

Discussion Forum on

**“Why Trade Matters in Development Strategies?”**

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**Paper on Bhutan**

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## 1. Introduction

The Kingdom of Bhutan is a landlocked state in South Asia measuring about 38,394 square kilometers situated in the eastern end of the Himalayas and bordered to the south, east and west by India and to the north by China. With a population of just over 700,000, Bhutan is one of the world's youngest democracies with the adoption of the first constitution and the first nation-wide parliamentary elections in 2008 which are some of the milestones reached by Bhutan in its endeavors towards representative democracy and equitable distribution of development gains.

### 1.1 Development Philosophy

The country's unique concept of Gross National Happiness (GNH) promotes a balanced approach to development encompassing good governance, environmental conservation, cultural preservation and community vitality, in addition to traditional socio-economic indicators with a strong equity focus. GNH has already gained global recognition as evidenced by the inclusion of Happiness as one of the Millennium Development Goals (MDG).

### 1.2 Development Context

Bhutan is still dominantly an agrarian country with three quarter of the population living in the rural areas, majority of them engaged in farming which is supported by the integrated use of agricultural, livestock and forest resources. Guided by the GNH development paradigm, prudent economic management and political stability have brought about a significant rise in living standards and improvements in human development outcomes. Bhutan continues to enjoy robust economic growth, with a real Gross Domestic Product (GDP) growth rate of 11.8% and an average inflation rate of 4.6% in 2010. A gradual shift in the economic structure from a traditional and agriculture-based economy to a more vibrant secondary and tertiary-based economy—with hydropower, construction, tourism, transport and communication as key drivers—can be observed.

### 1.3 Key Development challenges:

**Unemployment:** Achieving full employment will remain a challenge under the 11th FYP. Youth unemployment is almost three times higher among young people than the average of all age groups. Female unemployment is higher than for males, especially in the young age categories of 20-24 and 25-29.

**Urbanization:** Rapid urbanization has been identified as one of the major emerging challenges in Bhutan with over 31% of the total population now living in urban areas. It is estimated that by 2020, the urbanization level will be between 50% and 73% and that there will be an additional urban population of between 180,000 and 360,000.

**Quality of Education:** Although a number of initiatives have been taken during the 10th FYP and the quality of education has improved over the years, it remains a critical challenge, especially in rural areas.

**Gender Equality and Women's Empowerment:** Women and girls continue to lag behind in a number of areas: participation in politics and decision-making, in the economy—in particular

labour force participation, unemployment and underemployment—literacy rates, participation in tertiary education and are more vulnerable to gender based violence. Rural women are often seen as even more vulnerable.

**Adolescent Sexual and Reproductive Health:** Young people are particularly vulnerable to reproductive health issues especially given the high rates of early child-bearing in Bhutan. STI and HIV rates are disproportionately high among young people due in part to changing social norms and the lack of youth-friendly health services.

**The endemic threat of natural disasters and vulnerability to climate change** has taken on added significance in recent years given the increase frequency of natural disasters. This has had a significant impact on economic development—in particular the hydro power sector that is disproportionately impacted by water scarcity and unpredictability—on health with the emergence of new patterns of vector borne diseases and the agriculture sector due to changing crop patterns.

One of the greatest challenges facing Bhutan at present is **to reduce spatial disparities** that exist between rural and urban areas and between regions, Dzongkhags (districts) and geogs (blocks). This is not only true with regard to poverty but also with regard to the achievement of most Millennium Development Goals (MDG) and human development indicators.

## **1.4 Millennium Development Goals (MDG)**

Bhutan has made sustained progress towards meeting most of its long term goals defined in Vision 2020 as well as the MDGs. A number of targets have already been realized, such as these related to underweight children and girls to boys ratio in basic education. Nevertheless, there are a number of areas that require attention such as food poverty, gender parity in tertiary education and representation of women in the Parliament as well as in wage employment (non-agriculture), rising trend of HIV case detection, and, use of improved sanitation facilities.

However some MDGs are off track. These include the maternal, under-5 and infant mortality rates, malnutrition among under-five children; quality of education and out of school children; limited access to emergency obstetric care and poor knowledge and practices in child survival and reproductive health, water and sanitation.

## **2. Economy and Trade**

### **2.1 Trade Flows**

Bhutan has moved from a virtually closed economy in 1960s to an economy characterized by a fair degree of openness that is still concentrated on exports and imports on a limited market with neighboring countries specially India.

By far, the main export item from Bhutan is hydropower energy, which in 2009 accounted for 42 per cent of total exports. Agricultural products represented 4.7 per cent, and manufactures, only 3.4 per cent. Other relevant exports are related to mineral industries (e.g.

cement). Within the top selected commodities exported, potatoes, oranges and apples are identified as the main cash crop exports. In 2009 they ranked tenth, eleventh, and twenty-third, and they accounted for 1.7 per cent, 1.6 per cent and 0.4 per cent of total exports, respectively. The main destinations of Bhutan's exports in 2009 were India (93.5 per cent); Bangladesh (3.16 per cent); Hong Kong, China (2.82 per cent) and Nepal (0.35 per cent).

Petroleum oil was the major imported item in 2009, accounting for 11.8 per cent of the total. Manufactures represented 32.6 per cent of imports and agricultural products, 12.8 per cent. Rice is among the major imported items ranking third among imports in 2009 valued at 2.8 per cent of total imports. Bhutan's main supplier is India, accounting in 2009 for 77.8 per cent of total imports. Other important suppliers in 2009 were Singapore (2.9 per cent), Japan (2.2 per cent), China (1.9 per cent), the Republic of Korea (1.5 per cent) and Malaysia (1.5 per cent).

Trade has increased significantly since 2001. The Diagnostic Trade Integration Study (DTIFS) (2012) estimates export to average 38.2 percent of the GDP over the last five years and imports average 52.6% over the same period. This means that trade plays a major role and has accounted for an average of 90.8 percent of the GDP over the last five years.

While Bhutan's trade deficit significantly increased in 2010, the overall balance of payments has remained positive due to the significant external inflows on account of grants and loans. India remains by far the biggest trade partner of Bhutan; in 2010, the trade deficit with India represented one third of the overall deficit.

Available projections foresee that Bhutan will continue to enjoy robust economic growth over the 11th FYP period. Despite steady economic growth, strong performance against macro-economic indicators, and the bright prospects for the country based on anticipated returns from its hydropower investments, numerous development challenges remain to be addressed. Moreover, the country remains constrained by a high degree of economic vulnerability due to external factors beyond its immediate control.

## **2.2 Trade Agreements**

Bhutan has actively promoted trade through various bilateral, regional and multilateral trading frameworks.

### **Bilateral Trade Agreements**

At the bilateral level, Bhutan enjoys a free trade agreement with India and preferential trade with Bangladesh. Initiatives are under way to establish bilateral trade agreements with Nepal and Thailand, with whom Bhutan has direct air links.

India has always been Bhutan's largest trading partner, accounting on average for over 90 per cent of the total value of Bhutan's exports and over 80 per cent of imports from 2000 to 2009. This trade pattern can be attributed to India's geographical proximity and the extensive bilateral cooperation in hydropower development. This has boosted energy exports from Bhutan to India and also sustained the high import levels of energy-related equipment from India to Bhutan. It

has been facilitated by a bilateral free trade agreement, as well as the use of the Indian rupee in trade and the fixed exchange rate between the two national currencies.

### **Regional Trade Agreements**

At the regional level, Bhutan is a member of two sub- regional groupings: the South Asian Association for Regional Cooperation (SAARC), with Afghanistan, Bangladesh, India, the Maldives, Nepal, Pakistan and Sri Lanka, and the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC), with Bangladesh, India, Myanmar, Nepal, Sri Lanka and Thailand.

Bhutan is a founding member of SAARC and has negotiated three trade agreements under its umbrella: the Agreement on SAARC Preferential Trading Arrangement (SAPTA); the Agreement on South Asian Free Trade Area (SAFTA); and the SAARC Agreement on Trade in Services (SATIS).

### **Multilateral Trade Agreements**

At the multilateral level, Bhutan is still negotiating on its accession to World Trade Organization (WTO). The Royal Government of Bhutan submitted its application on 6 October 1999, which was accepted by the WTO General Council. The Memorandum of Foreign Trade Regime was formally submitted to WTO in February 2003. Bilateral market access negotiations are ongoing on the basis of re-vised offers in goods and services. The multilateral examination of the foreign trade regime is proceeding on the basis of a draft working party report circulated in December 2007.

## **2.3 Key Challenges in Trade**

### **Limited Export competitiveness and diversification**

Given the vulnerabilities that arise from a non-diversified export base and market, a major challenge for Bhutan is to expand its non-hydro exports and diversify its export markets.

Bhutan is currently promoting agricultural diversification through contact farming, Public private partnership, cooperatives in which Bhutan has, within South Asia, some comparative advantage. Bhutan is also strategically positioning itself in a number of organic high-value niche exports. Bhutan is particularly keen to promote trade in knowledge-based and cultural industry goods and services as a long-term strategy to diversify and broaden its economic and export base and to generate quality employment.

### **Supply side bottlenecks**

The Diagnostic Trade Integration Study (DTIFS) highlights various supply side logistical and technical barriers to trade development and diversification. Some key supply-side constraints to export diversification and competitiveness in agriculture are inherently related to climatic and soil differences, including limited availability of arable land, rough terrain and poor soil quality. Others are related to infrastructural or institutional deficiencies, particularly with

respect to inadequate rural facilities, low productivity of crops, the low adoption level of modern technologies, insufficient support services, limited access to finance and poor farmer linkages. More generally, the weak transport and communication infrastructure is a critical constraint to export diversification

### **Low level of technological base**

A major constraint and challenge is the low level of technological base

## **2.4 Mainstreaming trade in the development strategies**

### **United Nations Development Assistance Framework (UNDAF)**

Bhutan in 2008 voluntarily adopted the “Delivering as One” (DaO) approach through the United Nations Development Assistance Framework (UNDAF) as the key instrument for enhancing UN coherence at the country level. The current UNDAF was fully aligned with the 10<sup>th</sup> Five Year Plan which was extended by one year to bring it in line with the planning cycle for the 11<sup>th</sup> Five Year Plan. The new One Plan is fully aligned with the 16 National Key Result Areas of the 11th FYP of RGoB and is structured around the four pillar of Gross National Happiness.

UNDAF promotes the mainstreaming of all programmes by ensuring continued focused, coordinated and effective support for national development goals, the MDGs and the post 2015 agenda. This approach has definitely helped in mainstreaming the trade in the country’s development programme. The process of One Plan formulation has been mainstreamed by being inclusive, participatory and evidence-based.

Resident UN organizations in Bhutan participating in the One Plan 2014-2018 are: the Food and Agriculture Organization (FAO), the UN Development Programme (UNDP), the UN Population Fund (UNFPA), the UN Children’s Fund (UNICEF), the World Food Programme (WFP) and the World Health Organization (WHO).

Non-Resident Agencies, Funds and Programmes include the Joint UN Programme on HIV/AIDS (UNAIDS), the UN Capital Development Fund (UNCDF), the UN Conference on Trade and Development (UNCTAD), the UN Environment Programme (UNEP), the UN Educational, Scientific and Cultural Organization (UNESCO), , the UN Human Settlements, Programme (UN-HABITAT), the UN Industrial Development Organization (UNIDO), the UN Office on Drugs and Crime (UNODC), UN Office for Project Services (UNOPS), the UN Volunteers (UNV), the UN Entity for Gender Equality and the Empowerment of Women (UN Women) and the International Fund for Agricultural Development (IFAD)

### **Enhanced Integrated Framework (EIF)**

The Enhanced Integrated Framework recommends enhancing the production of selected commodities like citrus, apples, potato, cardamom, lemon grass, medicinal herbs, mushroom and red rice.

## **Contact and Commercial Farming**

Contract and Commercial Farming will be pursued both at the national and international level. Contract farming at the national level will be encouraged through groups and cooperatives to produce and supply to local institutions like the schools, monastic bodies and monasteries. At the commercial level, while local investors are encouraged through Public People Partnership, we will call for expression of interest and encourage international investors through Foreign Direct Investment as markets would then be assured by the investors.

## **Infrastructure Development**

Infrastructure be it road, bulking or processing facilities, transportation or storage is relatively still underdeveloped and needs government intervention to improve the facilities. The Department of Agricultural Marketing and Cooperatives will continue to develop the facilities to promote the trade in agriculture goods both for domestic and foreign markets.

During the current plan, the department will build storage facilities and market out lets at the district level. Infrastructure will also be developed for upstream bulking of agricultural products and Export Processing Zones and Auction Yards will be built to facilitate domestic markets and the export of agricultural products.

## **Acts and Policies**

Acts and Policies are being put in place to enhance coordination and linkages to support synergy and development of the domestic and international trade regime. Few examples of such acts and policies in Agriculture sector:

- Forest Act 1969
- The Livestock Act of Bhutan, 2000
- The Seed Act of Bhutan, 2000
- The Food Act of Bhutan, 2005
- Cooperative (amendment) act 2009 of Bhutan
- RNR Marketing Policy and strategy (draft)

## **3 Recommendations**

### ***3.1 Addressing supply side obstacles and enhancing export competitiveness***

Critical supply-side constraints hinder Bhutan's export competitiveness. The ability to benefit for market access will be contingent on overcoming these key supply-side obstacles. From a policy perspective, this calls for the mobilization of internal resources involving transfer of resources within the economy, across sectors.



In terms of domestic resource mobilization, a key issue is sustained growth in other sectors of the economy (hydropower) and transfer of resources within the economy, across sectors. Special credit lines to agriculture through public programmes or state banks would also contribute to channel funds to the sector. Public investment would need to be targeted carefully, favouring productive investment in strategic physical infrastructures, quality assurance and traceability systems (including organic labels), and suited innovation (research and development) and extension systems supportive of ecological agriculture.

### **3.2 Building up market access and market entry requirements**

A number of high-value niche products can be targeted as source of livelihood for rural people, and as export commodities: for example, handmade textile and other handicraft manufactures, as well as forest-based products, such as mushrooms, medicinal plants, and plants for the extraction of essential oils and special crops.

Besides market access barriers – tariffs and non-tariff barriers – Bhutan will most likely face a number of actual market entry barriers that stem from the structural characteristics of supply chains and markets. These impediments include important structural (for example, sunk costs and economies of scale) and behavioral barriers, such as access to distribution channels and the abuse of market power by incumbent firms, which severely hinder a new competitor’s ability to enter new export markets. Critical to overcome these barriers are policy options and models for integrating Bhutanese small agricultural producers in supply chains in a sustainable manner. By linking small producers to a guaranteed buyer who will also supply inputs, know-how, equipment and finance, these schemes can help Bhutanese farmers integrate into global supply chains and reach global markets. Given its distinctive development strategy (GNH paradigm), Bhutan may particularly wish to link with fair-trade schemes and organic labels and Geographical Indication and product differentiation strategy based on Intellectual property.

### **3.3 Retaining policy space to strengthen linkages in trade policy**

Support the importance of clustering and linkages between sectors and industries within the economy. For example, it is worth exploring how to link local agro-processing industries with tourist outlets. Bhutan may wish to retain the policy space needed to operationalize these linkages, including by means of local content requirements. This would include, for example, the provision of structured incentives to hotels and other tourist outlets to source certain goods and services locally. This type of measures would be commercially sound under certain conditions. Most notably, local suppliers may need to upgrade, in order to meet the stringent food safety and quality requirements imposed by hotels and other tourist outlets.

### **3.4 Agricultural and other enterprise diversification**

Bhutan is currently promoting agricultural diversification through contact farming, Public private partnership, cooperatives in which Bhutan has, within South Asia, some comparative advantage. Bhutan is also strategically positioning itself in a number of organic high-value niche

exports. Bhutan is particularly keen to promote trade in knowledge-based and cultural industry goods and services as a long-term strategy to diversify and broaden its economic and export base and to generate quality employment.

### **3.5 Continue capacity building for non trade sector and personnel**

Still there is a huge gap in capacity of the non trade sector on trade related subjects. So continued and enhanced capacity building programme should be given by UNCTAD and WTO and other related regional and national institutions.

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