) is currently around 53% of GDP. While this may appear high, the Ministry of Finance would like to highlight that the entire loan portfolio of the Royal Government consists of concessional borrowings and therefore, the debt service ratio is a manageable amount under 4%.

The Rupee loan from the Government of India has been availed for the construction of mega hydropower projects. The concessional loans from multilateral financial institutes have been availed to meet the convertible currency needs and finance power projects, investments in infrastructure such as roads, rural electrification, telecommunications, schools and rural credit, all areas which have high economic returns or are socially beneficial to our people. On an average, concessional borrowings fund about 5% of the budget outlay.

As far as debt management and repayment of loans is concerned, I am pleased to inform the honorable members that Bhutan has a reputation as a reliable and safe borrower.

Private Sector Development

One of the biggest challenges facing our economy today is the need to provide productive jobs for the young school leavers. Our current estimates show that about 70,000 young people will enter the job market by the end of the Ninth Plan. Towards this end, the Royal Government will continue its emphasis to promote a dynamic and strong private sector, as it must be the driving force behind economic growth, employment generation, achievement of favorable balance of trade and effectively competing in the international markets. Private sector development is particularly important for employment generation as the government sector can only absorb a tiny fraction of the new entrants given our commitment to maintain a small, compact and efficient civil service.

In an effort to create a conducive investment climate for the private sector, studies and consultations have been carried out at various levels to identify problems and weaknesses in private sector development. The recommendations of the studies are currently being implemented. Much progress has also been made in addressing the gaps in the legal framework and other areas. Overall, with strengthened legal and regulatory frameworks in place in most areas, the efforts of the Royal Government will now focus on the replacement of all case-by-case/adhoc processes with more transparent and systematic process.

The Royal Government will continue its emphasis on the development of the tourism industry as it is the largest source of hard currency earnings and holds vast potential for employment. In the past year, 6,393 tourists visited Bhutan and the gross earnings from this industry accounted for USD 9.2 million. To mitigate the problems of seasonality, the tourism royalty has been reduced from USD 63 to USD 55 for the low season. Feasibility studies are being conducted for the establishment of a Hotel Management and Tourism Training Institute to improve the level of services and develop greater professionalism in this sector. Concurrent efforts will be made to develop new products and improve infrastructure for expansion of this sector.

In order to encourage industrial development in Bhutan, the development of two industrial estates in Pasakha and Chuwabari (Gelephu) have been approved. I am also pleased to inform that half of the Nu. 3 billion earmarked for the human resource development during the Ninth Plan, will be for the private sector. This will help the private sector to improve their efficiency and further develop their skills and managerial capacity and make them more competitive in the regional and international markets.

Despite such concerted efforts, Bhutan's private sector is still small and weak as apparent from their sluggish growth, and their problems are compounded by the small size of the market and difficulties posed by the rugged terrain. In order to compensate for these disadvantages, the Ministry of Finance will continue to actively employ the fiscal policy tools at its disposal. In this regard, the Ministry of Finance would like to announce tax incentives to stimulate private sector development - in particular export based enterprises and private sector activities in the interior parts of the country. The Ministry will continue to monitor and study the impact of these initiatives closely.

Tax Initiatives

The Ministry of Finance is pleased to announce numerous tax-incentives to stimulate private sector investment. I would like to mention that there will be substantial loss of revenues on account of these incentives. Nevertheless, the tax incentives are being provided as we are confident that the potential benefits from boosting private sector growth, employment generation and trade diversification will outweigh the revenue losses. I would also like to highlight that the Ministry of Finance has also already provided numerous other concessions to help the private sector, including the removal of sales tax and customs duty on plant and machinery, removal of sales tax on raw materials and even removal of customs duty for raw materials used by convertible currency earning businesses. We are confident that these incentives will help to enhance viability and competitiveness of new enterprises.

Tax Holidays: Many countries offer tax holidays to induce and attract investment. As authorized by the Income Tax Act 2001, the Ministry of Finance is pleased to announce the following tax holidays (CIT and BIT) and other incentives to encourage market diversification and balanced regional development.

- 3 years for manufacturing industries
- 3 years for Information Technology training and vocational institutes
- 5 years for hotels, schools and auto-mechanical workshops established in the interior
- 7 years for manufacturing industries established in the interior

The tax holidays will be applicable to new industries only, and commence from the date of commercial production/operation.

The other incentives include the following:

- Income earned in convertible currency by manufacturing industries; Information Technology industries or services; and agriculture produce shall be exempt from CIT/BIT.
- The existing export tax on oranges, apples and cardamom exports shall be abolished.

- The tax-deductible salary limits shall no longer apply to incorporated companies. However, in the case of other business units, the tax-deductible salary limits will remain in force.
- Reinvestment allowance of 20% - A reinvestment allowance of 20% of total reinvestments will be provided to incorporated companies as an incentive to expand. It is hoped that these efforts will result in more jobs as well as enhanced productivity.

These tax incentives shall come into force from 1st January 2003.

The Ministry of Finance would like to remind the honorable members that tax incentives, while important, are only effective when other factors such as basic infrastructure, labor availability, sound government policies on all aspects pertaining to private enterprise are in place. As these factors are crucial to investment decisions and the creation of a sound investment climate, the other ministries are also in the process of streamlining licensing procedures, labour policies and other issues of concern to the private sector. The Ministry of Finance will also continue to take necessary steps to improve the investment climate, particularly in the areas of external trade, taxes and the financial sector.

The Ministry of Finance, as authorized by Income Tax Act 2001, is pleased to announce the following revisions and clarifications on the Income Tax Rules.

Clarifications to the PIT

The existing PIT rules on Salary Income from Employment excludes only the following three incomes from the computation of salary income: (1) Leave Travel

Concession, (2) Travel Allowance and Daily Allowance given while on tours and (3) Transfer Grants and transportation costs given on transfers.

The Ministry of Finance is pleased to announce the following additional concessions with regard to computing salary income from employment.

- Gratuity/Provident Fund payments received in lump sum shall be exempt from PIT.
- The monthly pension income shall continue to be under the purview of PIT. However, the contributions to the pension scheme and Provident Fund shall be allowed as a tax-deductible expenditure.
- Stipend received by trainees, exchange students and living allowances received by volunteers working in Bhutan shall be exempted from PIT.

Rental Income

- The existing PIT Rules under Rental Income do not allow deductions for rental property remaining vacant beyond three months. The Ministry of Finance would like to announce that deductions for such property will be allowed but subject to the fulfillment of other conditions in the rules.
- The existing PIT Rules under rental income state that only one dwelling unit per married couple will be exempt from tax. We would like to announce that married couples residing in separate locations due to employment related reasons, shall be allowed to claim tax deductions for one dwelling unit each for self occupation upon presentation of the proof of employment and that units are actually self-occupied and subject to the fulfillment of the conditions in the rules.

Interest Income

- Interest income accrued prior to 1.1.2002 paid after 1.1.2002 exempted from PIT

General Deductions:

Education Allowance

Although the Royal Government provides free education, many private schools have emerged in the recent years along with an increase in the number of children studying outside Bhutan at private expenses. In order to encourage privately financed education and reduce the burden on government schools, the following educational allowances shall be permissible subject to the fulfillment of the conditions set in the rules.

- Actual cost of education or Nu. 50,000 whichever is lower per child shall be allowed as tax-deductible expenditure.
- If the individual availing privately financed education is a taxpayer, then the cost of education shall be allowed as tax-deductible expenditure limited to the actual cost of education or Nu. 50,000 whichever is lower per individual. However, deductions can only be claimed either from the individual's own taxable income or his/her parents taxable income but not both.

Life Insurance Premium Deduction

The Ministry of Finance is pleased to announce that the premium for life insurance with a domestic insurance company shall be allowed as tax-deductible expenditure henceforth. We are confident that this will encourage our people to subscribe to life insurance schemes.

Financial Sector

A sound financial sector is an essential underpinning for development and growth in a modern economy. The importance of this sector cannot be over emphasized as it provides financial intermediation and ensures that hard earned savings are channeled into productive investments, which in turn provides incentive for further saving through higher returns. Conversely a weak financial sector can cause numerous economic difficulties as seen in the experience of many countries. Therefore, the development of a sound financial sector is critical to ensure economic stability, foster growth and spur private sector development.

Improved supervision by the Royal Monetary Authority (RMA), a stronger legal framework and deregulation have strengthened the ability of our financial sector to respond to market forces and improve financial intermediation. Non-performing Assets are under 15% and efforts are being made to reduce this important indicator to less than 10%. A combination of excess reserves and low demand saw both the commercial banks lower their interest rates. While it is still early to judge the effect of these revisions, the Royal Government is aware that the main problem lies in the lack of investment opportunities and thus, the need to address it. Accordingly, as mentioned earlier, efforts on further improving the general policy and regulatory environment including the provision of tax incentives to spur investment are being made.

A financial sector review was also undertaken to identify issues, both potential and emerging that confront and challenge our financial sector. Weaknesses identified included existing constraints to private sector activities, issues related to macroeconomic policy, poor financial market infrastructure, and weakness in the financial institutions themselves. The study provides a good basis for going forward, highlights the strong linkage between private and financial sector development, and the need to tackle issues in a more holistic manner.

The Royal Government has taken note of these important issues and efforts are already underway, led by the RMA and in consultation-with the private sector, to tackle the issues effectively. Furthermore, the Ministry of Finance will also improve its cash management practices, which should provide an outlet for excess liquidity in the financial system as well as help the development of a bond market over time.

Other Initiatives

Launching of the National Pension and Provident Fund Plan

It is my pleasure to report to the honorable members that the pension scheme will be launched on the first day of the coming financial year. This scheme, as the honorable members may be aware, will provide post retirement benefits to the civil servants, corporate employees and the armed forces. The scheme was initiated at the command of His Majesty the King, which as honorable members will agree, is crucial to ensure the well-being of public servants. In many countries, low pay and the resulting insecurity has been a cause for corruption that in turn imposes a burden on society. It is our hope that with this scheme, the people will serve the Tsa-Wa-Sum with even greater integrity, loyalty and dedication. It is also our hope that in time, this scheme can be expanded to include formal workers in the private sector and as such, it has been designed to accommodate such developments.

Establishment of the Bhutan Power Corporation

As mentioned earlier, the Ministry of Finance would like to inform that from July 2002, the utility functions of the Department of Power will be corporatized and it will be known henceforth as the Bhutan Power Corporation (BPC). The BPC with an estimated equity of about Nu. 4,221 million will be the largest corporate entity in the kingdom. It will take over power transmission and distribution functions within the country and will be responsible for the national electricity grid. The BPC will be regulated by the Bhutan Electricity Authority in accordance with the Bhutan Electricity Act, 2001. By operating as a commercial entity with increased autonomy, it is hoped that the establishment of BPC will lead to improved services and greater efficiency and accountability. However, the Royal Government will continue to bear investment costs for priority programs such as rural electrification, though it will be implemented by the BPC.

Conclusion

The Ministry of Finance is confident that the launching of the Ninth Plan will usher in yet another era of successful economic development as well as ensure the peace and stability of our country. The coming years will also provide an opportunity to consolidate our past achievements and pave the way for a stronger nation-state benefiting immensely from the political reforms that are underway with the drafting of the constitution and the decentralization process.

As a tribute to His Majesty the King's magnanimity and caring leadership that has successfully guided Bhutan through far reaching social, economic and political reforms, it is our solemn duty to serve the Tsa-wa- sum with unfailing dedication.

With all round successes, the future bodes well for Bhutan. As the economy transforms, the share of agriculture to GDP is expected to fall to around 24% by the end of the Ninth Plan, while that of the construction and electricity will have increased significantly to around 17% each. These structural changes and the gains in education will lead to an increasing number of people turning to other non-farm activities for employment. This shift is necessary if we seek to achieve and sustain higher rates of economic growth and productivity and successfully integrate into the international economic system.

The Royal Government is also confident that the coming financial year will maintain the momentum of growth thus far. The tax incentive package should spur investments and directly promote future growth and employment prospects. In addition, the introduction of the pension scheme will enhance the security of the public servants and the armed forces, both of which are crucial for safeguarding and furthering the interest of the people and the country.

With the implementation of the personal income tax from this year onwards, I am confident that our people will appreciate and realize the importance of their participation and contribution to the national development process. As mentioned earlier, the modest collections in the initial years must not allow us to underestimate the significance of this tax as it will help to ensure that the process of economic development does not marginalize certain sections of society and lead to the emergence of wide income disparities. As experiences in many developing countries show such income disparities are the causes of widespread social and political instability.

I would also like to take this opportunity to share the people's concerns on the security threat posed by the ULFA and Bodo militants in our territory. While the Royal Government continues to pursue peaceful means to persuade them to leave our territory, we are also prepared for military action if the peaceful means fail. Although the continued threat and possibilities of an armed conflict will cause a serious set back to our development process, I would like to inform the Honourable members that the Royal Government remains ever ready to devote all resources necessary to remove the problem.

May the blessings of our guardian deities, the enlightened leadership of our beloved King and the harmonious relationship between the Royal Government and the people continue to bring peace, prosperity and pride to our country.

Tashi Delek

Selected Monetary and Financial Indicators

Items Description	July-01	Dec-01	Percent Change
1 Total Assets of the Financial Sector	23237.03	25995.49	11.87
a. Royal Monetary Authority	9352.71	11011.18	17.73
b. Four Financial Institutions	13884.32	14984.31	7.92
2 Money Supply			
a. Quasi Money 1/	4941.96	5867.59	18.73
b. Demand Deposits	2889.70	3238.21	12.06
c. Ngultrum in Circulation	1483.09	1609.85	8.55
3 Domestic Credit	2017.87	1489.39	-26.19
of which Private Sector	2016.59	2308.74	14.49
	Millions of USD		
4 Gross International Reserves	294.20	326.29	10.91
a. Convertible Currencies	217.25	257.91	18.72
	Millions of Rs.		
b. Indian Rupees	3617.30	3276.56	-9.42
5 Exchange Rate for USD (Period Average)	47.01	47.92	1.94
6 GDP (Nominal)	21126.50		14.11
7 Real GDP Growth Rate			5.73
8 Consumer Price Index (%)	3.58	3.25	

Note:

1/ quasi money includes foreign currency deposits & time deposits

Note: for the calendar year figures the entry under 2000/01 is for 2000 - such as the GDP figures.

Selected Monetary and Financial Indicators

Items Description	2000/2001	April 2002
Structure of Interest Rates		
a. Deposits	In Percent	
i) Savings	5 - 7	5-6
ii) Fixed Deposits		
3 months to 1 year	7 - 8	7
1 year to less than 3 years	9 - 10	9
More than 3 years	10 - 11	10
b. Lending Rates		
i) Export Finance	13	13 - 15.5
ii) Manufacturing, Service, Transport and Agriculture	13	13
iii) Housing	14	14
iv) Working Capital	13 - 15.5	13.5 - 15.5
v) Personal and General Trade	15 - 16	15 - 16