



NATIONAL BUDGET

FINANCIAL YEAR 2004-2005

MINISTRY OF FINANCE
JUNE 2004

Introduction

The Ministry of Finance has the privilege to present the Financial Year 2004-2005 budget and a report on the Financial Year 2003-2004 budget.

First of all, the Ministry of Finance would like to take this opportunity to pay a special tribute to His Majesty the King and the security forces for successfully removing the armed militants from our borders in December 2003. While His Majesty was reluctant to resort to armed conflict, as reflected in a number of past National Assembly resolutions, His personal leadership ensured a swift conclusion to the conflict, with minimal loss of lives on both sides.

The Ministry would also like to express its appreciation to the militia volunteers for assisting the security forces in discharging their duty of safeguarding the country. We would also like to thank the Central Monastic Body for performing numerous Kurims for the safety and welfare of the country.

The Ministry of Finance would like to highlight that as desired by His Majesty, every effort was made to ensure that development works did not suffer on account of the security problem. As a result, we are happy to report that we remain on track to successfully implement the Ninth Plan, and that with the blessings of the guardian deities and under the enlightened and peerless leadership of His Majesty the King, Bhutan's future continues to look bright.

Economic Performance

The Ministry of Finance is pleased to report that on the whole, the economy is doing well, inspite of the various inherent difficulties. As per the provisional national accounts data, Bhutan is expected to have achieved a real GDP growth rate of 6.5% in 2003. Agriculture continues to be the dominant sector, accounting for around 30% of GDP, but growth is being driven mainly by the construction, manufacturing and transportation sectors.

In the external sector, as in the past years, the trade deficit continues to persist. However, it has improved by 9% over the previous year, and as of July 2003, it stood at around 11% of GDP. As the honourable members will understand, this is due to the large imports having to be made on account of numerous development activities being undertaken while the country's exports are still limited. At the stage of development our country is in, trade deficit will persist for a fairly long time to come. However, on the whole, the main aspect to be observed is the overall Balance of Payments, which remains favourable as aid inflows continue to offset the trade deficit. As of July 2003, the overall Balance of Payments surplus was 8% of GDP.

As of end 2003, Bhutan's foreign reserves stood at the equivalent of USD 366.71 m, sufficient to cover around 22 months of total imports. Convertible currency reserves of USD 288.28 m account for around 78.6% of the total international reserves.

As of December 2003, the public debt to GDP ratio was around 67% and the debt service ratio was around 3.5%. These are considered reasonable because the borrowings have been used mainly in high-return investments such as hydro-power projects.

Following developments in India, inflation, as recorded by the consumer price index, decreased further to a historical low of 1.3% in end December 2003. Domestic credit to the private sector is picking up, and it has grown by around 35% in the past year.

As per the latest labour force survey, unemployment has increased to 2.7%, up from 1.9% in 2001. However, it may be pointed out that this is still relatively low compared to other countries, given that some unemployment will always exist on account of new entrants into the job market and those in between jobs.

Review of Financial Year 2003-2004 Budget

The latest status of the 2003-2004 budget is as shown in the table below. As can be seen from the table, the budget has increased by around 8% from the original estimates.

REVISED BUDGET SUMMARY Financial Year 2003-2004

Nu. in millions

Description	Original Budget	Revised Budget, 30 April, 2004
Outlay		
1. Expenditure		
i. Current Expenditure	4,997.498	5,569.103
ii. Capital Expenditure	6,277.349	6,332.085
Sub-total	11,274.847	11,901.188
2. Net Lending	37.470	103.030
3. Repayment	225.420	475.420
Total	11,537.737	12,479.638
Sources of Finance		
1. Domestic Revenue		
i) Tax	3,350.311	3,350.311
ii) Non-Tax	1,864.445	1,864.445
Sub-total	5,214.756	5,214.756
2. Other Receipts	13.270	947.581
3. Grants		
i) Program Grants	2,000.000	1,824.000
a) GoI	2,000.000	1,750.000
b) Others	0.000	74.000
ii) Project-tied Grants	2,973.603	2,632.168
a) GoI	1,342.361	537.209
b) Others	1,631.242	2,094.959
Sub-total	4,973.603	4,456.168
4. Financing		
i) Project tied Borrowings	952.875	1,125.769
ii) Resource Gap	383.233	735.364
Sub-total	1,336.108	1,861.133
Total	11,537.737	12,479.638

On the **expenditures** side, most of the increase was on account of current expenditures, in particular, the interest subsidy to the Druk Air Corporation, the membership fees for acceding to the International Finance Corporation, and new appointments in the civil service. Consequently, current expenditure coverage by domestic revenues would be around 94%. The Ministry of Finance would like to highlight that every effort is made to keep the expenditures within the original budget, and particularly the current expenditures within the domestic resources envelope.

With respect to capital expenditures, there was a relatively small increase, and one of the major factors contributing to the increase was the provision for the restoration of roads damaged by monsoon. There were also a number of changes within the activities funded from external sources. Some of the larger activities for which supplementary budgets were included were the supply of agricultural machineries, rural electrification, expansion of the eastern grid power transmission lines etc. On the other hand, there were a number of activities earmarked for funding from grant sources, which could not be implemented due to non-finalisation of the projects.

Loan repayments increased substantially on account of the redemption of the National Pension and Provident Fund loan of Nu. 250 m.

On the **resources** side, there was a shortfall in program grants of around Nu. 176 m. This was mainly because at the time of budget preparation, negotiations with some large donors had not been completed. Most of this shortfall and the increase in expenditures would therefore be translated into an additional deficit of around Nu. 352 m over what was projected. Further, expected receipts of substantial amounts of grants for various projects did not materialise as the projects took time to be finalised with the development partners, due to the uncertainties and complexities of aid negotiations. Consequently, any shortfall arising on account of these has to be met from domestic borrowings in order to maintain the level of expenditures. Nevertheless, the Ministry of Finance is pleased to highlight that the revised resource gap is still substantially lower than the past years level and within the projected resource gap for the Ninth Plan.

Budget Estimates for Financial Year 2004-2005

The Ministry of Finance would like to report that the budget for the coming year has been prepared as usual with our policy of fiscal sustainability in mind. The expenditure budget for the financial year 2004-2005 has been drawn up at Nu. 13,622 m, and the summary is as given below:

BUDGET SUMMARY Financial Year 2004-2005

Nu. in millions

Description	Amount	Percent
Outlay		
1. Expenditure		
<i>i. Current Expenditure</i>	5,968.657	44
<i>ii. Capital Expenditure</i>	7,158.342	53
Sub-total	13,126.999	96
2. Net Lending	104.700	1
3. Repayment	390.040	3
Total	13,621.739	100
Sources of Finance		
1. Domestic Revenue		
<i>i) Tax</i>	3,575.486	26
<i>ii) Non-Tax</i>	2,226.204	16
Sub-total	5,801.690	42
2. Other Receipts	1,175.223	9
3. Grants		
<i>i) Program Grants</i>	1,894.000	14
<i>a) GoI</i>	1,750.000	13
<i>b) Others</i>	144.000	1
<i>ii) Project-tied Grants</i>	2,481.068	18
<i>a) GoI</i>	975.351	7
<i>b) Others</i>	1,505.717	11
Sub-total	4,375.068	32
4. Financing		
<i>i) Project tied Borrowings</i>	1,377.911	10
<i>ii) Resource Gap</i>	891.847	7
Sub-total	2,269.758	17
Total	13,621.739	100

The budget represents an increase of around 9% from the revised estimates of the 2003-2004 budget. In real terms, the increase is around 7%, and constitutes close to 20% of the 9th Plan outlay.

Expenditure Outlay

The honourable members will be pleased to note that the focus of the coming year's budget continues to be on rural development which includes large outlays on rural electrification, feeder and farm roads, and education infrastructure in the Dzongkhags. These make up the bulk of the **capital expenditure** budget. Capital expenditure budget constitute 53% of the total outlay. Other activities on which large budget provisions are made include low-income housing, the construction of the hangar for the new airplanes, construction of roads including the Thimphu-Babesa expressway project, and population census programme. The outlay for infrastructure, including buildings and roads, account for around 64% of capital expenditure. About 8% of the capital expenditure outlay is allocated for human resource development.

Current expenditure is capped at around 7% over the revised 2003-2004 budget estimates. Among the current expenditures, as in the past year, the wage bill is the single largest item, accounting for around 38%. Interest Payments constitute around 6% of the current expenditures, and subsidies to corporations around 4%. Around 8% of the current expenditure budget is provided for maintenance of infrastructure.

Decentralization

As honourable members are well aware, the hallmark of the Ninth Plan is the introduction of the Gewog plans. Due to teething problems with the new implementation mechanism as well as the time required for preparations at the Gewog level, not much Gewog level activities could be undertaken in the first year of the Ninth Plan. The situation has improved in the immediate past financial year, and it is expected to change significantly in the coming year during which Nu. 452 m has been budgeted for activities to be executed by the Gewogs. This represents a 62% increase over the

revised estimates for the past financial year. The total budget provision for Dzongkhags and Gewogs is 31% larger than the previous year's revised budget.

The Ministry of Finance would also like to point out that while the total budget for Dzongkhags and Gewogs account for around 22% of the total budget outlay, it does not include budget for activities such as rural electrification or rural telecommunication, even though the Dzongkhags and Gewogs are the direct beneficiaries of these centrally executed programs.

**Summary of Dzongkhag and Gewog Budget Allocation for
Financial Year 2003-2004 and 2004-2005**

Nu. in millions

Description	Revised Budget as of April 2004	2004-2005 Budget	Percent Change
Dzongkhags	2,049.999	2,588.579	26
Gewogs	279.052	452.442	62
Total	2,329.051	3,041.021	31

The Ministry of Finance would also like to report that support will continue to be provided to the Gewogs, particularly for enhancing the capacity of locally elected members, strengthening of the coordination mechanism and the framework for community participations through improved development planning and management. In-country training for Gups, Mangmis, Gup's assistants and Gewog accountants will continue to be provided. Budget provision has also been made for the supply of computers or typewriters to every Gewog. Given the importance of fiscal decentralization, the Ministry of Finance will continue to monitor the situation closely. It is our hope that as communities gain more experience from decentralization, they will be able to assume greater responsibility over resources and their proper use. For a small country with a limited resource base, this will be one of the most challenging aspects of decentralization. As we have often highlighted before, the devolution of authority under decentralization will be accompanied by greater responsibility and accountability.

Sector Allocations

A summary of the sector allocation of the financial year 2004-2005 budget is presented below.

Summary of Sector Allocation of 2004-2005 Budget

Nu. in millions

Sectors	Current	Capital	Total	Percent
Social Services	1,925.566	1,863.147	3,788.713	27
<i>Health</i>	704.477	845.705	1,550.182	11
<i>Education</i>	1,221.089	1,017.442	2,238.531	16
Economic & Public Services	1,490.880	3,872.712	5,363.592	40
<i>Agriculture</i>	741.231	747.680	1,488.911	11
<i>Mining & Manufacturing Industries</i>	61.622	107.262	168.884	1
<i>Roads</i>	192.871	1,248.970	1,441.841	11
<i>Housing & Public Amenities</i>	132.363	916.527	1,048.890	8
<i>Communications</i>	329.866	309.650	639.516	5
<i>Energy</i>	32.927	542.623	575.550	4
General Public Service	2,552.211	1,917.223	4,469.434	33
<i>of which National Debt Service</i>	377.260	390.040	767.300	6
Total	5,968.657	7,653.082	13,621.739	100

The sectoral allocations reflect the priorities of the Royal Government as set out in the 9th Plan. In this respect, the Ministry of Finance would like to highlight to the honourable members that the Royal Government's five-year plans essentially contain poverty-alleviating programmes, and as such the budget addresses the main issue of raising the living standards of our people.

In line with the long-standing policy of the Royal Government, the largest budget allocation is made to the social services sectors of health and education, followed by agriculture and roads. General Public Service, which is allocated around 33% of the total budget outlay, covers among others, national debt service. Some of the significant activities included in the budget of the sectors, are highlighted below.

Social Services Sector

In line with the Royal Government's policy, the social sector continues to receive the biggest share of the budget, approximately 27% in the coming year. The Ministry of Finance is pleased to highlight that it is largely on account of the gains in the social sector that Bhutan's ranking in the UN HDI, which is the most comprehensive human development index in use, has improved from 145 in 1999 to 136 out of 175 countries in 2001.

Education

In the area of education, the budget in the coming year focuses on expansion of facilities and capacities to meet the growing demand. A budget provision of Nu. 572 m has been made for education infrastructure. Among others, the third Phase of development of the two National Institutes for Education in Paro and Samtse are covered. This is to enable the two institutes to enhance the professional qualifications of teacher educators. Given the Millennium Development Goals on Primary Education for all by 2015, the budget targets mainly at the construction of schools and hostels. A budget provision of Nu. 178 m has also been kept for scholarships to support our overall human resource development programme.

Health

Considering the importance of ensuring universal access to Primary Health Care adequately supported by the secondary and tertiary level services in the country, a budget provision of Nu. 488 m has been made for health infrastructure. Among others, the expansion of the Jigme Dorji Wangchuck National Referral Hospital in Thimphu and the Mongar Referral Hospital are included. The enhanced capacity and facilities should help to reduce the number of patients being referred outside the country for treatment at great costs. Besides curative services the budget also covers other preventive, promotive and rehabilitative health programmes to ensure that Bhutanese are able to lead a healthy and longer life. Budget provision has also been made for Rural Water Supply Schemes to increase access to potable water in rural areas. Also, given the small but growing rise in the number of reported people infected by HIV/AIDS virus, the budget places attention on the prevention of HIV/AIDS and STDs.

Economic & Public Services Sector

Agriculture

Given that the livelihood of a majority of Bhutanese people depend on agriculture, it is another priority area of the Ninth Plan. The Royal Government will continue to provide subsidized farm equipment and machinery to alleviate the labour problems being faced by farmers. A budget provision of Nu. 154 m has been kept for the construction of farm roads, identified as a priority in the Ninth Plan. This should help to shorten the distance between farmers and their markets, reduce transportation time and costs, and benefit overall rural development.

To support rural development, budget provision has been made for the establishment of a training centre in Zhemgang where various vocational training programmes will be conducted in the RNR sectors. The centre's training programme will address all groups of farmers in the country, including the early school leavers, young farmers and community leaders through training in related fields. Post-training support will also be provided in all major areas, including access to finance through the Bhutan Development Finance Corporation (BDFC), input supplies at subsidized costs, and technical back-up from extension agents.

A budget provision of Nu. 127 m has also been provided to enhance the capacity of national research programmes nationwide, given their importance for intervention in this sector. The budget also provides for programmes to enhance productivity. In particular, recognizing the fact that the mandarin orange is an important cash crop for Bhutan, and that citrus greening and tristesa virus problems are constraining factors in increasing the productivity of the cash crop, resources have been provided to address this problem.

Industrial and Private Sector Development

As a priority of the Ninth plan, the Royal Government continues to explore ways to promote private sector development and thereby industrial development. One of the

main constraints in this has been the lack of infrastructure for establishment of industries such as industrial estates. Towards removing this obstacle, activities are underway to establish such estates and the one in Pasakha is ready for actual construction. Necessary budget appropriation of Nu. 10 m has been made for the initial works of the project. Similarly, preparations are being made for the execution of the dry port project in Phuentsholing for which a budget of Nu. 14.5 m has been kept. Both of these projects are expected to enable the private sector to increase the industrial production base of the country. Budget provisions have also been made for the preliminary works for the Bongdema, Jigmeling, and Tingtibi industrial estates.

Besides hydro-power, tourism is the other sector which has potential for growth in our country. Renewed effort is being made to develop the sector, with the view to generate employment opportunities and revenues. As it has always been our policy, the Government will ensure that there is no adverse impact through increase in the volume of tourist inflows on the nation's culture and environment. A significant initiative is the establishment of a Hotel & Tourism Management Training Institute, and a budget provision of Nu. 29.3 m have been made. Other initiatives in the sector for which funds have been allocated include the promotional programmes such as the participation in the Japan Expo 2005. Participation in such international events will provide an opportunity for us to showcase our tradition and culture to the world and Japan in particular, and thus enhance the growth of tourism. The acquisition of two new larger aircraft for the Druk Air fleet is also expected to boost the development of the sector.

Bhutan also acceded to the International Finance Corporation (IFC), becoming a member in December 2003, for a membership fee of USD 700,000 or Nu. 33 m. The Government decided to join the organisation as the private sector can borrow directly from the IFC. It will be especially useful for large projects that require substantial capital. The IFC has already provided a loan of USD 10 m to one Foreign Direct Investment project in the tourism sector.

One of the strategies for the development of the private sector is to join regional and international bodies, which would facilitate entry into and expand markets for our products. During the past year, Bhutan joined BIMST-EC (Bangladesh, India, Myanmar, Sri Lanka, Thailand Economic Group). The Royal Government is also in the process of negotiating preferential trade agreements with Nepal, and working to broaden the scope of the agreement with Bangladesh. Budget has also been provided for Bhutan to begin its accession to the WTO.

The Ministry of Finance would like to inform the honourable members that following the SAARC summit in Islamabad, the future of regional cooperation is looking brighter. In this context, the South Asian Free Trade Agreement (SAFTA) as well as the Agreement on Investment, Arbitration and Avoidance of Double Taxation are two important regional agreements being finalised. The closer integration of our economies through these agreements should enhance the flow of goods and services within the region. The SAFTA will mean a lowering of tariff barriers among our countries, which should translate into larger markets for our products. The investment agreement should help to promote greater investment in each other's economies to enhance the benefits from closer economic integration. These developments should present a number of opportunities to our private sector.

Roads

As the main transport infrastructure in the country, roads maintenance and expansion including broadening and shortening of highways, continues to demand a high share of the budget. As the honourable members will be aware, the construction and maintenance of roads are the most expensive of the activities. For the coming fiscal year, a sum of Nu. 175.097 m has been budgeted for road maintenance including Nu. 70 m for monsoon damaged road restoration works. Out of the total allocation of around Nu. 1,442 m, around 41% is allocated for construction of new roads and bridges in the coming year.

Among others, budget has been provided to complete the 6.2 Km Thimphu-Babesa expressway in the coming financial year. This should help to alleviate housing and traffic congestion problem in the Thimphu valley. A sum of Nu. 30 m has been provided for the construction of the Samtse-Phuentsholing road. Similarly, funds amounting to Nu. 27.5 m have been provided for the construction of the Nangar-Ura road in order to shorten the distance of the East-West highway, and Nu. 20 m for the Gomphu-Panbang road. Funds to the extent of Nu. 22.6 m have been provided for in the budget to complete the Tashithang-Damji district road. Funds have been mobilised for the Gyalpozhing-Nganglam road, and the work is expected to begin in the coming year. Also, the preparatory work for the double-laning of the Thimphu-Phuentsholing highway is going on, and the actual physical works are expected to commence thereafter. Besides, there are numerous feeder roads, which are under construction and funds to the extent of Nu. 198.86 m have been allocated in the 2004-2005 budget.

Human Settlements

Affordable housing, particularly in urban areas, is surfacing as an important issue. To meet some of the demand for affordable housing, the Royal Government undertook the Chang Jiji housing project in the Thimphu city. A budget of Nu. 179.25 m has been provided for the third phase of the project. Another Nu. 150 m has been provided for low-income housing in the Dzongkhags. The Royal Government has also created the National Housing Development Corporation to ensure that this important area receives the necessary attention and support.

Urban infrastructure development has become very important with the rapid growth of urban population. Accordingly, budget has been provided for implementation of the Thimphu and Phuentsholing urban infrastructure plans, for the continuation of works on urban infrastructure development in 12 major towns such as Paro, Wangdi Phodang, Tongsa, Zhemgang, Tingtibi, Bumthang, Mongar, Lhuentse, Tashigang, Rangjing, Duksum and Tashi Yangtse, and for starting such works in Gelephu, Tsirang,

Gyalpozhing and Samtse. A budget provision of Nu. 272.337 m has been made for the purpose.

Civil Aviation

The importance of air travel and air links to other countries cannot be overemphasized for a landlocked country. It is especially beneficial to the tourism industry. In view of these considerations, in spite of its poor direct financial returns, the Royal Government has decided to purchase two new aircraft, the first of which will start flying towards the end of this year. A budget provision of Nu. 187.708 m has been kept as part payment for the interest on bonds issued by Druk Air for the purpose. This is being provided as a subsidy to Druk Air from the Royal Government. The total cost of the two planes will be around USD 78 m. One plane will be provided as government equity while Druk Air will be responsible for meeting the principal repayment of its loans for the second plane. While the purchase of the two aircraft will impose a heavy burden on government finances, the larger aircrafts with their higher capacity and capability is expected to enhance considerably air transport to and from Bhutan. The Druk Air Corporation is already studying the potential for additional flights and linkages to make the best use of the new planes. A budget provision of Nu. 135 m has also been made for the construction of hangars for these planes. The runway will also be extended in the coming year. All these efforts should help to enhance the safety and reliability of our small aviation industry.

Information and Communications

A budget provision of Nu. 74.464 m has been made for this sector. The Royal Government recognizes the great potential and promise of Information & Communications Technology (ICT) for transforming the way we work and live. To provide an enabling policy framework for the development of ICT industry, the Ministry of Information and Communications have formulated an ICT development road map.

Budget provision has been kept to create Local Area Networks in all the Dzongkhags as well as to create a Wide Area Network for Thimphu. Further, to take the benefits and opportunities presented by ICT to the rural communities as well as to provide access to vital public information and services, budget provision has been made to begin, on a pilot basis, the establishment of multipurpose community tele-centers. As per the Plan, the implementation of the rural telecommunication network has also begun.

Discussions are underway for the financing of the establishment of a nation-wide television broadcasting system. As envisioned in the Ninth Plan, such coverage is extremely important for dissemination of information, especially in a country where the population is scattered.

Energy

In line with the Ninth Plan, rural electrification works continue to receive priority. For the coming year, the honourable members will be pleased to note that a budget allocation amounting to Nu. 242 m has been made. The Royal Government has negotiated a loan worth USD 10 m for the purpose. This will cover about 8,000 rural consumers, mostly households but including hospitals, schools and other public service facilities, in eight Dzongkhags. In this connection, it is important to bear in mind that as the costs of expanding rural electrification are high, and the Government cannot always resort to loans, it is necessary to raise resources through other means.

Budget provisions have also been made for electricity transmission lines to evacuate power, both for domestic use and for exports. Some of the major transmission works include Nu. 121 m for the Tingtibi-Tongsa-Bumthang line, Nu. 90 m for the Deothang-Rangia line, and Nu. 25 m for the Semtokha-Rurichhu line.

As the honourable members are aware, besides the activities included in the budget, the Government is implementing hydro-electric projects, which are the backbone of our economy. Among these, the Tala Hydro-power Project is the largest and is scheduled for completion by March 2006. Phase II of the Basochhu Project is progressing very well, and is expected to be complete well ahead of schedule. The Government has also embarked upon the preparation of a detailed project report (DPR) for the Puna Tsangchhu Hydro-power Project, with the assistance of the Government of India. The DPR for the 870 MW project started from March 2004 and is expected to be complete in two years time. Upon coming on stream of these projects, the Government's financial situation is expected to improve.

Employment

As honourable members may be aware, in view of the importance of the unemployment issue, the Ministry of Labour and Human Resources was created in the past year. A budget of Nu. 327.593 m has been allocated to the new ministry for its planned activities. The Royal Government is aware of the growing concern among parents that their children may face difficulties in finding proper jobs after years of schooling. To prevent such a situation, a number of strategies have already been drawn up and are under implementation. A budget provision of Nu. 178.819 m has been made for the expansion of vocational training so that the main problem of a mismatch between demand and supply of human resources can be corrected. The Ministry of Finance would also like to inform that in September 2003, the Royal Government instituted a Credit Guarantee Fund, together with the financial institutions, with an initial capital of Nu. 2 m to help new entrepreneurs, who have no collateral assets to establish small businesses. The beneficiaries will mainly be those trained under the vocational training programs, and the first batch of training for potential recipients of the collateral-free loans under the scheme is underway. The scheme aims to enhance self-employment.

Resources

On the resources side, domestic revenues are expected to finance around 42% of the total expenditures. Grants are estimated to finance around 32% and concessional borrowings around 10%. The balance has to be covered through domestic borrowings.

Domestic Revenue

As already mentioned, domestic revenue is estimated to cover around 42% of the total budget outlay for the coming fiscal year. The outlook for the new fiscal year's revenue is presented below.

Summary of the National Revenue Forecast for Financial Year 2004-2005

Nu. in millions

Source of Revenue	Amount	Percent
A Tax Revenue	3,575.486	62
I. Direct Tax	2,054.895	36
<i>Corporate Tax</i>	1,039.294	18
<i>Business Income Tax</i>	435.254	8
<i>Personal Income Tax</i>	134.502	2
<i>Other Tax Revenue</i>	445.845	8
II. Indirect Tax	1,520.591	26
<i>Sales Tax</i>	634.186	11
<i>Export Tax</i>	0.973	0
<i>Excise Duty</i>	739.439	13
<i>Import Duty</i>	141.174	2
<i>Other Tax Revenue</i>	4.819	0
B Non Tax Revenue	2,226.204	38
<i>Admin. Fees & Charges</i>	163.396	3
<i>Capital Revenue</i>	60.611	1
<i>Revenue from Govt. Dept</i>	42.013	1
<i>Dividend</i>	1,502.930	26
<i>Transfer of Profit</i>	218.935	4
<i>Other Non Tax Revenue</i>	238.319	4
Total	5,801.690	100

Total revenue is projected to increase by around 11% over the past year, and most of the growth is projected to accrue from Non-Tax revenue. Its share is expected to increase slightly to around 38% of total revenues from 36% in the previous period. Among the revenue components, most of the increase is expected to come from Other Non-Tax Revenue, Excise Duty and Health Contributions. Overall, among the various sources of tax revenue, corporate income tax is the largest contributor, projected at around 18% of total domestic revenues for the coming year. Personal Income Tax is also expected to grow significantly, though given the small base, its share of the total domestic revenues is nominal. The tax to GDP ratio is estimated to be at around 11%. Under Non-Tax revenues, dividends are expected to continue to be the main source, accounting for around 26% of total domestic revenues. This is mainly due to the hydropower projects. In fact, the Ministry of Finance would like to highlight that Bhutan has a very fragile revenue base, as around 33% of total domestic revenue comes from the direct contributions of the hydropower projects. Therefore, it will be important to broaden the tax base of the country.

The Ministry of Finance would like to report that the government's fiscal objective of current expenditure coverage by domestic revenues is expected to fall short in the coming year. This is mainly because of the increasing current expenditures such as on the maintenance of growing infrastructure and public services, while the growth in revenue is not keeping pace due to the narrow tax revenue base. However, the Ministry of Finance would like to clarify that some fiscal flexibility is necessary to adapt to short-term developments while ensuring that long-term objectives are not compromised.

We would also like to take this opportunity to apprise the honourable members that the Ministry is continuously striving to improve tax administration to enhance revenue generation. Efforts will also be made to enhance the institutional capacity so that tax services are more efficient and closer to taxpayers.

Other Tax Matters

As honourable members are well aware, the year 2003 began with much anxiety about the impending conflict with the armed militants. His Majesty the King was especially concerned about the welfare of the people in the potential conflict areas. In this respect, we are happy to inform the honourable members that in consideration of the hardship that people could face on account of the armed conflict, His Majesty was pleased to exempt the people from rural taxes for the calendar year 2003.

The Ministry of Finance would also like to report that during the course of the past financial year, as authorised by the Income Tax Act 2001, the Ministry of Finance granted Business Income Tax (BIT) exemption for the calendar year 2003 to the taxpayers in a number of areas affected by the armed conflict.

Also, following the decision of the last National Assembly session, and as authorized by the Income Tax Act 2001, the Ministry of Finance is pleased to announce that for small businesses located in remote areas i.e. inaccessible by road, BIT will be exempted on a yearly basis. The criteria for the BIT exemption as well as a list of existing business that are exempt, will be notified by the Department of Revenue and Customs.

Further, following the decision of the National Assembly in the past year, a committee comprising of representatives from the Ministry of Finance and the National Assembly was created, to revise, in line with the decision of the National Assembly, the top Personal Income Tax (PIT) rate from 25% to 15% and corresponding reduction in the rest of the rates. The report of the committee will be presented later in the National Assembly.

External Assistance

The Ministry of Finance would like to inform the honourable members that external assistance, grants and concessional borrowings, continue to fund around 80% of the

capital expenditures or around 42% of the total budget outlay. While we would like to finance all the capital expenditures of the 9th Plan through grant financing, the overall grants available are likely to be significantly below the requirement. Concessional borrowings are expected to offset some of the projected shortfall, but, as it stands, the balance will have to be made up by increases in domestic borrowing. However, given the close cooperation and support from the donors, the Ministry of Finance remains confident that more support will be forthcoming from our development partners to ensure that the Ninth Plan is successfully completed.

The Ministry of Finance is pleased to highlight that as in the past, Bhutan continues to enjoy very close cooperation with all its development partners. Our development partners continue to commend the proper utilization of aid resources. Nevertheless, as an integral part of our aid utilization policy, efforts will continue to be made to further streamline and improve the manner in which aid is planned, programmed, and implemented.

On behalf of the people and the Royal Government of Bhutan, the Ministry of Finance would like to take this opportunity to place on record our deep gratitude to all our development partners, especially India, our oldest and closest friend, for the generous assistance. We would also like to take this opportunity to assure all our development partners that every effort will be made to make the best use of their assistance.

Borrowings

External Borrowings

In the coming year's budget, external borrowings are projected to finance about 10% of the total outlay. The Ministry of Finance is pleased to inform the honourable members that the Royal Government continues to follow a prudent borrowing policy. These are all project-tied loans, and all of them are for vital sectors like rural electrification, construction of roads, urban development, education infrastructure, and

agriculture. These are all highly concessional loans from the international development financial institutions like the World Bank and the ADB.

The outstanding debt stock of the Government is as shown in the table below. These include the borrowings for the large hydro-power projects from the Government of India, which are outside the budget.

Summary of Outstanding External Borrowings

USD in millions

Description	Amount as of Dec 2002	Amount as of Dec 2003
1 Convertible Currency Loans	147.900	185.797
2 Indian Rupee Loans	183.800	286.396
Total	331.700	472.193

As of the end of 2003, total external debt outstanding grew by around 42% from the past year, to around 67% of GDP. Indian Rupee loans made up 59% of total loans outstanding. Around 73% of the increase in external borrowings was on account of loans from the Government of India, in particular for the Tala Hydro-Power Project. The growth in convertible currency borrowings was around 26%, reflecting increased disbursements as the pace of project implementation picked up. While the stock of debt is quite high, debt servicing at 3.5% is reasonably low, reflecting the concessional nature of the loans.

Internal Borrowings

Borrowings from the domestic financial market are expected to finance around 7% of the outlay for the coming year, as against about 6% in the revised 2003-2004 budget. Given the fairly substantial shortfall in external grants, the difference of Nu. 891.847 m has to be absorbed through domestic borrowing. The Ministry of Finance would also like to inform the honourable members that the increasing recourse to

borrowings is inevitable under the present circumstances in order to ensure that development momentum is maintained to achieve Plan targets. While this may cause financial difficulties in the short term, in the long run, the benefits are expected to far outweigh the costs, as the borrowings are used mainly for investments. Given the resource gap, the Royal Government will strive to work within the original budget and ensure that the resources are utilized properly. The Ministry of Finance will continue to monitor the situation closely so that public debt remains within acceptable levels. The total outstanding domestic debt as of now is Nu. 500 m.

Trust Funds

The Ministry of Finance is pleased to provide a brief report on the three trust funds. As honourable members are aware, these are extra-budgetary funds that have been created for meeting the cost of specific important needs so that related activities are not compromised on account of resource problems. As of end 2003, the total assets of these funds amounted to USD 46.245 m as follows:

Summary of Trust Funds

Name	USD in millions
	Amount
Bhutan Trust Fund for Environmental	28.946
Bhutan Health Trust Fund	16.488
Trust Fund for Cultural Heritage	0.811
Total	46.245

Out of the trust funds, the environmental trust fund is the only one in operation at present. The health and cultural trust funds are yet to commence operation as their target capital has not been achieved. The environmental trust fund is expected to finance around Nu. 11.5 m of the financial year 2004-2005 budget.

Financial Sector

The Ministry of Finance is pleased to report to the National Assembly that our financial sector continues to perform well. As of December 2003, the assets of the financial sector grew by around 7% or Nu. 1,300 m from 2002. Independent assessments undertaken by the monetary authority as part of their supervision and surveillance of the sector corroborate the fact that the performance of all the financial institutions improved in this period.

The assets of the two commercial banks grew by 5% in the past year. Significantly, around 54% of this growth was on account of loans and advances. The average non-performing loans ratio of the two commercial banks is around 8%. The Ministry of Finance would also like to highlight that as of December 2003, the problem of the excess liquidity that had been burdening the financial sector over the past few years, particularly the two commercial banks, has been considerably reduced. The monetary authority relaxed the Cash Reserve Ratio from 20% to 13% in January 2004. This should boost lending as it will help to free up resources and reduce the cost of funds.

The two non-bank financial institutions have also performed well in the past year, with their total assets growing by around 20%. It is of some concern, however, that these institutions have a high level of non-performing loans, which stands at an average of around 24%. Efforts are underway to bring this to acceptable levels. The Royal Government continues to support the rural credit programme of the BDFC to enhance rural access to finances.

The Ministry of Finance is also happy to report that the National Pension & Provident Fund (NPPF), established through the wisdom of His Majesty the King, as a separate entity in 2001 to manage the new pension scheme for public servants as well as the provident fund, is functioning well. Its assets grew by around 16% over the past year and in terms of size, it is bigger than the BDFC and the RICB. As of April 2004, the NPPF had a total membership of 33,936. A total of 95 beneficiaries are being supported

through the new pension scheme. The NPPF is extending additional benefits to its members through the housing and education loans scheme as well as through the expansion of its real estate programme.

The Ministry of Finance would also like to report that a greater degree of competition is emerging in the financial market. Most notably, the interest rates for housing fell to 10% in response to the introduction of housing loans to its members by the NPPF. It may be noted that some degree of competition is healthy for the efficiency of the sector, although we have to ensure the stability of the system.

Keeping with the pace of development in other sectors, one of the policies of the Government is to develop the domestic securities market, and as such we are encouraging the growth of a bonds market. Till now the Government has issued bonds on a very limited scale, and recently the Druk Air Corporation has also issued bonds. Besides equities, the only other instrument in the market at present is the RMA bills.

Public Enterprise/Corporations

As the honourable members are aware, public corporations are a source of substantial revenues for the Government. Over the past year, their performance has been quite satisfactory. Their combined contribution to the national exchequer in the past year has been to the extent of Nu. 2,079.227 m by way of taxes and dividends. The largest contributor has been the CHPC with an amount of Nu. 1,871.473 m followed by the Bank of Bhutan with Nu. 88.491 m. It will be our endeavour to ensure that the corporations function efficiently, and that they continue to contribute to the national revenues on an increasing basis. The Ministry of Finance will also continue to closely monitor the performance of the corporations, which are in difficulty, and explore ways to minimise their burden on the exchequer, while not compromising their public policy functions.

Conclusion

As submitted earlier, the honourable members would be aware that the implementation of the 9th Plan programmes have been less than satisfactory for the first year. As submitted to the National Assembly last year by my predecessor, this was due to the financing not being fully tied up. Moreover, much time was taken in the election of the Gups through the new system. In the second year, activities have picked up substantially, but we still have to catch up, and hence the larger budget for the coming year. The Ministry of Finance submits that every effort will be made to ensure that works do not suffer due to lack of financing. A mid-term review of the Ninth Plan is being planned for in the coming year, to take stock of the progress achieved.

As the honourable members are well aware, management of public finances is one of the most important roles of the government. How it is managed is critical to the development of the economy and thereby, the lives of people. There are numerous examples of countries facing economic and social hardships as a consequence of poor fiscal management. The Ministry of Finance would like to highlight that the Royal Government has a long history of sound and prudent fiscal policies. However, given the importance of this responsibility for the future of the nation and its further development, the ministry finds it in the best interest of the country that a legislative framework to guide future fiscal decisions and actions be put in place. It is in this context that the Ministry of Finance is pleased to inform the National Assembly that a Public Finance Act is under formulation. Among others, it will clearly spell out the responsibilities of fiscal management within the government, and thereby enhance fiscal accountability and the quality of fiscal decisions. The Act will contribute considerably to good governance, and be one of its most important pillars.

The Ministry of Finance would like to highlight that Bhutan's quest for modernization, which began in earnest in the sixties with the launching of the first five year plan, is already a reality in most parts of Bhutan today. Bhutan has undergone tremendous transformation over this period, and the quality of our lives have improved manifold.

It was not long ago that people had to walk most of the time to get anywhere in Bhutan, and saw motor vehicles for the first time. Now most of the country is connected not just by roads but by telephones and internet, and have improved access to social and other public services. Most significantly, contrary to the experience of many countries where development has come at the cost of the environment, or culture and traditions, we can still boast of a pristine natural environment that generations of Bhutanese can enjoy, and a living culture and tradition that continues to enrich our lives and strengthen our bonds as Bhutanese. Our development in this holistic manner has been made possible by the enlightened leadership of His Majesty the King, and his philosophy of Gross National Happiness. The Ministry of Finance is pleased to report that it is on account of this approach, i.e., development with equal emphasis on the material and non-material needs, that Bhutan is increasingly recognised as a development model.

On behalf of the Royal Government, the Ministry of Finance would like to take this opportunity to rededicate itself to the achievement of our development objective of Gross National Happiness. With the successful resolution of the problem of the armed militants, we are confident that Bhutan's prospects can only get better. We would, however, like to remind each and every Bhutanese to remain ever vigilant and ensure that such a situation does not come to pass again.

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.

Selected Monetary and Financial Indicators

Items Description	2002/2003	2003 (Dec)
	Millions of Ngultrum	
1 Total Assets of the Financial Sector	32,691.67	31,880.14
<i>a. Royal Monetary Authority</i>	12,527.30	12,223.54
<i>b. Four Financial Institutions</i>	20,164.37	19,656.60
2 Money Supply		
<i>a. Quasi Money 1/</i>	7,461.32	7,076.14
<i>b. Demand Deposits</i>	5,094.73	4,967.54
<i>c. Ngultrum in Circulation</i>	1,699.00	1,802.31
3 Domestic Credit	3,815.00	3,467.77
<i>of which Private Sector</i>	3,663.80	4,250.54
	Millions of USD	
4 Gross International Reserves	373.85	366.71
<i>a. Convertible Currencies</i>	302.10	288.28
	Millions of INR	
<i>b. Indian Rupees</i>	3,351.65	3,575.92
5 Exchange Rate for USD - BTN/USD (Period Average)	47.93	45.59
6 GDP (Nominal)		31,884
7 Real GDP Growth Rate		6.5
8 Consumer Price Index (%)	1.81	1.33

Note: 1/ quasi money includes foreign currency deposits & time deposits

Selected Monetary and Financial Indicators

Items Description	2002/2003	2004 (April)
Structure of Interest Rates	In percent	
a. Deposits		
i) Savings	5 - 6	5
ii) Fixed Deposits		
3 months to 1 year	5.5 - 7	5.5
1 year to less than 3 years	7.5 - 9	6 - 7.5
More than 3 years	8.5 - 10	7 - 8.5
b. Lending Rates		
i) Export Finance	13-15	13 -15
ii) Manufacturing, Service, Transport and Agriculture	12-16	12 -16
iii) Housing	13	10
iv) Working Capital	13 - 15	13 -15
v) Personal and General Trade	15 - 16	15 - 16