



NATIONAL BUDGET

FINANCIAL YEAR 2005 - 2006

MINISTRY OF FINANCE

June 2005

Introduction

The Ministry of Finance has the honour to present the Financial Year 2005/2006 budget, and a report on the Financial Year 2004/2005 budget revision.

The past financial year has been yet another eventful one for our country. Two historic events took place which, together serve to strengthen the future stability and welfare of our nation. Firstly, the installation of HRH the Crown Prince as Chheotse Penlop is a source of deep fulfilment to us all, conscious as we are of His Royal Highness' firm commitment to serve his people now and in the future with dedication and purpose.

More recently, the publication of the Draft Constitution, was another landmark event in the history of our nation. It launches our people on a new and challenging journey into the 21st century. With full participation and good will of all citizens, it will surely lead our nation to a secure and stable future. Our constitution will be the bedrock of our nation, which will provide a firm and lasting foundation for our monarchy, our institutions and people.

Once again, our King, HM Jigme Singye Wangchuck, has shown the most selfless leadership by the drafting of the Constitution. This move can be seen as nothing other than his great concern for the future well-being of our country and people. We all know that throughout the history of most other countries, such steps have ensued only from the wells of discontent of the people, often violently expressed. It is a matter of great pride for us that here in Bhutan, in a background of peace and harmony, it is our own beloved monarch, who is leading us, his people, along this challenging road into a secure and democratic future fit for the 21st century. Every citizen and every institution must be grateful that we are guided by so inspiring and far-sighted a leader, - a leader in whose vision, dedication and understanding of the future we have total confidence.

The Ministry of Finance is acutely aware that the best way it can serve our King and our nation, now and in the future, is through the careful and conscientious guardianship of the financial resources of the Kingdom – aware always that our national finances are a crucial part of the means by which we shall achieve our ends – the happiness, success and well-being of our citizens and the security of our nation.

With these auspicious events forming the background, I would like to turn to the main aspects of this year's report, starting with the progress of the 9th Five-Year Plan.

Progress of the 9th Five Year Plan

As we enter the second last year of the 9th Plan, it is appropriate to report to this august Assembly the status of the progress so far. I would like to report that a mid-term review (MTR) of progress in implementing the Ninth Plan of the government agencies was conducted last February, under the chairmanship of the Honourable Prime Minister. The review for the Dzongkhags and Gewogs activities will be undertaken next, i.e., in July 2005.

As with the past Plans, the first half of the Plan period experienced slow progress, due mainly to the time required for resource mobilization and preparatory works. The financial utilization rate of the central ministries and agencies reviewed during the MTR was not more than 37 %. As the Honourable Members may be aware, given the high level of dependence on external assistance, low levels of achievement in the initial years of the Plan are a normal and unavoidable occurrence. Notwithstanding the financial difficulties, notable progress has been made in key areas of development, such as in the social services sector. The main issues raised by the review were the need to revise the Plan to incorporate developments since the Plan began, enhance coordination, improve quality of infrastructure and services, human resource development, decentralization of procurement and improvement in planning.

Therefore, the forthcoming budget focuses on addressing these issues and in particular, increasing the momentum of implementation. In this regard, the Ministry would like to highlight that negotiations with most development partners have been completed. The external resource position having become clearer, the number of projects ready for implementation have increased significantly. Therefore, greater impetus in the implementation of the planned activities is expected in the remaining period. The Ministry of Finance remains optimistic that the objectives of the plan will largely be achieved. The MTR also included elements to assist current planning underway at the Ministry of Finance for the Tenth Plan.

Review of Economic Performance

On the **Gross Domestic Product (GDP)** front, preliminary estimates from the National Statistical Bureau indicate that our GDP will have grown by around 7.1 % in the 2004/2005 Financial Year. This is very satisfactory and indicates that our projected growth path of 7 % to 9 % is on average on track. Growth is expected to be driven mainly by the construction sector, on account of the continued work on Tala project, and by government spending on infrastructure and investments in housing, which is estimated to contribute 22 % to the GDP. The other major growth sectors of electricity and transport, are estimated to contribute about 12 % and 11 % respectively. The agriculture sector, on which a majority of the Bhutanese people continue to depend on for their livelihood, remains an important sector and accounts for around 24% of GDP. Overall, our economy is undergoing a rapid transformation with the tertiary sector now accounting for 33 % of GDP and the secondary sector at 43 % of GDP.

Annual **inflation** increased slightly from 3.36 % in the previous year to 3.91 % as at the end of December, 2004, largely influenced by the price movements in India. While this is among the lowest in the region, the Ministry of Finance is monitoring it closely as it directly influences Government expenditures. In the area of **exchange**

rates, the Ngultrum continued to gain value against the US dollar, and over the year ending December 2004, it appreciated by 3.66 %. Thus far, the appreciation of our currency does not appear to have had any significant bearing on our competitiveness, at home and abroad. Nevertheless, this is also being monitored closely given its consequence for competitiveness.

As regards **employment**, the 2004 labour census indicates that unemployment increased to 2.5 % from 1.8 % in the previous year. While this is an increase over the past year, it is still low by international levels e.g. of over 6% for advanced economies and around 4% for Newly Industrialized Asian economies. Increased private sector activities, fuelled by the strong level of investments assisted by government policies have helped to keep unemployment from rising further. In particular, tourism has rebounded sharply from the post 9/11 and SARS epidemic levels, resulting in a positive impact on employment.

With respect to the **Balance of Payments**, the Ministry is pleased to highlight that in spite of a persistent trade deficit, inflows of aid are helping to keep the current account positive. Bhutan's **foreign reserves** grew by around 2 % and stood at around US \$ 391 million as of the end of December 2004. Though the net growth has fallen slightly from the past year, mainly on account of the domestic financing of the two aircraft purchases, and to a smaller extent, industrial development, our foreign reserves remained at satisfactory levels, and were sufficient to cover 18.5 months of imports. Tourism, which is one of the main source of convertible currency earning, contributed US \$ 12.5 m in 2004 against US \$ 8.3 m in 2003, an increase of around 51 %.

On the **monetary and credit** developments front, reflecting the growth in private sector credit and developments in the balance of payments, the money supply grew by 20 % during the year ending 2004. The most significant development is the growth in domestic credit, which grew by 70 % during the period. The bulk of the credit was

extended for transport and construction sectors including the Government financing for the aircraft. With the expansion of domestic credit, and the Royal Monetary Authority's (RMA) active policy intervention, the liquidity in the banking system reduced.

The Ministry of Finance would like to draw the attention of the honourable members to the International Monetary Fund (IMF) Article IV Mission that was concluded in March 2005. As the honourable members may be aware, the Article IV Mission is essentially an exercise undertaken as part of the IMF's global economic surveillance mandate. This takes the form of regular (usually yearly but biennially in our case) comprehensive consultations with individual member countries about their economic policies. The IMF staff review the soundness of fiscal, monetary, and exchange rate policies, and examine other issues that may affect macroeconomic performance. The Ministry of Finance is pleased to report that overall, the findings of the latest mission are that the medium-term macroeconomic prospects remain favourable.

Review of Financial Year 2004/2005 Budget

As of end-March 2005, the revised budget for the Financial Year 2004/2005 was estimated at Nu. 15,993 m, or an increase of around 18 % over the original budget. Capital expenditure budget grew by around 27 % while the current expenditures grew by around 9 %.

REVISED BUDGET SUMMARY Financial Year 2004/2005

	Nu. in millions	
	Original Budget	Revised Budget
<u>Sources of Finance</u>		
Total Resources	11,352	12,069
Domestic Revenue	5,802	6,641
<i>i) Tax</i>	3,575	3,447
<i>ii) Non-Tax</i>	2,226	3,194
Other Receipts	1,175	395
Grants	4,375	5,033
<i>i) Program Grants</i>	1,894	1,894
<i>a) GoI</i>	1,750	1,750
<i>b) Others</i>	144	144
<i>ii) Project-tied Grants</i>	2,481	3,139
<i>a) GoI</i>	975	878
<i>b) Others</i>	1,506	2,261
<u>Outlay</u>		
Total Expenditure	13,232	15,601
<i>i. Current Expenditure</i>	5,969	6,506
<i>ii. Capital Expenditure</i>	7,158	9,056
<i>iii. Net Lending</i>	105	39
Overall Balance	-1,880	-3,532
<u>Financing</u>		
<i>i) Other Domestic Borrowings</i>	1,880	3,532
<i>ii) Project tied Borrowings</i>	0	1,753
<i>Repayment</i>	1,378	1,636
<i>Repayment</i>	390	392
<i>iii) Resource Gap</i>	892	535

On the **capital expenditure** side, almost the entire increase was on account of the cost of one aircraft provided as government equity in the Druk Air Corporation. On the **current expenditures** side, most of the increase can be attributed to the public

service salary increase affected from January 2005 (Nu. 260 m), as well as the subsidy to Druk Air for interest payments on its bonds issued for the other aircraft (Nu. 121 m). As the honourable members may be aware, the salary revision had become necessary due to the large erosion in real income of the civil servants since the last revision, which was in 1999. The pay increase was possible because of the increase of the CHPC power export tariff. An exercise is now underway to review and reform the salary system, so that it develops in a more orderly fashion. This is necessary to protect the real income of public servants as well as avert large and ad hoc adjustments, which have detrimental impact on, amongst others, government finances and the pension scheme. **Net lending** decreased by around Nu. 66 m on account of higher-than anticipated recoveries of on-lent funds. Aside from these developments, the revised budget has remained within the original outlay, mainly due to the mid-budget exercise undertaken by the Ministry of Finance to weed out less productive expenditures. The Ministry of Finance is pleased to highlight that efforts to improve resource sharing and utilization in the government have begun in earnest with the pooling of light government vehicles and disposal of heavy vehicles.

On the **Resources** side, certain revisions and reclassifications among the various heads were undertaken. Some of the changes in the revenue heads were due to increase in revenue from CHPC on account of the tariff increase, and transfer of surplus reserves from government-owned corporations. Around Nu. 54 m had to be reduced from the original revenue projection of Nu. 135 m following the decision of the 82nd National Assembly to reduce the Personal Income Tax slab rates by 40 %. Domestic revenue is now estimated at Nu. 6,641 m which is expected to cover the revised current expenditure estimates. The details are as in the table below.

Revised Revenue Summary for Financial Year 2004/2005

Nu. in millions

Source of Revenue	2004/2005	2004/2005 revised
A Tax Revenue	3,575	3,447
I. Direct Tax	2,055	1,929
<i>Corporate Tax</i>	1,039	973
<i>Business Income Tax</i>	435	429
<i>Personal Income Tax</i>	135	81
<i>Other Tax Revenue</i>	446	446
II. Indirect Tax	1,521	1,518
<i>Sales Tax</i>	634	634
<i>Export Tax</i>	1	1
<i>Excise Duty</i>	739	737
<i>Import Duty</i>	141	142
<i>Other Tax Revenue</i>	5	4
B Non Tax Revenue	2,226	3,194
<i>Admin. Fees & Charges</i>	163	156
<i>Capital Revenue</i>	61	146
<i>Revenue from Govt. Dept</i>	42	48
<i>Dividend</i>	1,503	1,475
<i>Transfer of Profit</i>	219	1,075
<i>Other Non Tax Revenue</i>		13
<i>Interest receipt from Corporations</i>	238	281
TOTAL	5,802	6,641

The Ministry of Finance would like to highlight that the upward revision of the CHPC power tariff was solely due to the personal initiative of His Majesty the King which manifest his concern for the financial health of the Government. The Ministry of Finance takes this opportunity to thank the Government of India also for considering the tariff increase. It will have a substantial positive impact on the 2005/2006 budget.

Total **grants** are expected to grow by around 15 %, mainly on account of project-tied grants, reflecting a faster project implementation rate and concomitant disbursement.

As the combined increase in revenues and grants of Nu. 717 m would only be sufficient to cover 30 % of the total increase in expenditure, the estimated **fiscal deficit** grew sharply from the 5.5 % originally projected to around 10.3 % of the estimated GDP. In particular, domestic borrowings increased from 2.6 % to around 6.7 %, but this was mainly on account of the loan for the purchase of the aircraft. The honourable members may note that while the fiscal deficit is projected to increase significantly as a result, the actual resource gap, excluding this transaction, fell from the original projection of 2.6 % of GDP to 1.6 % of GDP. This was partly due to higher-than-projected receipts on account of project-tied borrowings, and to a smaller extent, the successful implementation of the mid-budget fiscal measures to weed out less productive expenditures mentioned earlier.

Budget Estimates for Financial Year 2005/2006

The basic aims of all our annual budgets have been to further the overall objectives of our five-year development plans within our cherished philosophy of Gross National Happiness. Poverty alleviation and the Millennium Development Goals, adopted as major goals throughout the developing world, form an integral part of our development plans also, and thus of our annual budgets.

The budget for the Financial Year 2005/2006 of Nu. 15,113 m has been framed against this backdrop amidst serious challenges. The budget forms 22 % of the 9th Plan outlay, a slightly higher than the proportionate level, but this has been felt to be necessary to achieve the objectives of our Plan. Specifically, the underlying principles for this budget has been the basic policy of meeting the current expenditures by domestic revenues, and the need to maintain the capital expenditure at fairly substantial levels for achieving the 9th Plan targets given that this is the fourth year of the Plan and yet a great deal of activities still remaining in hand, but ensuring at the same time that these do not have destabilising effect on the overall economy in terms of inflation, balance of payments, liquidity for the private sector credit, unemployment and levels of debt stock.

The budget is summarised in the table below.

NATIONAL BUDGET
Financial Year 2005/2006

Nu. in millions

Description	Budget 2005/2006	Percent
<u>Sources of Finance</u>		
Total Resources	12,960	100.0
Domestic Revenue	7,388	57.0
<i>i) Tax</i>	4,446	34.3
<i>ii) Non-Tax</i>	2,943	22.7
Other Receipts	94	0.7
Grants	5,478	42.3
<i>i) Program Grants</i>	1,894	14.6
<i>a) GoI</i>	1,750	13.5
<i>b) Others</i>	144	1.1
<i>ii) Project-tied Grants</i>	3,584	27.7
<i>a) GoI</i>	1,980	15.3
<i>b) Others</i>	1,604	12.4
<u>Outlay</u>		
Total Expenditure	14,701	100.0
<i>i. Current Expenditure</i>	6,888	46.9
<i>ii. Capital Expenditure</i>	7,764	52.8
<i>iii. Net Lending</i>	49	0.3
Overall Balance	-1,741	-13.4
<u>Financing</u>	1,741	13.4
<i>i) Project tied Borrowings</i>	1,244	71.5
<i>Repayment</i>	411	23.6
<i>ii) Resource Gap</i>	907	52.1

Expenditure Budget Outlay

The expenditures budget outlay of Nu. 14,701 m is around 6% lower than the revised outlay of the previous year. This is mainly on account of the large increase in the revised 2004/2005 budget outlay due to the incorporation of the cost of one aircraft. Adjusted for the aircraft cost, the estimated expenditure budget outlay reflects an increase of 6%.

Current expenditures are budgeted to grow by around 6%, largely on account of the full impact of the pay raise for public servants (Nu. 634 m), the subsidy to the Druk Air Corporation (Druk Air) for payment of interest on its bonds (Nu. 142 m),

and the interest on the Royal Government's short-term loan for the aircraft purchase (Nu. 132 m). Expenditure for personal emoluments is now projected to be at Nu. 2,797 m or around 41 % of the total current expenditures, as against 36 % in the previous year's original outlay. Interest payments (Nu. 530 m) account for around 8 % of current expenditures or 3.5 % of total outlay.

Capital expenditures are projected to fall from the previous year's revised expenditure levels by around 14 % mainly on account of the aircraft cost. Adjusted for the aircraft cost however, capital expenditures are projected to increase by around 6 %. The major item of capital expenditure is construction of buildings, which account for around 34 % of total capital expenditures. Road works account for around 16 %, and around 8 % is planned for human resource development.

Dzongkhag & Gewog Expenditure Budget

A total of Nu. 3,659 m or around 24 % of the Financial Year 2005/2006 budget has been provided for execution by Dzongkhags (20 % of the total outlay) and by Gewogs (4 %). In comparison to the revised 2004/2005 budget, this represents an increase of around 24 %. As highlighted in previous budget reports, this amount does not include a number of significant activities such as rural electrification, rural water supply, feeder roads, and budget allocation for agriculture and livestock sectors in six Eastern Dzongkhags. These activities benefit the Dzongkhags and Gewogs directly although their funding is provided as part of the relevant line ministries' budget. Most of the increase provided for Dzongkhags and Gewogs is on account of capital expenditures, particularly for the Gewogs. Current expenditure budget accounts for around 62 % of this outlay, intended to further promote the Government's decentralisation policies.

**Summary of Dzongkhag and Gewog Budget Allocation for
Financial Year 2004/2005 and 2005/2006**

			Nu. in millions
Description	Revised Budget March 2005	2005/2006 Budget	Percent Change
Dzongkhags	2,534	3,097	22
Gewogs	417	562	35
Total	2,951	3,659	24

The largest share of the Dzongkhag and Gewog budgets (around 45 %) goes towards the Education sector, mainly for secondary and primary education at the Dzongkhag level and for community schools at the Gewog level. The Health sector accounts for around 10 % of the outlay, with works related to hospitals, basic health units and outreach clinics. This is followed by Urban development (7 %) and Agriculture (6 %), and Administration and Direction services, 20 %. At the Gewog level, this includes construction of Gewog offices, and Nu. 89 m have been allocated for 46 on-going and 45 new Gewog offices.

Sector Allocations

The sectoral thrust of the Financial Year 2005/2006 budget is presented in the table below.

Summary of Sectoral Allocation of 2005/2006 Budget

Sectors	Current	Capital	Total	Nu. in Million
				Percent
Social Services	2,353	2,171	4,524	30
Health	874	949	1,823	12
Education	1,479	1,222	2,701	18
Economic & Public Sector	1,682	4,430	6,112	40
Agriculture	865	1,187	2,052	14
Energy	38	744	782	5
Mining & Manufacturing Industries	81	152	233	2
Roads	198	1,156	1,354	9
Communications & Transport	274	513	787	5
Housing & Public Amenities	226	678	904	6
Culture Services	261	216	477	3
General Public Service	2,063	947	3,010	26
Public Debt Service	530	411	941	6
Net lending	-	49	49	0
Total	6,889	8,224	15,113	100

Social Services

Health

In keeping with the long standing government priority for the social sector, it has been allocated Nu. 1,823 m, or around 12 % of the total budget. Its current expenditures are estimated at Nu. 874 m accounting for 13 % of total current expenditures. The sector's capital expenditures are budgeted at Nu. 949 m, which makes up 12 % of the total capital expenditure outlay. Some of the significant new activities included in

the budget are the Rural Water Supply scheme in twenty Dzongkhags, for which a budget of Nu. 75 m has been allocated, and the construction of outreach clinics and basic health units for which Nu. 26 m have been provided. The other major new activity in this sector is the construction of the 150-bed regional referral hospital in Mongar with a budget provision of Nu. 186 m. Important on-going activities include the construction of hospital in Phuntsholing for which budget allocation of Nu. 31 m has been made, and the expansion of the Jigme Dorji Wangchuck National Referral (JDWNR) Hospital in Thimphu with a budget provision of Nu. 283 m. Emphasis is also being given to human resources development in this critical area, and a budget allocation of Nu. 25 m has been made for this purpose. Besides the above, substantial fund allocations of Nu. 125 m have been made for HIV Aids & STD Prevention and Control, and TB Control.

Education

The Education sector continues to be another priority area, and in this budget, it has been allocated Nu. 2,701 m, which is 18 % of the total outlay. This is made up of Nu. 1,222 m. for capital expenditure, which is 15 % of total capital expenditure outlay, and Nu. 1,479 m. for current expenditure or 21 % of total current expenditure outlay. The budget emphasis continues to be on the development of human resources and expansion of educational infrastructure necessary to keep up with the growing demand. The construction of ten new schools around the country will be started in the coming year, for which a fund allocation of Nu. 231 m has been made. Substantial funds continue to be provided also for capacity building of in-service teachers (Nu. 85 m) and for the undergraduate scholarship programme (Nu. 70 m).

For tertiary education, a total of Nu. 319 m has been allocated. It includes funds for the initial construction costs of the Rigzhung Institute at Tagtse in Tongsa, infrastructure development for the Royal University of Bhutan, upgrading of facilities at Sherubtse College, and other similar developments in tertiary education.

Economic and Public Sector

Agriculture

The agriculture sector is another priority area of the government, as it continues to be the source of livelihood for more than 79 % of our population. Accordingly, Nu. 2,052 m has been allocated to this sector representing 14 % of the total outlay. The pertinent activities for which funds have been allocated are constructions of 60 new irrigation channels, 39 farm roads including power tiller tracks, 24 Renewable Natural Resources centres, veterinary hospitals, and quarantine stations. The total amount budgeted for these activities are Nu. 273 m. All these programmes are geared towards increasing food production and providing access to markets.

Energy

A sum of Nu. 311 m has been set aside for rural electrification projects. Electrification is considered so important for rural development that the Royal Government availed loans to implement the programme. So far, two loans have been fully disbursed, amounting in total to Nu. 700 m, and the third one for Nu. 395 m is under implementation. Over 2,000 additional households should receive electricity in the 2005/2006 Financial Year. Where it is not feasible to provide electricity through the grid, solar facilities are provided and a sum of Nu. 15 m has been set aside for the purpose.

Nu. 89 m is also earmarked for the expansion of the national electricity transmission grid along the Rurichhu-Tsirang-Dagana line. Further, a sum of Nu. 188 m is set aside for the continuation of the Tingtibi-Tongsa-Bumthang transmission line, and Nu. 75 m for Deothang-Rangia transmission line.

While projects related to power distribution appear in the budget, Honourable members may be informed that projects related to power generation are kept outside the budget to avoid distortion. If included in the budget, this sector would receive the largest

share particularly on account of the Tala project, and as honourable members are aware, the total cost of the Tala project is bigger than our whole GDP!

Industrial and Private Sector Development

Given the continued focus on fostering the growth of industries and generation of employment, a sum of Nu. 317 m has been budgeted for the 2005/2006 fiscal year. Among the important activities which the budget covers is the continued works on the development of the Pasakha Industrial Estate with a budget allocation of Nu. 32 m. This project should provide one of the major boosts to the private sector, enabling them to establish industries, the lack of which has been one of the major bottlenecks in the past. The Government has already allocated plots to 13 industries within the estate, and seven have started construction at their sites. A sum of Nu. 10 m has also been earmarked for preliminary works of the establishment of a dry port in Phuentsholing. Emphasis will also be placed on the formulation of project proposals to tap any further industrial development potential for which a sum of Nu. 11 m has been earmarked. To complement these efforts, the Royal Government has undertaken a new initiative to provide railway access to our industries. A Memorandum of Understanding has already been signed with the Government of India to study the feasibility of extending their railway lines to the major border towns in the south.

Another major area for which budget has been earmarked is the development of tourism infrastructure, as the Royal Government continues to place considerable importance on its growth potential. It has been provided with a budget of Nu. 63 m. It includes the construction of the Hotel and Tourism Management Training Institute in Thimphu, which should help the private sector and generate employment.

While efforts, as outlined above, are being made on the physical aspects of industrial development, it is necessary to promote trade with other countries given that we have a very limited domestic market for our products. Therefore, the budget also

provides for market access and related activities. It will finance activities related to the on-going accession negotiations for membership of the World Trade Organisation (WTO), the developments under the South Asia Free Trade Agreement (SAFTA) framework and the Bay of Bengal Initiative for Multi Sector Technical and Economic Co-operation (BIMSTEC).

Tax Measures to Foster Private Sector Growth

Besides the above expenditures, the Ministry would also like to highlight some of the fiscal efforts made to promote private sector development. The encouragement of the growth of the private sector is an integral part of the Royal Government's development policy. Its impact on the imminent problem of youth unemployment could be significant. Tax policy is one of the main instruments employed, usually in the form of tax holidays, and a combination of tax incentives and exemptions.

As honourable members may be aware, the Ministry of Finance announced a number of tax incentives in September 2003. Currently, eleven manufacturing units are enjoying tax holidays from Corporate Income Tax and Business Income Tax. The cost to the exchequer in terms of tax revenue foregone is estimated at Nu. 32 m per annum. This cost is expected to rise in the coming years as the number of industries benefiting from these concessions increase.

Besides tax holidays, raw materials imported by manufacturing units are exempted from Customs Duty and Sales Tax subject to fulfilment of certain criteria. During the past one year (2004), Nu. 295 m worth of raw materials was imported from third countries by manufacturing units under this facility. The revenue foregone on account of this incentive was around Nu. 68 m. Imports from India under the same facility amounted to Nu. 5,185 m for the same period, and the sales tax exempted was estimated at Nu. 259 m. In total, tax exemptions granted to the private sector on raw materials was Nu. 327 m for the year 2004.

Import Duty and Sales Tax are also exempted on the import of plant and machinery by manufacturing and service industry, thereby reducing the capital cost of such units. The revenue foregone by the government on account of this exemption in the past one year was Nu. 804 m. The total cost to the government in providing the above exemptions was approximately Nu. 1,163 m in 2004.

The Ministry of Finance is planning a review in the Financial Year 2005/2006 to assess the impact of these incentives on industrial development and employment generation. Based on the findings, the Ministry will carefully calibrate its interventions to ensure that the desired objectives are being achieved even if the Royal Government has to face some cost on account of revenues foregone.

Some of the other developments in the taxation area that will help the private sector are the South Asian Free Trade Agreement and *Bay of Bengal Initiative for Multi Sector Technical and Economic Cooperation*. These initiatives were reported in my last budget report to the Assembly. While no immediate results have yet emerged from these efforts, a more concrete initiative that is being taken is the bilateral Double Taxation Avoidance Agreement (DTAA) with our largest trading partner India. The Ministry of Finance is in the process of finalising the draft agreement after consultations with the relevant agencies. In view of the close integration of our economies, and in the interest of the taxpayers in both the countries, the Ministry of Finance hopes to successfully conclude the DTAA with the Government of India as early as possible.

The Ministry of Finance would also like to highlight that initiatives are underway to improve customs regulations and services. The objective is to balance the rights and obligations of importers so that trade, critical for a small economy like Bhutan, can be conducted more smoothly. The new procedures will be closely aligned to international practice. This should have a positive impact on private sector activity.

Roads

The roads sector has been allocated Nu. 1,354 m or 9 % of the total outlay. More significantly, it receives around 15 % of the total capital outlay. As roads are critical to development in our terrain, the Royal Government continues to place a high priority on them. The maintenance costs of roads are high, and in the fiscal year under consideration, Nu. 567 m has been earmarked for the regular maintenance of roads including resurfacing. This represents 41 % of total roads sector budget. This is without including the cost of restoration works on roads damaged by the monsoons. The average annual cost of restoration works, based on the expenditures of the past three years, works out to Nu. 50 m.

For the constructions, Nu. 415 m is kept, which forms 31 % of the total roads sector budget. Among the fund allocations, Nu. 305 m has been provided for the on-going constructions. Some of the major ones are Nu. 102 m for completion of the Thimphu-Babesa expressway, Nu. 50 m for Gomphu-Panbang road, Nu. 41 m for Lhuentse-Dungkhar road, Nu. 36 m for Yadi-Serzhong road, Nu. 34 m for Nangar-Ura road, and Nu. 30 m for Samtse-Phuentsholing road.

A sum of Nu. 110 m has been allocated for starting new constructions. Among them, the major ones are Nu. 50 m for Gyalpoizhing-Nganglam road, Nu. 10 m for Damji-Zamechhu (Gasa) road, Nu. 20 m for Jangchhubchheoling-Tashidingkha road, and Nu. 30 m for the other smaller roads.

In addition to the above, there are other road works being executed by the Government of India. They are the completion of the Pasakha-Manitar road, the double-laning of the Babesa-Phuntsholing Highway, survey works for the Damchhu-Chhukha bypass, a new bridge over the Semtokhachhu and initial works on double-laning of Chhudzom-Paro Highway. These are all very important and substantial aspects of the 9th Plan, and the Royal Government is confident that they will be completed in time.

Communications & Transport

The allocation for this sector is Nu. 787 m or around 5 % of the total outlay. Some of the significant new activities in this sector include the subsidy to the Bhutan Broadcasting Service (BBS) amounting to Nu. 229 m. The major activities of the BBS include the construction of a TV centre and procurement of equipment, together estimated at Nu. 113 m. Another sum of Nu. 79 m has also been set aside for procuring equipment to improve the quality and coverage of short-wave radio transmission. This subsidy recognises the value of having our own national broadcasting and television service particularly when it becomes ever more important to ensure that our citizens are well-informed about developments in the kingdom.

Another important activity under this sector for which budget has been kept is the e-governance project. This will enhance delivery of public services and transparency with the use of Information and Communications technology. To improve the infrastructure for the use of this technology, Nu. 20 m has been provided for conducting a feasibility study to install a fibre optic network in the country. Also, Nu. 27 m has been set aside for providing computer education in primary and secondary schools throughout the country.

In order to provide telecommunications facilities to the rural areas, the Government has availed a loan of Euro 16 m (Nu. 862 m) from the Danish International Development Agency (DANIDA) under its mixed credit scheme. For the coming financial year, an amount of Nu. 258 m has been budgeted for onward disbursement to Bhutan Telecom, which is executing the project. The project will be completed by December 2006, and will have provided at least 10 telephone lines to ninety Gewogs which presently do not have any telecom facility.

In the Civil Aviation area, a sum of Nu. 90 m has been budgeted for completing the construction of hangars to accommodate Druk Air's two new aircraft. Nu. 11 m has

also been kept aside for reducing the height of the ridge on the northern approach flight path to further enhance flight safety.

A sum of Nu. 142 m is budgeted for subsidy to Druk Air Corporation to cover interest payments on its bonds and on its previous loan. Honourable members will be fully aware that Druk Air plays an indispensable role in the communications structure of our land-locked kingdom, and so will appreciate that given the limited avenues for profitable operations of the airline, the Government will have to continue to subsidise its operations.

Urban Development, Housing and Public Amenities

Around 6 % of the total budget outlay or Nu. 904 m has been provided for housing and development of district towns. Housing activities are mainly focussed on low-income housing in Thimphu city and in the Dzongkhag urban centers with a budget provision of Nu. 250 m. Among the Dzongkhags, priority is being given to the Dzongkhag where the housing situation is acute and the market for housing is thin. For the development of district towns, a budget provision of Nu. 169 m has been made. As honourable members are aware, the development of urban centres in every Dzongkhag is a necessary strategy to provide, among others, market benefits for farmers as well as off-farm employment opportunities. Also, a sum of Nu. 51 m is budgeted for subsidy to Thimphu City Corporation, to enable it to carry out improvement works in the city.

Cultural Services

A sum of Nu. 477 m is budgeted under the cultural sector. This is another priority sector given the importance of a rich and vibrant culture for the quality of life of our people and as an inalienable part of our development philosophy of Gross National Happiness. The emphasis in this budget is on preservation of Dzongs, temples and monasteries which are invaluable assets of our cultural heritage and thus represent

an important investment for present and future generations of Bhutanese. Some of the major works include the continuation of the restoration of the Semtokha Dzong (Nu. 69 m over the next two financial years), construction of Tsirang Dzong (Nu. 30 m), renovation of Tashichho Dzong (Nu. 16 m), the continuation of the construction of Jigmechheoling Datshang in Sarpang (Nu. 7 m), renovation of Bjakar Dzong and Wangdichheoling Dzong (Nu. 5 m) relocation of Shakor of Kujey Lhakhang (Nu. 3.5 m), construction of Dashag in Punakha Dzong (Nu. 3.3 m), completion of renovations of Risum Goenpa, old Tashi Yangtse Dzong, and Gomkora Lhakhang, totalling Nu. 10.4 m.

General Public Service and Debt Service

This group includes the budget of certain line ministries, Dzongkhag administrations and autonomous agencies as well as the public debt service. The total amount budgeted under this sector is Nu. 3,999 m or around 26% of the total budget outlay. The public sector debt service accounts for around 24% of the outlay under this sector, or around 6% of the total budget outlay.

Resources

Domestic Revenue

Domestic revenue are projected to increase by 11% over the previous year's revised levels, to Nu. 7,388 m mainly due to the CHPC electricity export tariff rate increase and excise duties. This represents around 50% of the total expenditure outlay, and a surplus on the current account of around 7% is expected. Tax revenues are projected to account for 60 % of total revenue, of which excise duty and corporate tax are the main sources, making up 56 % of tax revenues. Sales tax constitutes 11 %, and Business Income Tax and Personal Income Tax together form 7 % of the total revenue. Non-tax revenue forms around 40 % of total revenue, with dividends as the chief source, making 68 % of non-tax revenue or 27 % of the total revenue. The details are as shown in the table below.

Summary of National Revenue Forecast for Financial Year 2005/2006

Source of Revenue		Nu. in millions	
		2005/2006	Percent
A	Tax Revenue	4,446	60.2
I.	Direct Tax	2,153	29.1
	<i>Corporate Tax</i>	1,166	15.8
	<i>Business Income Tax</i>	435	5.9
	<i>Personal Income Tax</i>	85	1.2
	<i>Other Tax Revenue</i>	466	6.3
II.	Indirect Tax	2,293	31.0
	<i>Sales Tax</i>	818	11.1
	<i>Export Tax</i>	3	0.0
	<i>Excise Duty</i>	1,314	17.8
	<i>Import Duty</i>	153	2.1
	<i>Other Tax Revenue</i>	4	0.1
B	Non Tax Revenue	2,943	39.8
	<i>Admin. Fees & Charges</i>	202	2.7
	<i>Capital Revenue</i>	102	1.4
	<i>Revenue from Govt. Dept</i>	53	0.7
	<i>Dividend</i>	1,997	27.0
	<i>Transfer of Profit</i>	296	4.0
	<i>Other Non Tax Revenue</i>	10	0.1
	<i>Interest receipt from Corporations</i>	284	3.8
TOTAL		7,388	100.0

The Ministry of Finance would like to highlight that continuous efforts are being made to enhance revenues mainly through improvements in tax administration and revenue collection. As the Honourable members may be aware, there is limited scope of raising much tax revenue at this stage of our development. Total tax revenue as percentage of GDP comes to around 11 % only.

External Assistance

Grants are expected to grow by around 9 % over the previous year's revised budget, with all the increase expected in project-tied grants from India. This is because the development assistance package having been finalized, the funds are expected to flow smoothly in keeping with the increase in the momentum of activities. As in the past, India's assistance forms the largest part of the total grant assistance Bhutan receives. The total grant from the Government of India is projected at a total of Nu. 3,730 m, with Nu. 1,750 m as Programme Grant and Nu. 1,980 m as Project-tied Grant. Grants from Bhutan's other development partners are projected to remain steady at Nu. 1,604 m for the year. The Ministry of Finance would like to highlight here that this reflects only what is budgeted already, and that there are many aspects for which preparations are still going on and thus would be incorporated in the budget at a later stage.

Some of the major activities which the Government of India's Project-tied Grant covers are the Tingtibi-Bumthang-Tongsa power transmission line (Nu. 296 m), expansion of JDWNR Hospital (Nu. 283 m) and Construction of Mongar Regional Referral Hospital (Nu. 186 m), Strengthening of Livestock Development Initiative (Nu. 224 m), Construction of 10 new schools (Nu. 208 m), Establishment of TV Centre and Upgrading Radio Transmission for the BBS (Nu. 192 m), and construction of Low-income Housing in Dzongkhags (Nu. 150 m). These are testimonies to the friendship between our two countries, and we look forward to completing all the activities within the 9th Plan.

Our other development partners also continue to make substantial contributions to our development. In the Financial Year 2005/2006 budget, the contribution of some of the major development partners are, around Nu. 394 million from the Danish government, mainly in the areas of health, education, environment, urban and good governance, Nu. 279 million from the Netherlands government, in the areas of

environment, HRD and rural electrification, Nu. 291 million from the UN system, in the areas of health, education, rural enterprise development, environment and food aid, Nu. 183 million from the government of Japan towards increasing food production, and Nu. 161 million from the government of Switzerland in the areas of HRD, RNR research, rural development and forestry.

Also, it may be highlighted that in addition to the Government of India, the Danish government is also providing assistance in the form of budgetary support, and these are in the areas of health and education. The Ministry of Finance is pleased to inform the honourable members that the experiment with budgetary support in these two sectors is working well, and it is hoped that the experience will provide a sound basis for moving more external cooperation in that direction. The budgetary support approach provides more flexibility of resource use for the recipient, and should result in more effective and efficient use of aid resources.

The Ministry of Finance would also like to inform the Honourable members that a Round Table Meeting with our development partners is being planned. Among others, the meeting will be utilised to update Bhutan's development partners on the progress of the 9th Plan, mobilise additional resources necessary and sensitise them on the Tenth Plan. This forum continues to be important for Bhutan given that even with the revenues from Tala Project, substantial official development assistance will still be required to meet the goals of the Vision 2020 and the Millennium Development Goals. The Bhutan Living Standards Survey and the Poverty Analysis Report of 2004 both underline the formidable development challenges that still remain for Bhutan notwithstanding the enormous progress the kingdom has made over the past years. The Ministry of Finance acknowledges the crucial role which our development partners have played in the past and is optimistic that they will continue to assist Bhutan in the future as well, given the close bonds of friendship and goodwill which continues to exist between ourselves and all our development partners. Our effective

aid-utilisations and good governance is well recognised by our partners, and as Bhutan moves towards the democratic constitutional monarchy enshrined in our forthcoming constitution, our partners will be further encouraged in their support.

The Ministry of Finance would like to take this opportunity to extend, on behalf of the Royal Government and the people of Bhutan, our deep appreciation and gratitude for all the assistance provided by our development partners. In particular, the assistance provided by India, our closest friend and neighbour has been most significant, contributing as they do in the most critical areas of infrastructure. We also take this opportunity to reassure all our development partners that their resources will continue to be put to the best use for the benefit of the people of Bhutan.

Fiscal Deficit

As a result of the combination of slightly lower levels of projected expenditure and the higher expectation of revenues and grants in comparison to the revised budget, the Royal Government anticipates a **fiscal deficit** of around 4 % of estimated GDP in the Financial Year 2005/2006 budget. Project-tied borrowings are expected to finance around 48 % of this gap. It may be noted that out of the total project-tied borrowings of Nu. 1,244 m, around 21 % is for rural telecommunications, followed by 19 % for the education sector, 18 % for the agriculture sector, 16 % for roads, 9 % for urban development and 5 % for rural electrification. Around 50 % of the total project-tied borrowing is expected from the World Bank, 25 % from Asian Development Bank, and around 21 % from Denmark.

The balance of the projected fiscal deficit will need to be met either through domestic borrowings or through additional external borrowings. The Ministry of Finance is planning to explore the possibility of program loans, which will help to reduce the need for domestic financing which in turn will lessen the danger of crowding out of the private sector as well as reduce the impact on foreign reserves. In framing the

Financial Year 2005/2006 budget, the Ministry of Finance carefully examined the effect of the 4% fiscal deficit on the debt stock. Infact a long-term fiscal plan for the Government has been drawn up which anticipates fiscal deficits of under 5 % even over the next two financial years. The Ministry of Finance would like to highlight that a small level of fiscal deficit is inevitable in the present circumstances in order to maintain expenditure levels for achieving the Ninth Plan targets. As long as they are contained under 5 % of GDP, it would still be consistent with a sustainable level of growth in debt stock. Honourable members will be pleased to note that independent assessments of the Ministry's policies by international agencies have deemed them to be reasonable in light of the presently foreseeable circumstances.

Debt

External Debt

The outstanding external debt increased by around 27 % over the past calendar year, and 62 % of this increase was accounted for by the Indian Rupee loans disbursed for the Tala project. The total external debt outstanding was US \$ 598 m as of the end of December, 2004. While it may appear high, honourable members may note that the Indian Rupee loan accounted for around 61 % of the total outstanding. All of the Indian Rupee loans are in the power projects, which are self-liquidating, and also they have no exchange rate fluctuation risk. These debts are a necessary precursor to the very considerable benefits that will eventually accrue to Bhutan as a result of the capital investments. Honourable members will be reassured to know however that our total debt service ratio was under 5 %, which reflects the concessional nature of the debt stock.

Summary of Outstanding External Borrowings

Description	USD in millions	
	Dec 2003 Amount	Dec 2004 Amount
Convertible Currency Loans	186	233
Indian Rupee Loans	286	365
Total	472	598

The Ministry would like to highlight that the convertible currency loans, which are all concessional, have been obtained to mostly support planned capital expenditures. Out of the total convertible currency loans outstanding of US \$ 233 m, 34 % (US \$ 79 m) has been used for energy, 22 % (US \$ 52 m) for agriculture, 11 % (US \$ 25 m) for roads, 10 % (US \$ 24 m) for education, 7 % (US \$ 16 m) for financial sector, 6 % (US \$ 13 m) for urban development, 5 % (US \$ 12 m) for health, 3.3 % (US \$ 8 m) for industries, and 1.5 % (US \$ 3.4 m) for labour & employment. As the honourable members will agree, these sectors are key to the further development and progress of our country. In terms of financing sources, 39 % is from the ADB, 26 % from the World Bank, and 9 % from the International Fund for Agricultural Development. The Royal Government remains highly grateful to the multilateral financial institutions for their generous support towards Bhutan's development, not only in terms of the concessional loans highlighted above, but also for a sizeable amount of technical assistance in the form of grants.

As in the past, the Government follows a conservative borrowing policy. Borrowing is always obtained only as a last resort, and at the best terms and conditions available. While the Ministry of Finance has been cautiously optimistic about the level of public debt as reported to the National Assembly in the past budget, the Ministry consulted experts from the international development financial institutions as well. The general opinion was that the debt stock was within sustainable levels unless future fiscal operations deviated significantly from current trends. Nevertheless, the Ministry of

Finance is fully aware that any borrowing, concessional or otherwise, carries repayment obligations and therefore, it will be used with the utmost caution and prudence. To strengthen debt management, a Debt Management Committee has been instituted within the Ministry. The establishment of a computerised debt management system is also under process with a view to improve debt monitoring and reporting.

Internal Debt

The outstanding domestic debt increased significantly by around Nu. 1,753 m in the past year. This was primarily on account of the Royal Government's decision to finance one of the new aircraft for Druk Air Corporation as government equity. The Royal Government raised the financing from the domestic financial market by way of a loan. The honourable members may like to note that the Royal Government decided to resort to domestic financing for the procurement of aircraft in the absence of external concessional financing, and in light of the abundant liquidity with the financial institutions, as well as the adequate level of foreign exchange reserves. The Royal Government considered this decision justified given the profound importance of air service to our overall development policies.

As highlighted in previous years, recourse to borrowings, domestic or external, is inevitable within reasonable levels, to ensure that the government is able to achieve its plan targets. With respect to the composition of debt between external and domestic, in line with the debt policy, the Royal Government will seek to maintain a debt mix that is optimal and consistent with developments in the financial sector. The Ministry of Finance is acutely aware of the importance of responsible and prudent debt management to ensure the sustainability of our finances into the future.

Trust Funds

The Ministry of Finance is pleased to provide a brief report on the three Trust Funds shown in the table below. There has been an increase of US \$ 4.131 m as compared to the last Financial Year. The total assets of the three funds amount to US \$ 50.376 m as of December 2004.

Summary of Trust Funds

USD in Millions	
<u>Name</u>	<u>Amount</u>
Bhutan Trust Fund for Environmental Conservation	31.500
Bhutan Health Trust Fund	18.000
Trust Fund for Cultural Heritage	0.876
Total	50.376

As reported last year, of the three funds, only the Bhutan Trust Fund for Environmental Conservation is in full operation. It is expected to finance around Nu. 17 m in the Financial Year 2004/2005 budget, in particular, the activities related to conservation of the environment and maintenance of the national parks.

The Health and Cultural trust funds are yet to achieve their target capital. Over the past year, the two trust funds grew by around US \$ 1.58 m (the Health Trust Fund by US \$ 1.51 m), or around 9.1 %. As of December 2004, the Health Trust Fund achieved 75 % of its target capital of US \$ 24 m, and the Cultural Trust Fund has achieved 8.8 % of its target capital of US \$ 10 m so far. Given the important objectives for which they were created, the Government is intensifying efforts to mobilise the balance funds so that it can obtain the full benefit from these funds.

Financial Sector

The Ministry of Finance is pleased to report that the financial sector's performance has continued to be commendable. The total assets of the financial sector grew by 13 % over the past calendar year. Loans and advances grew by 42 % and accounted for 44 % of the total assets. On the liabilities side, deposits grew by 18 % and accounted for around 74% of total liabilities.

The combined assets of the two commercial banks grew by 15 %. This was entirely accounted for by increases in Loans and Advances, with the share of real estate loans growing particularly fast. Similarly, on the liabilities side, increase in deposits accounted for 99 %. A significant development is the increase in the loans to deposit ratio from around 44 % to around 54 % over 2004 while the level of Non-Performing Loans has decreased to 10.5 % from 13.2 % in the previous year. As already reported, the overall liquidity in the system has decreased over the past year, with mainly the aircraft financing. The Royal Monetary Authority has been stepping up its supervision activities to ensure that the financial sector remains healthy.

The Ministry of Finance would also like to highlight that high priority is attached to extending financial services to the rural population. Toward this end, the Royal Government introduced a rural savings scheme recently. The rural people can now deposit their savings with the BDFC through its mobile banking system. This will save time and effort for the people by not having to come to the banks in the urban centers. It is hoped that this facility will not only enhance rural savings but also have a positive impact on rural development.

The assets of the National Pension and Provident Fund grew by 16 % over the past year ending June 2004. On the assets side, increase in investments account for 94 %, mainly on the back of the housing and educational loan schemes introduced in 2003. As a result, the NPPF was able to credit an interest rate of 5 % on the members

provident fund account. Contributions to the Pension scheme accounted for 66 % of the Fund's growth, while contributions to the provident fund accounted for 30 %. A total of 520 members are presently receiving benefits from the pension scheme.

Public Enterprise/Corporations

The overall performance of the public enterprises during the year 2004 has been satisfactory, with the exception of the Druk Air Corporation, Bhutan Power Corporation, Kurichhu Hydro-power Corporation (KHPC), and Bhutan Agro Industries Limited, which continue to incur losses. The companies fully owned by the government earned a total pre-tax profit of Nu. 2,000 m during the year 2004 against Nu. 2,065 m during the previous year, registering a small decrease of 3 %. This was mainly on account of KHPC's losses as a result of the monsoon damages to the transmission lines. The total assets of the companies increased to Nu. 23,869 m compared to Nu. 20,444 m in the previous year. This is mainly contributed by the two aircraft purchased for Druk Air Corporation. The Chhukha Hydro-Power Corporation (CHPC) continues to be the highest revenue contributor to the exchequer, projected at around 32 % of the total revenue in the 2004/2005 Financial Year. Fully government-owned public enterprises in total contributed Nu. 1,301 m as revenue against their operational result of 2004. Of this, Dividends was Nu. 1,183 m, while Corporate Income Tax (CIT) was Nu. 118 m.

The Ministry is also pleased to report that efforts continue to be made to improve the governance of public enterprises, so as to enhance their accountability and efficiency. During the past financial year, the Ministry of Finance introduced guidelines to assist government representatives on boards of public companies.

Future Outlook

The Ministry of Finance is confident that Bhutan is well placed in terms of its future economic outlook. As planned under the far-sighted leadership of HM the King, the major revenue base of our country is the hydro-power resources. With the natural advantage provided by our terrain, hydro-power projects will remain the mainstay of our revenues in the future. Even now as stated earlier, the CHPC is the major contributor to the national exchequer.

In accordance with the Plans, the Tala Hydro-power Project is scheduled for completion in March 2006. The coming-on stream of this project will be a momentous event for Bhutan as it will take us closer to our goal of economic self-reliance. It will enhance our domestic revenues substantially. It will also be the achievement of yet another landmark of Bhutan-India friendship, and set new standards for mutually beneficial cooperation. With this, Bhutan's growth prospects are expected to receive a huge boost, with GDP growing sharply in Financial Year 2006/2007. On the fiscal side, the inflow of revenues from the Project will enable the Government to meet all of its current expenditures with some balance for capital expenditures. While surplus is expected on the current account, some fiscal deficits will still be necessary, as highlighted previously, to maintain the level of expenditures for achieving the plan targets. Total debt as a percentage of GDP, is projected to move on a downward trajectory in the next few years on account of the sharp GDP growth in Financial Year 2006/2007 and due to the lower levels of fiscal deficit targeted thereafter.

With respect to other important economic indicators, the Ministry of Finance expects inflation to remain within acceptable bounds, in line with the medium term inflation projections for India, and thus cause no major disruptions to economic activity and growth in the near future. The Ngultrum is expected to continue to appreciate against the US dollar in the medium term but at a pace which should not unduly affect our competitiveness. Unemployment is also expected to remain within the present levels

as the government's initiatives for private sector development, mainly in the infrastructure and market access areas mentioned earlier, help to boost investments further. On the Balance of Payments front, exports, particularly to India is expected to double in the next financial year with the commissioning of Tala Project, and a trade and current account surplus is expected in the next financial year. Over the next few years, current account surpluses are anticipated to continue mainly on the back of aid-related inflows. Net foreign reserves are expected to remain at adequate levels, and are projected to be sufficient to cover over 16 months of imports. Overall, it may be mentioned that the medium term prospects are positive, but care will have to be taken to ensure that the Royal Government remains on the projected fiscal path and that key assumptions, particularly related to Tala project, hold.

As the Honourable members are aware, five other hydro-power projects are in the pipeline, namely the Punatsangchhu Phases I & II, the Mangdechhu, Dagachhu and the Kulongchhu. During the visit of His Majesty to India in January 2005, the Royal Government signed a Memorandum of Understanding with the Government of India to prepare the Detailed Project Reports for the Punatsangchhu II and Mangdechhu hydropower projects. Given the mutually beneficial nature of these clean hydropower projects, the Royal Government will give the utmost priority to speeding up their implementation. The DPR related to the 150 MW Dagachhu hydropower project is also being initiated with the help of the government of Austria. The project is expected to be developed under the Clean Development Mechanism (CDM), with possibility of financing for the project itself, as well as additional revenues from carbon trading. The Ministry of Finance is also pleased to highlight that works on the Dungsum Cement project, assisted by the Government of India, will resume in this financial year. All these should add substantially to the revenues of the Government to fund important activities in the future.

Nevertheless, given the high dependence on external assistance, the Ministry of Finance strongly feels that there is little room for fiscal complacency. Great care has been paid to the formulation of the Financial Year 2005/2006 budget so that resources are put to the most productive uses. Emphasis is also being given to monitoring and evaluation to ensure that funds are used as effectively as possible. Efforts will also continue to be made to improve public financial management. In addition, the Ministry of Finance has already engaged assistance of the World Bank for the preparation of a Medium Term Fiscal Framework (MTFF). This will lead to better resource predictability over the medium term, strengthen fiscal management and discipline and also help to plan financing requirements well in advance.

The Ministry of Finance is confident that over the financial year 2005/2006 and the succeeding budget year, the Ninth Plan targets will be largely met. The guiding development philosophy of Gross National Happiness continues to ensure that we remain on a development path that is consistent with all that we cherish, such as balanced and equitable economic development, environmental conservation, good governance and a vibrant and living culture. On its part, the Ministry of Finance will also continue to ensure that its fiscal policies closely support these principles so that development truly results in greater contentment and happiness in the Kingdom.

In concluding my presentation of the budget for the Financial Year 2005/2006, I pray that with the blessings of our guardian deities, the unsurpassed leadership of our Beloved King, and the steadfast solidarity of thought and action of our people and government, our country will continue to enjoy peace, prosperity and happiness.

Selected Monetary and Financial Indicators

Items Description	2003 (Dec)	2004 (Dec)
Total Assets of the Financial Sector (millions of Nu.)	31,880	36,151
a. Royal Monetary Authority	12,224	13,934
b. Four Financial Institutions	19,657	22,217
Money Supply (millions of Nu.)		
a. <i>Quasi Money 1)</i>	7,076	8,546
b. <i>Demand Deposits</i>	4,968	5,983
c. <i>Ngultrum in Circulation</i>	1,802	2,071
Domestic Credit (millions of Nu.)	3,468	5,878
<i>of which Private Sector</i>	4,251	6,058
Gross International Reserves (millions of USD)	367	391
a. <i>Convertible Currencies (millions of USD)</i>	288	267
b. <i>Indian Rupees</i>	3,576	5,432
Exchange Rate for USD-BTN/USD (Period Average)	45.59	44
Memorandum Items		
GDP (Nominal) (millions of Nu.)	27,745 (actual)	31,172 (projected)
Real GDP Growth Rate	6.8 %	8.4 %
Consumer Price Index	3.36 %	3.91 %

Structure of Interest Rates

As of December 2004

	BOB	BNB
Deposit Rates (in percent)		
Savings Deposits	4.5	5.0
Term Deposits (General)		
3 months to less than 1 year	4.5	5.5
1 year to less than 2 years		6.0
2 years to less than 3 years	6.0	6.5
More than 3 years	7.0	7.0
Corporate Deposits		
46 days to less than 3 months	3.0	3.25
Lending Rates (in percent)		
Loans by purpose:		
General Trade	15	...
Export Finance	13-15	...
Manufacturing Industry	12-13	12-13
Service Industries	12-13	12
Transport (heavy)	13-16	13
Transport (light-commercial)	15	16
Transport (light-non commercial)	15	12
Agriculture & Livestock	13	...
Housing	10	10
Equity Finance	13	12
Personal Loan	15	15
Small Loan to Government Employee	...	16

N.B: The Royal Monetary Authority of Bhutan has fully liberalized the interest rate since 1999