



NATIONAL BUDGET

FINANCIAL YEAR 2003-2004

MINISTRY OF FINANCE
JUNE 2003

Introduction

The Ministry of Finance has the privilege to present the National Budget for the financial year 2003-2004 and the report on the financial year 2002-2003 budget to the National Assembly.

With the blessing of the guardian deities and the enlightened leadership of His Majesty the King, Bhutan continues to make significant social and economic progress. The Ninth Five Year Plan has been successfully launched and it will continue to focus on improving the living standards of all the Bhutanese people. In the past year, we have also witnessed significant political reforms including the drafting of the constitution and further decentralization of economic and political decision-making power to the grassroots level. We are confident that rapid economic progress and the farsighted political reforms will take us closer to attaining Gross National Happiness.

Economic Performance (Financial Year 2002-2003)

In the past year, Bhutan achieved a growth rate of about 7% with the major impetus coming from the hydropower, transportation and construction sectors. The inflation rate recorded by the consumer price index fell to 2.7% from 3.5% in the previous year. With strong levels of growth and record low inflation, Bhutan continues to enjoy a stable macroeconomic environment conducive to sustained growth.

The Balance of Payments remains favorable with inflow of foreign aid, concessional loans and some foreign investment offsetting the persistent trade deficit. Bhutan has accumulated foreign reserves amounting to the equivalent of USD 355 million, which is sufficient to cover around 19 months of imports. Convertible currency reserves account for USD 259.4 million and Indian Rupee reserves stand at Rs. 4,617 million.

The total debt outstanding is USD 331.7 million, of which around 45% is comprised of convertible currency debt and the balance is denominated in Indian Rupee. The debt to GDP ratio stands at around 58% and the debt service ratio is under 4%. As the honorable members are well aware, the external loans have been availed mainly for investments in productive areas such as large hydropower projects, road infrastructure and education infrastructure.

I am also happy to report to the honorable members that the International Monetary Fund (IMF) Article IV country surveillance consultations were held in end 2002. The IMF team provided a positive assessment of the economy and commended the financial management of the Royal Government. This was based on the strong economic performance, prudent economic policies and successful implementation of development plans. Such a positive evaluation by an international agency such as the IMF is an important endorsement of our policies and plans and enhances the image of the Royal Government in the eyes of the international community.

Review of Financial Year 2002-2003

As honorable members may be aware, the first year of a plan is always confronted with resource uncertainties on account of issues related to project readiness and finalization of negotiations with donors. In view of the shortfall in expected assistance, the Ministry of Finance had to impose some marginal cuts during the past financial year. However, the overall revised expenditures for the year 2002-2003 is slightly larger than the approved outlay and thus, as far as overall expenditure is concerned, the Ninth Plan targets have not been adversely affected.

Summary: Financial Year 2002-2003 Budget

Nu. in millions

Expenditure Outlay	Approved	Revised
1. Current Expenditure	4,597.266	4,863.783
2. Capital Expenditure	6,318.764	6,024.236
3. Net Lending	28.296	73.558
4. Repayment	240.317	240.317
Total	11,184.643	11,201.894
Sources of Finance		
	Projected	Revised
1. Domestic Revenue	5,100.215	5,100.215
2. Other Receipts	18.333	18.040
3. Grants		
a. GoI Program Grant	2,000.000	800.000
b. GoI Project Grant	765.413	631.838
c. Grants from Other Sources	1,648.254	1,867.891
4. Financing		
a. Project-tied Loans	1,152.428	1,128.328
b. Resource Gap	500.000	1,655.582
Total	11,184.643	11,201.894

On the expenditure side, current expenditures increased by around 6%. This was mainly on account of expenses related to the remuneration of: Chimis, Mangmis, Gups, Gewog clerks; new appointments in civil service; interest payments on Basochhu Power Project and domestic borrowings; medical treatment outside Bhutan; enhanced travel benefits for support staff in the government offices etc. Net lending also increased on account of on-lending to the Bhutan Development Finance Corporation (BDFC). The Royal Government will continue to support the BDFC given its important role in providing rural credit and lending to small borrowers.

On the resource side, domestic revenue and other receipts were on target. Domestic revenue was able to cover the current budget once again. With regard to external assistance, grants from other sources increased by over 13% but grants from the Government of India (GoI) were significantly lower than projected. As a consequence, the resource gap increased substantially to around 15% of the revised budget.

As honorable members may be aware, the GoI disbursed Nu. 800 million as program grant assistance against the Royal Government's request for Nu. 2,000 million. In view of this shortfall, several development activities could not be taken up during the current financial year. I would, however, like to assure the honourable members that all the important activities for the Ninth Plan will be taken up and that such delays are quite normal in any plan. The Royal Government and the GoI have held several rounds of negotiations and we are now nearing a final agreement on India's total assistance package for Bhutan's Ninth Plan. As honorable members will recall, India's assistance for our Ninth Plan was projected at Nu. 20,000 million, out of which half was targeted for program assistance. In addition, the GoI, as you all are aware, is also financing other large activities outside the plan including the Tala hydropower project, which is expected to cost over Nu. 40,000 million. The GoI was of the view that with its completion by September 2005, the Tala hydropower project would generate substantial revenue and that Bhutan would no longer need the program grant thereafter.

After a series of negotiations both in Thimphu and New Delhi, the GoI has agreed to provide Nu. 7,338 million for project grant assistance in the Ninth Plan but suggested that the program grant be phased out during the plan period. The Royal Government, appreciating the explanations given by the GoI, agreed to the proposal as it is also in line with our own goal of attaining self-reliance. We have, however, requested GoI to consider granting Nu. 2,000 million per annum as program assistance till the commissioning of the Tala hydropower project. The GoI has agreed to re-discuss the matter and assured us that as a close friend and neighbour, the GoI was committed to supporting Bhutan's development and would not like to see Bhutan face any serious financial difficulties.

The Ministry of Finance is aware that the budget cuts in the past year, which was inevitable, may have alarmed many people. We would like to emphasize that the overall expenditures were not reduced; in fact it was larger than projected due to increase in grants from other sources. The budget cut was also marginal representing only 5% of the total outlay. Most importantly, these budget cuts were targeted at low priority activities that do not have significant negative impact on activities of direct benefit to the people. Moreover, most of the budget cuts were made in the area of constructions, which in most cases were not ready for implementation. The Royal Government would like to assure the honorable members that irrespective of what happens on a year-to-year basis, all activities included in the Ninth Plan will be supported and implemented, particularly those meant for the Dzongkhags and Gewogs.

The Ministry of Finance would like to inform the National Assembly, that despite the shortfall in external assistance, the past year marked the successful launch of the Ninth Plan. This is evident in the strong GDP growth rates. We also witnessed the successful implementation of the DYT/GYT Chathrims including the successful election of DYT/GYT chairpersons. These institutions will strengthen the foundation for national progress and prosperity.

In order to orient the newly elected local leaders to their expanded roles and responsibilities appropriate trainings have already been conducted. These sessions provided excellent opportunities for the government and the people's representatives to exchange views and discuss problems and their solutions. The Ministry of Finance is pleased to inform the honorable members that from our own interaction with the newly elected chairperson of the DYT/GYT, it was evident that the Bhutanese people had exercised their franchise responsibly and elected the most capable people to these important posts. This augurs well for our future.

Financial Year 2003-2004

The projected outlay for the fiscal year 2003-2004 exceeds the revised budget for the past year by about 3% or Nu. 335.843 million. The Ministry of Finance would like to highlight that this is a modest but realistic budget given our limited absorptive capacity. The summary of the Financial Year 2003-2004 budget is given below:

Summary: Financial Year 2003-2004 Budget

Nu. in millions

Expenditure Outlay	Amount	Percent
1. Current Expenditure	4,997.498	43.3
2. Capital Expenditure	6,277.349	54.4
3. Net Lending	37.470	0.3
4. Repayment	225.420	2.0
Total	11,537.737	100.0
Sources of Finance		
	Projected	Percent
1. Domestic Revenue	5,214.756	45.2
2. Other Receipts	13.270	0.1
3. Grants		
a. GoI Program Grant	2,000.000	17.3
b. GoI Project Grant	1,342.361	11.6
c. Grants from Other Sources	1,631.242	14.1
4. Financing		
a. Project-tied Loans	952.875	8.3
b. Resource Gap	383.233	3.3
Total	11,537.737	100.0

On the expenditure side, capital and current expenditures are projected to increase by around 4% and 3% respectively over the past year. The Royal Government will continue to focus on poverty reduction by investing in the social sector and infrastructure development. It is the belief of the Royal Government that such targeted interventions will help to bring about sustainable, balanced and equitable development.

One of the most important events that will have an impact upon the national budget is the creation of three new ministries: Ministry of Labour and Human Resources, bifurcations of the Ministry of Health & Education and the Ministry of Communications. This is based on the recommendation of the report "Enhancing Good Governance: Promoting Efficiency Transparency and Accountability." The objective of creating these new institutions is to further strengthen and enhance the performance of the Royal Government in its various functions. A budget of Nu. 10.5 million has been allocated for the establishment of the three new ministries. However, the Ministry of Finance would like to highlight that this is a very conservative estimate.

On the resource side, domestic revenues are projected to increase only by around 2%. This is mainly on account of the various incentives announced last year and the government's decision not to impose new taxes in this financial year. The domestic resources are projected to cover current expenditures fully. Grants, particularly from the GoI, is expected to increase significantly in view of project readiness and possible finalization of the GoI's assistance package for Bhutan's Ninth Plan. An overall resource gap of about 3% is projected. The Ministry of Finance would like to reiterate that given our high dependence on external assistance, any decline in aid would directly lead to an increase in our budget deficit or require budgetary cuts.

A significant feature of the Financial Year 2003-2004 budget is decentralization and the increasing role that will be played by the peoples' representatives in the management and use of government funds. There are a number of implications from this change.

Firstly, unlike the past, it provides peoples' representatives greater control over resources. Secondly, their accountability to the government, and more importantly to their constituents, on the management and use of public funds will increase. To facilitate decentralization, the Ministry of Finance has initiated the Gewog based budgeting system. Additional finance personnel have been trained and posted to the Dzongkhags to cater to the needs of Gewogs. The Royal Government will post one accountant (non-civil servant) in every Gewog by the end of the Ninth Plan.

The Ministry of Finance is also happy to report that in line with the GYT Chathrim 2002, the Gewogs are now retaining their rural taxes. We are confident that with time and the experience gained in the management and use of these funds, the process of decentralization will be further strengthened.

A common feature of all the Gewog budgets is the request for funds for the construction of Gups offices. I would like to take this opportunity to reiterate His Majesty the King's advice that at this stage of the decentralization process, the GYTs should accord higher priority to Gewog development activities that benefit the people rather than on the construction of Gups offices.

However, the Royal Government appreciates that unlike the past, with the expanded roles and responsibilities of the Gup, as well as to ensure continuity and convenience for the people, there is a need for a more permanent office establishment to support this important institution. Thus the Royal Government will support construction of Gups offices but in a phased manner. Also, there are numerous other Gewog infrastructure needs such as Renewable Natural Resource (RNR) Centers being planned by the government. To ensure maximum benefit and convenience to the people, the Royal Government will coordinate the construction of these facilities to create an Integrated Gewog Development Center (basically a Gewog Headquarter). Over time, this is expected to become a growth center that will create economic opportunities

including employment for the Gewogs in addition to cost and convenience benefits. It should also create an additional market for village produce and bring in other benefits in much the same manner as the Dzongkhag towns.

Sector Allocation

As the improvement of the living standards of all the Bhutanese people forms the central thrust of our development policies and plans, major investments will be made to address the concerns of the majority of the people living in the rural areas. In addition to the focus on social sector development, concerted efforts will also be made to pursue integrated rural development through enhanced rural access, expansion of rural electrification and establishment of rural telecommunication infrastructure, etc.

The sector allocations are as summarized below.

Sector Allocation: Financial Year 2003-2004 Budget

Sectors	Nu. in Millions			
	Current	Capital	Total	Percent
Health and Education	1,755.375	1,101.025	2,856.400	24.8
Agriculture	672.906	777.164	1,450.070	12.6
Human Settlement	75.123	735.561	810.684	7.0
Communications	119.293	116.335	235.628	2.0
Roads	201.781	1,448.490	1,650.271	14.3
Energy (excluding mega projects)	29.666	806.944	836.610	7.3
General Public Services	1,376.493	1,052.330	2,428.823	21.1
Debt Service	180.745	225.420	406.165	3.5
Others	586.116	276.970	863.086	7.5
Total	4,997.498	6,540.239	11,537.737	100.0

Social Sector

As in the past, the health and education sector will continue to receive the largest share of the budget allocation. This is a reflection of the high importance accorded to human resource development. Major investments in the education sector include the construction of additional schools around the country to meet the growing demand.

Most of the constructions are located in the Dzongkhags to ensure equitable access to education facilities. A loan of USD 30 million will be sought from the World Bank in the coming year to finance the resource gap. The provision of free health and education services continues to cost the government 25% of its entire expenditure.

As the honourable members are aware, the most significant development in the education sector is the establishment of the Royal University of Bhutan. The University, being developed on a federated model, will serve as an umbrella organization for all the higher institutes of learning and confer Bachelors, Masters and Doctoral degrees. The main responsibility of the university will be to set standards to enhance the quality of higher education in Bhutan and ensure that the degrees awarded by the university are well recognized even outside Bhutan. The university will enhance the status and dignity of higher learning in the country and become yet another symbol of national sovereignty and pride.

In the health sector, I am pleased to inform that primary health care coverage has already exceeded 90%. Emphasis will now be given on consolidation and improvement in the quality of services. The largest project in the health sector is the construction of Thimphu and Mongar Referral Hospitals for which the Government of India has agreed to provide about Nu. 1,020 million over the next few years.

In order to ensure sustainability of health financing, the Royal Government has established the Bhutan Health Trust Fund, which currently stands at USD 17.5 million. The honourable Minister for Health and Education, in order to enhance awareness and to mobilize additional funds, undertook the “Move for Health” walk from Trashigang to Thimphu. This event received enormous publicity and appreciation even outside Bhutan and generated substantial contributions to the Health Trust Fund. The income of the Health Trust Fund will go a long way to finance the recurrent cost of essential health services in the country.

Agriculture

As the vast majority of our people still depend on agriculture for their livelihood, the Royal Government will make every effort to enhance agriculture productivity through integrated rural development programs. This includes promotion of modern farming technologies; farm mechanization; provision of research support; training of farm business entrepreneurs; and continued provision of rural credit. We hope that such targeted interventions will encourage the development of agro-based business including livestock businesses and provide profitable and gainful self-employment for some of our young people. Even today, cash crops such as apples, oranges and potatoes form a major source of cash income for our farmers.

Communications

A reliable and efficient communications infrastructure is integral for national security, successful economic development, effective decentralization and private sector growth. In order to further link the rural areas and take advantage of developments in information technology, major investments will be made to improve rural telecommunications. The Royal Government is in the process of obtaining a loan to finance the rural telecommunications project. The rural electrification program along with rural telecommunication will help our people in the far-flung areas to benefit from telephone, facsimile, email and Internet facilities. A mobile cellular phone service will also be introduced in the coming year in the Thimphu and Phuentsholing areas. This service will be expanded to other towns based on the economic and technical feasibility.

Roads

The Royal Government will continue to make major capital investments to improve the national highways and expand the feeder and farm road networks as evident in the large capital outlay allocated to this sector. Priority will be given for the construction of rural farm roads by using our own resources as well as availing grant assistance and loans from our development partners.

Substantial investments will be made to improve the East-West lateral highway, through loan financing, as it is a vital link of immense strategic and economic importance. As there has been a rapid increase in the traffic on the Thimphu-Phuntsholing highway, major works to double lane this road will also be initiated in the coming year. The Royal Government is confident that improvement and expansion of road networks will have a positive catalytic impact on the economy by encouraging rural agro-based businesses, improved access to markets and services as well as reducing transportation costs.

Human Settlements

As economic development leads to the emergence of urban townships, it is important that these growth centers are planned properly. To ensure the comfort and safety of the people, we must ensure the provision of basic urban amenities like water, roads, electricity, and sewerage services. I am pleased to report that works related to the development of the twelve Dzongkhag towns are progressing well. We are confident that once completed these towns will serve as growth centers in the Dzongkhags. This will further help in our efforts to promote balanced regional development and address other issues related to unemployment and rural-urban migration.

The Thimphu Structure Plan has also been completed and approved by the government. Thimphu is the largest urban center in the country where people from all over the country live and work or transit through. With an annual population growth rate of about 7%, it is important to ensure planned development of the capital city so that there is no compromise on the environmental and aesthetic aspects while meeting the needs of a growing population.

I am pleased to report to the National Assembly that the first phase of the low-income housing complex in Thimphu and Phuntsholing has been completed. This will provide a financial respite to the lower income people and help them to enjoy a better quality

of life. Such public housing schemes will be undertaken in other Dzongkhags if necessary. However, to the extent possible, the Royal Government will discourage government agencies from constructing staff quarters. This is to encourage private individuals in the villages, Dzongkhags and satellite towns to participate in the housing sector and benefit from rental income.

Energy

As the honourable members are aware, Bhutan is blessed with immense potential to generate hydroelectric energy. Accordingly, the Royal Government has made significant investments to harness this valuable resource to encourage industrial development in the country; expand rural electrification and export to India. The Basochhu Phase I and the Kurichhu hydropower projects are functioning smoothly. The transmission lines for the evacuation of power from Kurichhu hydropower project are also completed and will facilitate power transmission domestically as well as for exports.

I am pleased to report that the works on the 1020 MW Tala hydropower project is progressing well. Most recent estimates show that more than 66% of the work is complete and all indications shows that the Project will be successfully completed by September 2005. The Royal Government is most grateful to the Government of India for their financial and technical support in undertaking such a large and complex project.

The construction of the Basochhu II hydropower project is also progressing smoothly. This project may be completed by September 2004, six months ahead of its schedule. The completion of these power projects will provide great benefits for industrial and rural development.

In order to extend the benefits of hydropower to the rural areas, substantial investments are being made through the rural electrification program. As honourable members may be aware, the majority of our people, around 65%, still do not have access to

electricity. Given the remote and scattered nature of settlements in most rural areas of Bhutan, the per capita cost of distribution is one of the highest in the world while our tariff is among the lowest. Also, almost all of the power projects including some of the transmission lines have been built through loan financing. Many donors have expressed concern about the sustainability of the power sector vis-à-vis the low domestic tariff and made their further financing conditional to the upward revision of the tariff rates. Thus, after lengthy discussions and careful consideration of its likely impacts, the power tariff was revised in the past year. As the honourable members are aware, a block tariff system was introduced to minimize the impact on the rural people while ensuring that those who consume more pay higher rates.

The Royal Government is aware that hydropower is an abundant resource and a source of comparative advantage for Bhutan. We would like to highlight that even the revised tariffs are among the lowest in the region and probably most of the world. Infact, despite the tariff increase, the Royal Government is still subsidizing electricity given the high debt servicing and power distribution costs. Therefore, the Royal Government will do its utmost to maintain the tariff at affordable levels but we must be prepared to accept periodic tariff increases in future. Only in this manner can we obtain the financing necessary to take electricity to the majority who are without it as mentioned by the honourable Tengye Lyonpo in his meeting with the Chairpersons of the DYT and GYT recently.

Domestic Revenue

The Ministry of Finance is pleased to report that in line with our fiscal policy, domestic revenues is again projected to cover current expenditures in the coming financial year.

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

Summary: National Revenue Forecast for Financial Year 2003-2004

Source of Revenue	Nu. in millions	
	Amount	Percent
A. Tax Revenue	3,350.311	64.2
1. Direct Tax	1,936.568	37.1
Corporate Income Tax	1,150.824	22.1
Business Income Tax	377.749	7.2
Personal Income Tax	119.644	2.3
Health Contribution	30.508	0.6
Royalty	257.844	4.9
2. Indirect Tax	1,413.743	27.1
Bhutan Sales Tax	648.376	12.4
Export Tax	0.802	0.0
Excise Duty	524.696	10.1
Motor vehicle Tax	82.139	1.6
Import Duty	112.632	2.2
Business & prof. License	25.045	0.5
Other Tax Revenue	20.052	0.4
B. Non-Tax Revenue	1,864.446	35.8
Admin. Fees & Charges	111.785	2.1
Capital Revenue	43.337	0.8
Revenue from Govt. Depts.	56.893	1.1
Dividend	1,417.823	27.2
Transfer of Profits	225.680	4.3
Other Non-Tax Revenue	8.927	0.2
Total	5,214.757	100.0

As we have often highlighted before, achieving a surplus on the current budget is necessary to ensure the sustainability of our investments. Funding for capital expenditures will continue to be sought from our development partners through a mix of grants and concessional loans. However, we must aim to fund larger portions of the total outlay through domestic resources. This will help to build the intrinsic strength of the country, ensure sustainability and provide us greater command over our destiny. The peace, prosperity and progress of our country can only be sustained if we are economically self-reliant.

Domestic revenue growth is projected at only 2% for the coming year since the Ministry of Finance decided not to increase or introduce new taxes in order to promote private sector development. In line with past trends, domestic revenue will amount to about 19% of the GDP. The share of tax revenue continues to grow and is projected to account for about 64% of total domestic revenue. Among the different sources of revenue, the largest contributors are dividends, Corporate Income Tax and the Bhutan Sales Tax. Business Income Tax is projected to account for around 7.2%, a marginal increase from the past year. PIT is projected to account for a little over 2% of the total revenues.

We are pleased to inform that a number of measures to enhance domestic revenues are being introduced in the coming year. Special attention is being paid to the rationalization of taxes and strengthening tax collection and administration so that higher revenue collections can be achieved with fewer additional taxes. Efforts are also aimed at making tax transactions easier and user friendly. Concurrent efforts will be made to educate people about taxes and the consequences of evasion and non-compliance. Given the importance of taxes for nation building, national security and the achievement of our common aspiration of Gross National Happiness, tax education and inculcating tax discipline will be an important part of the tax administration efforts in the years to come.

Implementation of the Personal Income Tax

Over the past few years, the Personal Income tax has been widely discussed in the National Assembly as well as among the general public. I am honored to report to the honourable members of the National Assembly that the first year of PIT implementation was very successful. As a result of intensive publicity campaigns through the media, local workshops and wide-ranging public consultations nationwide, over 23,000 people registered for the PIT. As of now, the total collections stand at Nu. 91 million.

The Ministry of Finance is also pleased to report that to obtain an independent view of the PIT as well as our tax structure in general, a technical mission from the Fiscal Affairs Department of the IMF was invited to Bhutan. I am happy to inform that the team has endorsed the PIT and the related decisions and policies of the Government. They find that our PIT structure has found a good balance between its objectives of equity, participation in nation building, revenue and simplicity. Amongst others, they have reviewed issues such as the tax on dividends and the exemption thresholds, and they have fully endorsed the steps the Government has taken. They have also provided some recommendations to guide tax developments in the future.

The Ministry of Finance would like to express its deepest gratitude to the honourable members of the National Assembly and the public for their support in making the first year of the PIT a great success. From the interaction and the feedback we have received, there is a clear indication that the people have a deep appreciation for the PIT, as it will contribute immensely towards nation building, strengthening national security and ensuring equitable and sustainable development in the country.

External Assistance

I am pleased to report to the honourable members of the National Assembly that the Eighth Round Table Meeting (RTM) for Bhutan was held in Geneva in February 2003. The RTM is the highest-level forum for aid coordination and policy dialogue between the Royal Government and its development partners. The Eighth RTM witnessed a high-level representation from 18 bilateral donor countries and 27 multilateral and other agencies with a total number of 106 participants. This is a clear reflection of the friendship and support that Bhutan enjoys in the international community.

In contrast to past RTMs, resource mobilization was not the purpose of the 8th RTM. As honorable members may already be aware, resource mobilization is now an ongoing process that has been institutionalized over the years. The main focus of the RTM was to exchange views on the Ninth Plan and its important thematic areas of decentralization and poverty alleviation.

From the RTM as well as the periodic meetings with our development partners, I am happy to inform that there is tremendous goodwill towards Bhutan, although this does not necessarily translate to increased financial support. All our development partners commended our development philosophy of Gross National Happiness, successful environment conservation efforts, good governance, including decentralization and the drafting of the constitution and our efforts to promote our traditions and culture. Most of the donors have categorically stated that Bhutan is one of the most successful development partners for them. Thus there is every reason for the Government and the people of Bhutan to be pleased and proud to hear such positive remarks from our donor friends.

We are very grateful to all our development partners for the generous assistance provided to the Bhutanese people. The Royal Government is ever mindful of the fact that aid is essentially taxes collected from people in donor countries, and thus the need

to ensure its most judicious use. I would also like to make a special mention and thank the Government of India, Bhutan's oldest friend and the largest donor, for their friendship and generous assistance over the years.

While Bhutan continues to enjoy generous support from all our development partners, every effort must be made to attain our cherished goal of economic self-reliance. To this end, we will continue to channel development assistance to productive investments areas such as poverty alleviation and private sector development etc., which have a catalytic impact in strengthening and diversifying Bhutan's economy.

Borrowings

As of end 2002, the stock of external debt outstanding was USD 331.7 million or around 58% of GDP. Out of this, convertible currency debt stock accounted for around 45%. The entire convertible currency debt stock is concessional in nature with the most favorable terms and conditions. The debt service ratio for the same period was 3.5%, reflecting the highly concessional nature of our debt portfolio. In the coming year, external borrowings are expected to fund 15% of total capital outlay. As in the past, concessional loans will be availed for priority investment projects with high economic returns and for which grant financing is not forthcoming.

Summary of External Borrowings

Debt Outstanding	Millions of USD
	Amount
Convertible Currency Loans	147.9
Indian Rupee Loans	183.8
Total	331.7

The Ministry of Finance is pleased to report that government borrowings are well within our repayment capacity and that the funds are all being used for important projects as mentioned earlier. This is also borne out by an assessment of our fiscal

sustainability undertaken by the IMF Article IV consultation mission mentioned earlier. The study confirmed the soundness of our borrowing policy and that our indebtedness was well within acceptable thresholds. Stress tests revealed that our debt dynamics remain sustainable even under a number of domestic and external shocks such as large exchange rate and fiscal policy shocks. This was mainly on account of expected rapid GDP growth rate and the concessional nature of the bulk of the debt stock. We will continue with our policy of turning to borrowings as a last resort, seek the most favorable terms and conditions, and target its use carefully.

Private Sector Development

As in the past budget reports, I would like to emphasize the importance of private sector development to foster economic growth, enhance economic diversification, generate employment and strengthen the national economy. Given the rapid changes induced by the forces of globalization, a strong and vibrant private sector is most important to ensure that Bhutan can also benefit from it.

The Royal Government will continue to foster private sector growth by creating an enabling environment for business activities and improving the investment climate. All efforts will be made to create clear and transparent policies; streamline administrative requirements and reduce bureaucratic red tape, all of which impose considerable costs on the entrepreneurs. In order to create a stable and predictable business climate, measures will also be undertaken to strengthen the rule of law and enforce contracts. The Royal Government will also introduce de-licensing in selected areas; develop commercial infrastructure; improve access to finances through financial sector reforms; improve delivery of public services and promote competition in all possible commercial areas.

I am also happy to report that physical works on the industrial estate at Pasakha have begun and preparations are underway for the establishment of a dry port at

Phuentsholing. The projects should benefit the private sector immensely through greater efficiency and lower transaction costs for conducting trade. Additional Industrial Estates have also been planned for Gelephu, Mongar, Zhemgang and Samdrupjongkhar.

One important area of concern to the private sector, and as highlighted by the IMF in their Article IV consultations, is the danger of introducing employment regulations that will raise labor costs and undermine efforts to foster private sector development. This is an important cost consideration that will affect the competitiveness of our private sector and which coupled with the pace of economic liberalization in India could result in loss of previously captive export markets. Therefore, the Royal Government will continue to allow the use of foreign labor but in a regulated manner that minimizes adverse social impacts. The Royal Government will also continue to encourage mechanization wherever feasible.

The need to enhance our economic productivity and competitiveness is all the more pressing considering the rapid pace of global economic integration. As seen from the direct and indirect impacts on Bhutan arising from the war in Iraq and the SARS virus outbreak, we cannot insulate ourselves from exogenous shocks. Therefore, it is in our interest to harness our economic potential and reap the gains arising from globalization. To this end we will continue to progressively liberalize the economy and help strengthen our private sector.

Bhutan has already begun the process of accession to the World Trade Organisation. The WTO is an intergovernmental organisation that seeks to promote multilateral trade through legally binding agreement. Membership to the WTO will confer Bhutan numerous trading rights and privileges to conduct trade in a stable and predictable environment. The full benefits of WTO can, however, only be realized if Bhutan's private sector is strong and competitive in the international market. Hence there is additional compulsion to foster private sector growth and improve competitiveness.

Employment

There is widespread concern on the need for employment generation both in the government and among society at large. With the number of school leavers growing each year, the need to create gainful employment opportunities for the young people is of utmost priority. I would like to take this opportunity to reiterate that the perception of an emerging unemployment crisis arises largely from the mismatch between the skills of the school leavers and the jobs available in the economy. While most of the school leavers aspire for white-collar desk jobs in the civil service, the government cannot absorb all job seekers, as it would lead to an increase in the bureaucracy and additional costs on the economy.

Thus, to address the problem of skills mismatch, the Royal Government is seeking ways to expand the capacity for training as well as to ensure that it is demand driven. In the coming year, two new vocational training institutes will be constructed in Buna in Trashigang and Khuruthang in Punakha.

As honorable members are well aware, the Royal Government had created the Department of Employment and Labor to address the employment concerns. Considering the importance of addressing employment related issues, the Royal Government has decided to establish the Ministry of Labour and Human Resources.

I would like to clarify that the establishment of a Ministry is not a panacea for employment creation as its main role is to facilitate job seekers to find jobs that match their skills and to create just working conditions. The private sector is the largest source of employment in almost all the countries in the world, and thus the emphasis on private sector development for employment generation. On its part, the Royal Government will seek to develop an economic and financial environment that is conducive to entrepreneurship, risk taking, and private sector-led investment and growth.

I am happy to inform that a credit guarantee scheme has been launched as part of the Royal Government's effort to address emerging unemployment concerns as well as to provide an incentive for those who acquire or have some vocational skills. This scheme will provide access to capital particularly for small self-employment type business. Since no equity or collateral is required from those who qualify for financing under the scheme, it will especially benefit the poorer people. Over time and based on experience, the government hopes to expand the size and scope of the scheme so that it can be another useful avenue for gainful employment creation.

Financial Sector

The financial institutions still continue to suffer from excess liquidity although credit to the private sector has picked up in the last year, growing by 29%. In response, the financial institutions have lowered both their lending and deposit rates. The RMA has also begun implementation of the revised Prudential Guidelines and introduced instruments to absorb some of this liquidity. The institutions are also studying the introduction of additional services and instruments that may increase opportunities for lending. Improving access to finances for housing is one potential area that will be studied. The lack of competition and commercial orientation within the financial sector is another area that needs improvement. The Royal Government will explore means to inject more competition in the sector. The Royal Government will also urge the financial institutions to place greater emphasis on human resource development to foster professionalism and commercial orientation.

The Ministry of Finance would like to highlight here that despite the excess liquidity situation, our financial institutions have been performing well. In fact, while financial sectors have been a primary cause of economic woes in many countries around the world today, our financial institutions are a source of stability. Also, over the past four years, the percentage of non-performing loans, which were as high as 16.5% in 1999, are down to around 9.7% today. This is a significant accomplishment.

The Ministry of Finance would also like to remind that the financial sector is not the cause of the excess liquidity problem. In fact the excess liquidity problem is itself a symptom of bigger problems within the economy that constrain investments. While there is room for improvement in the financial sector, particularly in lending practices and the number of products on offer, they are not a critical factor impeding investments. We must bear in mind that an excess liquidity problem can easily turn into a large non-performing loans problem if the financial sector becomes too aggressive. The financial institutions have the sacred responsibility of ensuring the safety of the deposits, which are owned by the general public. Thus, our efforts to ease and improve access to finances will be undertaken without compromise of prudent practices but through regular review of products and rates to ensure that they meet our financial needs and are competitively priced.

Also, there is limited scope for the monetary authority to deal with this situation as it is more equipped to deal with situations of scarcity. Moreover, its interventions impose considerable cost on the institution and the economy. Thus, as often stated before, a lasting solution can only come about if the real root causes impeding investments are addressed.

Other Initiatives

Foreign Direct Investment Policy

As we have often highlighted before, experience all over the world show that FDI can be a driving force for rapid economic growth. Foreign investment provides access to capital, markets and new technologies as well as transfer of managerial skills. In addition, FDI is a more stable source of foreign capital. Therefore, even though Bhutan is not an attractive FDI destination given the numerous disadvantages of being a small, landlocked, mountainous country, we must try to attract as much foreign investment in the areas where we have some advantage. To provide the framework for such

investments, the Royal Government approved the Foreign Direct Investment (FDI) Policy in December 2002. This must now be followed up by a foreign investment act that should boost investor confidence as well as protect our domestic firms by spelling out clearly the legal parameters within which foreign investment will occur.

Accession to World Customs Organization

Bhutan acceded to the World Customs Organization (WCO) in February 2003. The WCO is a UN agency dedicated to dealing with customs administration and related matters. As Bhutan's economy modernizes and its trading activities expand, the WCO will facilitate trans-border trade and improve surveillance. Bhutan will also benefit from various technical assistance, personnel training and establishment of working relations with customs agencies in other member countries.

Membership of International Finance Corporation

The Royal Government will also seek membership in the International Finance Corporation (IFC) in the coming year. The IFC is a member of the World Bank Group that serves as a multilateral source of loan and equity financing for private sector projects in developing countries. Membership in the IFC will benefit our private sector immensely through access to large international financing as well as technical assistance. The ability of the private sector to access such foreign capital will be based solely on the economic viability of the project and not be dependent on any government intervention or guarantees.

Conclusion

With the enlightened leadership of His Majesty the King, the Bhutanese people are most fortunate to live in one of the most successfully managed countries in the world. Although we are a developing country, we enjoy a living standard that is far better than many other countries. As all the Bhutanese people are aware, our country continues

to make all round social and economic progress. At the same time, we are fortunate that our traditions, culture and values still remain intact and enrich our daily lives. Our pristine natural environment and sound conservation policies will continue to benefit us as well as the future generations. With the strengthening of the institutions of good governance, there is every reason for the Bhutanese people to be optimistic of the future. Gross National Happiness is not just a distant dream but an objective we are getting closer to achievement.

Given the large financial outlay of the Ninth Plan, there is some concern about the adequacy of resources. I would like to reassure the honourable members of the National Assembly that this should not be a problem as our domestic revenue generation is increasing and we also enjoy good support from our development partners. The completion of the Tala Project will also improve our revenue position substantially. Therefore, the implementation of development activities in the Ninth Plan will not be affected.

As we are all aware, the issue of foremost concern in the minds of all Bhutanese people is the presence of armed militants that threatens our security and sovereignty, and strains our relation with India. It is on this front that Bhutan is going through the most difficult period in our history. As the honourable members of the National Assembly are aware the 78th session of the National Assembly had mandated the Government to persuade the militants to leave Bhutan by peaceful means and use force as a last resort.

I would like to inform the honourable members that an emergency kidu fund amounting to Nu. 1,000 million has already been created with plans to increase it to Nu. 2,000 million, if necessary. This fund will be used to ensure that the welfare of the internally displaced people are well looked after. Furthermore, I would like to assure the

honourable members that the Royal Government is prepared to devote all resources necessary to resolve the problem.

In conclusion, as the term of the present Council of Ministers draws to an end, I would like to express our gratitude to His Majesty the King for his wise and able leadership, which has inspired and guided the Royal Government successfully over the years. We would also like to thank the honourable members of the National Assembly for their support during our term in office.

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

Tashi Delek

Selected Monetary and Financial Indicators

Items Description	2001/02	Dec-02	Percent Change
	Millions of Nu.		
1 Total Assets of the Financial Sector	26495.97	30693.29	15.84
a. Royal Monetary Authority	11006.24	12321.86	11.95
b. Four Financial Institutions	15489.73	18371.43	18.60
2 Money Supply			
a. Quasi Money 1/	6057.45	6732.26	11.14
b. Demand Deposits	3313.58	5322.78	60.64
c. Ngultrum in Circulation	1600.19	1648.29	3.01
3 Domestic Credit	2280.46	2949.00	29.32
of which Private Sector	2728.88	3149.24	15.40
	Millions of USD		
4 Gross International Reserves	316.90	355.32	12.12
a. Convertible Currencies	240.70	259.41	7.77
	Millions of Rs.		
b. Indian Rupees	3730.62	4617.01	23.76
5 Exchange Rate for USD (Period Average)	48.21	48.14	-0.15
6 GDP (Nominal)		27532.7	
7 Real GDP Growth Rate		7.7	
8 Consumer Price Index (%)	2.71	2.26	

Note:

1/ quasi money includes foreign currency deposits & time deposits

Selected Monetary and Financial Indicators

Items Description	2001/02	May-2003
Structure of Interest Rates		In Percent
a. Deposits		
i) Savings	5-6	5-6
ii) Fixed Deposits		
3 months to 1 year	7	5.5-7
1 year to less than 3 years	9	7.5-9
More than 3 years	10	8.5-10
b. Lending Rates		
i) Export Finance	13-15.5	13-15
ii) Manufacturing, Service, Transport and Agriculture	13-16	12-16
iii) Housing	14	13
iv) Working Capital	13-15.5	13-15
v) Personal and General Trade	15-16	15-16