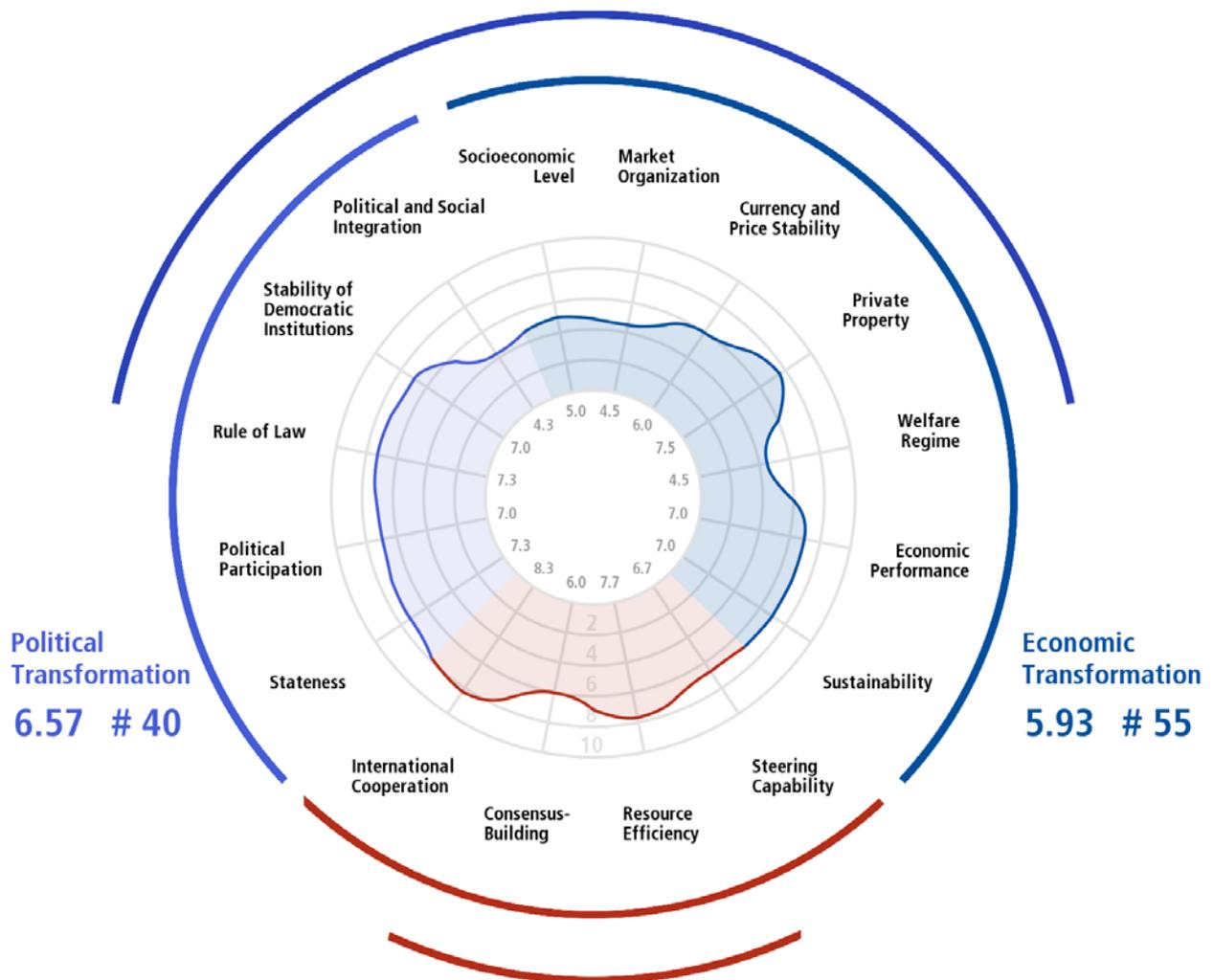


Bhutan

Status Index

6.25 # 45

on 1-10 scale out of 129



Political Transformation
6.57 # 40

Economic Transformation
5.93 # 55

Governance Index

6.50 # 16

on 1-10 scale out of 129

This report is part of the Bertelsmann Stiftung's Transformation Index (BTI) 2018. It covers the period from February 1, 2015 to January 31, 2017. The BTI assesses the transformation toward democracy and a market economy as well as the quality of political management in 129 countries. More on the BTI at <http://www.bti-project.org>.

Please cite as follows: Bertelsmann Stiftung, BTI 2018 Country Report – Bhutan. Gütersloh: Bertelsmann Stiftung, 2018.

This work is licensed under a [Creative Commons Attribution 4.0 International License](https://creativecommons.org/licenses/by/4.0/).

Contact

Bertelsmann Stiftung
Carl-Bertelsmann-Strasse 256
33111 Gütersloh
Germany

Sabine Donner

Phone +49 5241 81 81501
sabine.donner@bertelsmann-stiftung.de

Hauke Hartmann

Phone +49 5241 81 81389
hauke.hartmann@bertelsmann-stiftung.de

Robert Schwarz

Phone +49 5241 81 81402
robert.schwarz@bertelsmann-stiftung.de

Sabine Steinkamp

Phone +49 5241 81 81507
sabine.steinkamp@bertelsmann-stiftung.de

Key Indicators

Population	M	0.8	HDI	0.607	GDP p.c., PPP \$	8744
Pop. growth ¹	% p.a.	1.3	HDI rank of 188	132	Gini Index	38.8
Life expectancy	years	69.8	UN Education Index	0.504	Poverty ³	% 14.5
Urban population	%	39.4	Gender inequality ²	0.477	Aid per capita \$	123.5

Sources (as of October 2017): The World Bank, World Development Indicators 2017 | UNDP, Human Development Report 2016. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$3.20 a day at 2011 international prices.

Executive Summary

The second national democratic election went smoothly in 2013 and confirmed Bhutan's growing familiarity with and acceptance of democracy. The new government of the Druk Phuensum Tshogpa party (DPT) has provided stable government. Both the National Assembly and National Council have continued to propose, scrutinize and pass legislation. Local elections were successfully run in 2016 although voter turnout was only 55.8%. Other important democratic bodies including the Anti-Corruption Commission and the Royal Audit Authority have worked efficiently and effectively, demonstrating independence from the legislature. However, there has been criticism of the judiciary for uneven delivery of justice and the Supreme Court Chief Justice has called for improvement. Bhutanese citizens are growing more familiar with the democratic mode of government, but its endorsement, especially in rural areas, is yet to be evaluated. Citizens increasingly gain access to information, especially through television and mobile phones, and the information gap between rural and urban areas is closing. However, there are concerns that the media engage in self-censorship and that government organizations are reluctant to share information.

Socioeconomic development has continued its positive trend but not as strongly as in earlier years. Economic growth has gradually recovered from the 2013 low of 2.1% and is forecast to reach 8% in 2017. Bhutan will become a middle-income country in 2018. Secondary school and university enrollments have risen, health indicators have improved, the rural road system has been extended, and environmental concerns figure prominently in policy decisions. The overarching developmental philosophy of Gross National Happiness has been embraced by all political parties, in line with the implementation of five-year plans. The government is viewed as an effective utilizer of development assistance offered by international financial institutions. Poverty has declined to 12% but still remains high in some rural regions. There is now gender balance in secondary education, although males still outnumber females at the tertiary level. Women were elected to only four out of 67 parliamentary seats in 2013 and are poorly represented in executive

positions in public sector organizations. The government has rejected calls for women's quotas in parliament.

The state has been prominent in developmental activities while stressing the importance of the private sector in generating income and jobs. A number of impediments prevent the emergence of a fully functioning market economy in Bhutan. Entrepreneurs face the challenges of distance from markets, being landlocked, credit denial, a shortage of rupees, severe rules for investment protection and high costs of trading across borders. However, tourism is growing. The government has gradually introduced measures to liberalize the economy and facilitate entrepreneurship, but Bhutan still ranks low on global surveys of competitiveness. There has been little progress in diversifying the economy and its growth continues to rely on hydroelectric power and tourism.

Investment in export-oriented hydroelectric power plants is a major reason for fiscal deficits. Public debt and the current account deficit are high. This derives from the construction of major hydropower projects. The fiscal situation is expected to improve only when export of electricity can commence around 2019. India provides the loans for hydropower-related projects and accounts for 85% of Bhutan's trade. This highlights Bhutan's strong dependence on India. While high hopes are set on the South Asia Association for Regional Cooperation (SAARC) and other regional initiatives, Bhutan's inter-regional trade with countries other than India is unlikely to experience any significant growth over the next few years. Bhutan still has no formal diplomatic relations with its northern neighbor China.

History and Characteristics of Transformation

Bhutan underwent a major and generally peaceful transformation from direct royal rule to a constitutional monarchy over the course of 10 years. In June 1998, direct royal rule was ended by royal decree (kasho) and a cabinet of ministers was appointed. This initial step toward institutional reform was followed in September 2001 by the announcement that a written constitution would be prepared on orders of the king for the new democratic order that he had announced. On March 25, 2005, the draft constitution was publicly released. In a series of presentations and meetings with ordinary Bhutanese men and women throughout the kingdom and abroad, the king and his government presented the draft constitution to the people. On July 18, 2008, the constitution was formally enacted.

The constitution established a parliamentary system with the right to form political parties, for the first time in Bhutanese political history. A governing party would be elected by simple majority while the remaining parliamentary seats would be occupied by the opposition party. The former National Assembly debated and enacted a range of legislative measures associated with the formation of political parties, the conduct of elections, and the establishment of an Anti-Corruption Commission in preparation for the new democratic order.

A major concern among policymakers was to educate the Bhutanese population about parliamentary elections and processes. Therefore, during April and May 2007, mock elections were held with fictional political parties to help educate the voters. The Druk Yellow Party “won” 46 of the 47 seats. This fictional party was associated with traditional, pro-monarchy values, whereas the defeated Druk Red Party was associated with industrialization and development. The outcome of the mock elections proved, in retrospect, to be very similar to that of the general elections held in 2008.

Elections for the newly created non-partisan National Council were held in December 2007 and January 2008 with one member being selected from each of the 20 constituencies. Five other members were chosen by the king.

The National Assembly elections held in March 2008 featured two newly formed political parties – the Bhutan Peace and Prosperity Party (Druk Phuensum Tshogpa, DPT) and the People’s Democracy Party (PDP). A third party, the Bhutan People United Party (BPUP), was disqualified from competing in the elections when its registration was annulled by the Election Commission.

In the first-past-the-post elections the PDP won only two seats while the DPT took the other 45 and gained total control of the National Assembly. Despite its meager number of seats, the PDP received 33% of the votes, indicating substantial support.

The country’s second general elections (for both the National Council and National Assembly) took place in 2013 and attracted lower voter turnouts than the 2008 elections. The National Council elections featured more candidates and the National Assembly elections more parties. Five parties were slated to run in the National Assembly elections, but one party was excluded after having failed to nominate qualified candidates in one district. The four remaining parties, including two new ones led by women, competed in a primary election to determine which two parties would compete in the general election. The two new parties did not make it past the primaries, leaving the DPT and PDP to run against each other in the general election. In an upset election, the PDP won 32 seats while the incumbent DPT won only 15 seats, leaving the PDP to emerge as the governing party.

Female representation in parliament had been modest following the 2008 elections, with the National Council featuring four elected women and two appointed by the king, and the National Assembly featuring four elected women. In 2013, no women were elected to the National Council and only three were elected to the National Assembly.

Economic and social change have been proceeding rapidly in Bhutan. This has been particularly evident in the capital Thimphu, which has grown from 30,000 inhabitants in 1993 to about 115,000 in 2016. Despite the pace of urbanization in Thimphu and elsewhere in Bhutan, 61% of the population continue to live in rural areas and are predominantly engaged in agriculture. 96% of the population were rural residents in 1960. However, the country’s expanding education system, the growth of government and the spread of a market economy have helped accelerate rural-urban migration that began in the 1980s.

Traditionally, the Royal Civil Service has provided employment for school and college graduates. However, since 2000, the number of graduates has exceeded the number of available posts and there is growing concern over the private sector's ability to provide employment alternatives. Slowing economic growth rates in 2013 and 2014 underscore the difficulty in generating strong private sector development in the country. Recent reports from Thimphu suggest as well increasing social problems associated with the effects of urban life on the structure of Bhutanese families, as youth in particular feel the impact of insufficient employment opportunities. Although Bhutan continues to make improvements in providing infrastructure, health services and education, the negative effects of modernization are increasingly palpable in urban areas and have also led to rural depopulation in some areas. However, urban populations are happier than rural residents according to the 2015 Gross National Happiness survey.

The so-called southern question regarding Lhotshampa refugees, who fled or were expelled from Bhutan in the early 1990s, remains unresolved. Although the governments of Bhutan and Nepal agreed to a joint program aimed at verifying the status of refugees, the verification process ceased following attacks on Bhutanese officials in December 2003. The resettlement of refugees has gained traction in recent years with at least 90,000 moving to third countries, in particular the United States. While this provides an opportunity for the refugees to rebuild their lives, it has also provided new platforms for the refugees to criticize Bhutanese authorities. Adapting to new Western environments has proved difficult for some. Approximately 10,000 refugees remained in camps in Nepal at the beginning of 2017.

The BTI combines text analysis and numerical assessments. The score for each question is provided below its respective title. The scale ranges from 1 (worst) to 10 (best).

Transformation Status

I. Political Transformation

1 | Stateness

The state has the monopoly on the use of force throughout the country. Bhutan's ethnic diversity is not a cause of political mobilization. Political unrest can sometimes spill over from the Indian state of Assam, when insurgents flee over the border into Bhutan to escape the Indian military. Some banditry and kidnapping affecting Bhutanese citizens has occurred along the border with India. Responsibility for patrolling the border areas and forests rests with the Royal Bhutan Army, including the Royal Bodyguard of Bhutan and Royal Bhutan Police. The latter has posts nationwide. An estimated 1% of GDP is used for military expenditure. No rebel groups or criminal organizations operate in Bhutan. Relations with neighboring India are close and cooperative, including with the Indian military, which has a presence in Bhutan. Bhutan has no formal diplomatic ties with its northern neighbor, China, and there is still an unresolved border dispute between the two countries. Negotiations on the dispute have been conducted amicably since 1984. The 24th round of border talks took place in August 2016 with the resolution of the dispute reportedly coming closer.

The concept of Bhutan as a nation-state is widely accepted in the country among all its component ethnic groups. Before and since the expulsion or flight of thousands of ethnic-Nepali Lhotshampas, in the late 1980s and early 1990s, the government vigorously promoted the concept of the Bhutanese nation-state, such that it has acquired legitimacy among all groups. Yet, the state is not making honest efforts to integrate the 10,000 ethnic-Nepali Lhotshampas who remain in the country after the forced mass expulsion.

Access to citizenship is determined by the 1985 Citizenship Act. The rules are strict. Persons whose parents are both Bhutanese qualify for citizenship as do those domiciled before December 31, 1958. Otherwise applicants for citizenship should have at least 15 years (public servants) or 20 years (others) proof of residence and proficiency in the national language. Some external organizations have commented on the "very strict criteria" facing "ethnic-Nepali Bhutanese" when trying to obtain

Question
Score

Monopoly on the
use of force

8

'06 '18 10

8 7 8

1

State identity

7

'06 '18 10

6 7

1

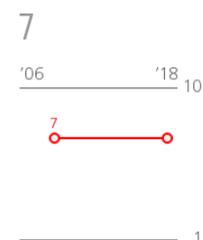
citizenship and security clearances. Failure to secure such clearances can limit access to employment, business ownership, education and international travel. The number of residents without such clearances is not disclosed by government.

The constitution declares that religion is separate from politics and that religious institutions and personalities must remain above politics. Thus, the state is officially secular. Certainly, there is no political activity by the Buddhist establishment in a country where Mahayana Buddhism is the dominant religion (75% of the population). Furthermore, the personnel of religious institutions are prohibited from standing in elections or voting. However, the constitution does state that preserving the country's religious heritage of Buddhism is important and that society is "rooted in Buddhism." Buddhism is closely tied with the establishment elites, and there is an obvious bias against Hindus in particular. The national flag and emblem also draw from Buddhist symbolism. Thus, while there is no state religion in Bhutan, Buddhism comes close to occupying such a position. The state continues to provide some financial support for monasteries and religious activities. The law has been influenced by Buddhism but the rule of law applies in the country and legal institutions are entirely separate from religious institutions. There is religious freedom in Bhutan but missionaries are banned and the constitution forbids any attempts to force people to change their religion. Government approval is necessary for the construction of religious buildings. There have been reports of the government favoring Buddhist over Hindu buildings, but a large new Hindu temple has recently been built in the capital, Thimphu. There is a very small number of practicing Christians in Bhutan – estimated to be between 2,000 and 25,000 – who meet discretely. They do not have formal recognition by government and thus no religious buildings. Two Christian pastors were fined and sentenced to prison for evangelism in 2016.

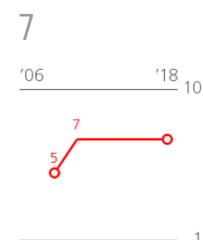
Bhutan has a generally well-functioning system of public administration involving central ministries in the capital and their decentralized offices in the districts (dzongkhags). The system has been traditionally bureaucratic in character involving concern with hierarchy, process and seniority. In recent years, there have been efforts to modernize the civil service using foreign aid and technical assistance. However, many traditional features remain.

With a relatively small and underdeveloped private sector, especially in rural areas, the state has taken most of the responsibility for service delivery, for example in education, health and infrastructure. Basic services are provided throughout the country and the coverage and quality of these services has been steadily improving. Universal primary education has been achieved and secondary enrollment has increased from 12% in 1985 to 74% in 2013. Life expectancy has risen from 52.4 years in 2000 to 69.5 years in 2014; 95% of households now have electricity (as recently as 2008 only 60% of households had electricity); and as of 2013, 98% of the population have access to an improved water source and 81% to improved sanitation. Poverty levels were recorded at 23% of the population in a 2007 survey, but halved

No interference of religious dogmas



Basic administration



to 12% in 2013 where they have remained since. Tax as a percentage of GDP rose from 5% in 2004 to 7% in 2012. It is predicted to increase as incomes rise and hydroelectric projects come on stream. Although only 6% of the population pays any direct tax in Bhutan, this is still the highest percentage among the South Asian Association for Regional Cooperation (SAARC) countries.

2 | Political Participation

Bhutan's first national elections were held in 2007 for the National Council and in 2008 for the National Assembly. The second elections for the National Council and National Assembly were held in 2013 as scheduled in the constitution and Election Act of 2008.

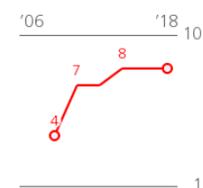
Bhutan also has non-party elections at the local block (gewog) level. For the National Council, which is seen as a house of review, one member is elected for each district (dzongkhag) regardless of population size. In 2013, the number of candidates for the 20 elected seats in the National Council increased from 51 to 67 although the number of female candidates fell from six seats to five. No female was elected but two women were appointed by the king, who selects five members. Only six of the 15 incumbents standing in 2013 were returned. Voter turnout fell from 53% of registered voters to 45%.

In the National Assembly elections, two new parties, both led by women, contested the primary election along with the government and opposition parties. The primary election serves to select the two parties for the general election. Both new parties failed to attract the necessary votes and the government and opposition parties from the first parliament remained to compete in the 2013 general election. Their familiarity to the electorate undoubtedly placed them at an advantage. The result was a resounding victory for the opposition from the first parliament, the People's Democratic Party (PDP) over the government party from the first parliament, the Bhutan Peace and Prosperity Party (Druk Phuensum Tshogpa, DPT). The PDP captured 32 seats and 68% of the votes while the DPT won 15 seats and 32% of the votes. There were only four successful female candidates, the same as in 2008. The 2013 General Election saw a turnout of 66% of the registered voters, considerably lower than in 2008, when 79% went to the polls. Once again, the Electoral Commission strictly and impartially ran the election. Electronic voting across the whole country allows for the results to be revealed a few hours after the polling stations close.

Overall, the 2013 elections marked advances for democratic consolidation with more parties and candidates, and results that showed the electorate would oust incumbent parties and members. There were few cases of infractions of the electoral rules. However, low numbers of women competing and winning in the elections, declining

Free and fair elections

8



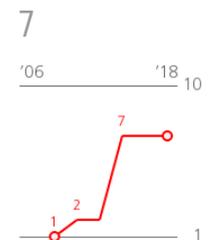
voter turnouts and the weakness of parties due to strict rules, especially with regards to their funding, remain concerns. The next general election is set for 2018.

Bhutan's political elite is small and has demonstrated consistent loyalty to state and king. The military has no record of challenging the state, the clergy do not participate in politics, and there is to date neither a trade union movement nor a powerful business lobby. In short, there are no active domestic veto players. However, there are two potential veto players, one domestic and one external. The potential domestic veto player is the king. He is part of the parliament and has the power of assent for bills of parliament. He may return bills with recommendations for amendments but must abide by the final decision of both houses. The king and the institution of monarchy are held in very high esteem in Bhutan and the two houses of parliament are highly unlikely to make proposals with which the king would strongly disagree. There is thus an anticipatory element to policy-making in Bhutan. However, the king has never taken any overt action that could be interpreted as veto behavior. The potential external veto player is India. It provides considerable financial aid to Bhutan and accounts for 75% of all trade. There are Indian troops based on Bhutanese soil. The Bhutanese government is careful to avoid actions likely to annoy India. However, following a conversation between the prime ministers of Bhutan and China on the sidelines of an international meeting in the run-up to the 2013 election, conjectures emerged that the Indian government was irritated by Chinese statements about establishing diplomatic relations with Bhutan. The Indian government removed the subsidies on kerosene and cooking gas exported to Bhutan leading to a doubling of their prices in Bhutan. The Indian government explained its action as a result of the expiry of the agreement on subsidies, and that a new agreement was not yet in place. Some commentators speculated that the action was taken as a warning on adverse consequences that might result from opening up relations with China.

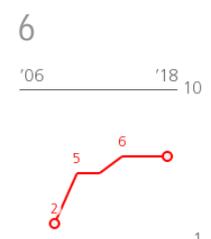
Two potential policy influencers are the Buddhist hierarchy and the emergent class of wealthy entrepreneurs. The former might be able to mobilize against any perceived threat to their situation, while the latter appear to be making greater contributions to policy debates on economic matters. This is likely to increase as the private sector grows.

The constitution guarantees freedom of assembly and freedom of association but in practice there are some restrictions. Citizens can join political parties that have been approved by the Election Commission. In 2008, only two parties were approved for the first national election but in 2013, there were five although only four were permitted by the Electoral Commission to run in the election. Membership in political parties is low, numbering between 135 and 799 persons in 2013. Parties set up by ethnic-Nepali refugees are regarded as illegal and operate only outside the country. Protests or demonstrations are permitted but must be approved by government. However, it seems that only one "solidarity march" has ever taken place, and that was in sympathy with the families of seven children who were swept away and drowned

Effective power to govern



Association / assembly rights

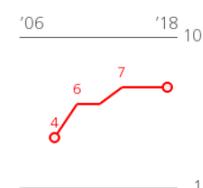


in a flood. Public protests are portrayed as a non-Bhutanese mode of behavior. Freedom of association has the proviso that it is only for groups “not harmful to the peace and unity of the country.” Thus, civil society organizations (CSOs) that might work on refugee, human rights or other sensitive issues are not allowed to operate. All CSOs must register with the government. The number has grown in recent years and numbered 50 in 2017. There are no trade unions because of the rural subsistence nature of much of Bhutan, the relative absence of large organizations and lack of government support for unions.

The constitution guarantees the freedoms of opinion and expression as well as the right to information. However, there is no freedom of information act, no press council or broadcasting code. The media are not officially censored and have grown considerably in number since democratization in 2008. In 2016, there were 11 newspapers (seven in English and four in Dzongkha) as compared to three in 2008. Radio stations have increased from four to five but only the state-owned Bhutan Broadcasting Service (BBS) has full national coverage. Both television stations are run by BBS. In the post-democratization period, there have been increasing numbers of newspaper articles exposing corruption or questioning government actions. However, there still seems to be significant self-censorship and media outlets are well aware of the Security Act of 1992 that prohibits expression deemed to undermine the security and sovereignty of the country. With small circulations, the print media is highly dependent on government advertising and there has been some concern that this financial clout has been used to influence newspaper content especially in privately owned media. Bhutan was ranked 64 out of 177 in 2012 on the World Press Freedom Index falling to a low of 104 out of 179 in 2015 and recovering slightly to 94 out of 181 in 2016. Bhutan still ranks above all other South Asian nations in freedom of press. Opinion polls in Bhutan have painted a mixed picture of the public’s trust in the media. There has been considerable increase in numbers of television sets, mobile phones and internet connections, which has enabled greater access to information and opinion formation for the vast majority of citizens. By 2012, 58.5% of households had television, 23% used the internet and 93% had at least one mobile phone. The growth of social media has greatly expanded access to information and the ability to exchange opinions especially among young Bhutanese.

Freedom of expression

7



3 | Rule of Law

The constitution clearly sets out a separation of powers. The executive, legislature and judiciary are formally independent of each other. However, the 45 seats to two seats domination of the first National Assembly by the DPT raised questions about the institution’s ability to counter executive power. The opposition PDP were seen by domestic observers to have “fulfilled their constitutional role well” and, on one occasion, were prepared to use judicial processes to achieve their desired result. In the second parliament, the opposition have 15 seats and thus have a more substantial

Separation of powers

7

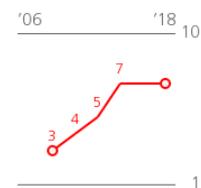
presence than in the first parliament. The non-party National Council provided a critical forum in the first parliament and continues to do so in the second parliament. The monarchy still exercises formal authority as part of the parliament, but also wields considerable informal power. Prior to democratization, the judiciary was frequently viewed as an extension of the government machinery and/or a tool for supporting the interests of the powerful. The Supreme Court demonstrated independence in 2010, ruling against the government in a case brought by the opposition. In March 2013, a district court found the National Assembly speaker and the minister of home affairs guilty in a case brought by the Anti-Corruption Commission. A later case against the foreign minister for misuse of public property while occupying another position went from district court to the Supreme Court where the minister was acquitted. The Anti-Corruption Commission (ACC) was concerned about the message this judgment transmitted to public officials.

Under Article 21(1) of the constitution, the Bhutanese judiciary is independent and charged with upholding the rule of law. The Supreme Court sits at the top of the courts hierarchy. Below it are the High Court in the capital Thimphu and dzongkhag courts in each of the country's 20 districts and dungkhad courts in 15 sub-districts. The decisions of the lower courts can be appealed upwards and each level of the court system maintains its independence.

There has been investment in upgrading the skills and knowledge of the officials in the judiciary through foreign technical assistance and with the establishment of the National Legal Institute. This organization arranges continuing judicial and legal education including outreach programs to schools and supporting television programs.

The Supreme Court has so far managed to act as the guardian and interpreter of the constitution and has developed credibility both domestically and internationally. In the past, courts at all levels of the judicial system demonstrated independence. However, the effectiveness and efficiency of the formal judicial system is partially restricted by insufficient functional operability and, of course, informal systems of conflict arbitration remain dominant in many parts of the country and in daily life.

Despite this overall positive development, a 2016 judicial integrity scan report noted that there was uneven delivery of justice, that the judiciary was still widely viewed as a closed system and that decisions were sometimes popularly viewed as being corrupt (although it was observed that citizens' definitions of corruption often differed from those normally used in academe and legal circles). There was a challenge to judicial integrity in 2016. A journalist posted an online petition in support of a young doctor in a property dispute involving the father-in-law of the Chief Justice. The journalist was sued for defamation, but she called for an investigation into the involvement of the Chief Justice in the case, alleging she was the victim of a witch hunt by the justice and that his actions challenged democratic



Independent judiciary

7



freedoms. The defamation case was dropped in January 2017 but there were no comments by the judiciary.

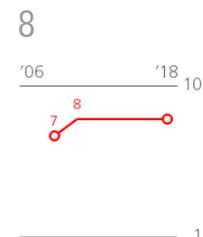
There is a low incidence of corruption in Bhutan, especially as compared to its neighboring countries, but considerable official and public concern about potential adverse effects from it. The Anti-Corruption Commission has worked well since commencing operations in 2006. In its first 10 years of operation, the Commission dealt with 4,333 complaints, undertook 148 investigations and had a conviction rate of 90%. Between 2011 and 2015, 45.6% of complaints involved abuse of functions by public servants, 20.8% concerned embezzlement, but only 2.5% related to bribery. The ACC described half of the complaints as administrative lapses, rather than corruption. There is a considerable backlog of cases. The ACC has a broad mandate to investigate, prevent and educate about corruption. The Commission also administers the online compulsory asset declaration system covering all public officials. Much funding has come from development partners (58.5% in 2015). The ACC has not shied away from prosecuting cases against leading officials. For example, in March 2013, it secured a guilty verdict against the Speaker of the National Assembly and Home Minister in connection with an administrative offence concerning land allocations committed before their election to office. In 2016, the ACC was involved in a case against the foreign minister.

The fundamental civil rights are set out in Article 7 of the constitution, but refer in most cases to citizens only, like the freedoms of speech, opinion, expression, movement and religion and the right to vote, and equality of access to public services and before the law. However, according to Article 33, these rights may be suspended when a Proclamation of Emergency has been declared. Furthermore, Article 7 gives the state permission to apply 'reasonable restriction by law' when 'the interests of the sovereignty, security, unit and integrity of Bhutan' and when peace, stability and national wellbeing are judged to be threatened.

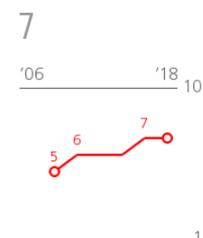
There is no capital punishment. In a 2016 survey, there were no reports of disappearances, arbitrary killings or torture. Prisons have been judged to generally meet international standards. NGOs claimed that there were 28 political prisoners in 2016, 47 having being released since 2010. Rules against arbitrary arrests and detention are generally observed.

The police have sometimes been taken to task over human rights violations while there have been allegations, especially by external ethnic-Nepali organizations, of discrimination and human rights abuses against the Nepali Lhotshampa population. An unknown number of this group does not have full citizenship and the rights associated with that status. While freedom of religion is guaranteed in the constitution, missionaries are banned and government permission is needed for the construction of religious buildings.

Prosecution of office abuse



Civil rights



Bhutan is a signatory to the Convention on the Elimination of All Forms of Discrimination against women and other international agreements. NGOs report little overt discrimination against women and that women have equal access to public services. However, Bhutan ranked only 121 out of 144 countries in the Global Gender Gap Index 2016. The report showed considerable gender disparities in health, education, economy and politics. There have been media reports indicating a rise in the incidence of domestic violence and sexual assaults. It is difficult to ascertain whether this indicates a disturbing rise in such violence or if there is greater confidence in the enforcement agencies. The government acknowledged the seriousness of the issue by passing the Domestic Violence Prevention Act in 2014. The National Commission for Women and Children is responsible for the country's obligations to international agreements on women and children while there are NGOs which focus on women's and children's issues.

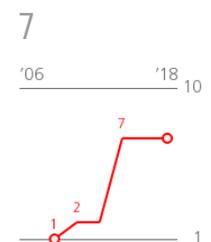
4 | Stability of Democratic Institutions

The democratic institutions have so far proved capable of fulfilling their functions. The National Assembly has produced policy although the overwhelming domination of the DPT in the first parliament resulted in a weak opposition. However, the opposition's performance was satisfactory, given its mere two members. With a 32-15 split between government and opposition in the second parliament, the opposition is fit to act as a check and balance on the government. The National Council has been an effective counterweight to the National Assembly in its role of scrutinizing legislation. Both parties, the National Council and the king have explicitly expressed their commitment to achieving the goals of the national development philosophy and strategy of Gross National Happiness. It is difficult to ascertain how far the king's informal power and universal respect informs the operation of democratic institutions; however, the king has repeatedly declared his commitment to the values associated with a constitutional monarchy.

There have been two local elections in Bhutan, in 2011 and 2016. Voter turnout has been stable at around 55%, but in some constituencies positions remained uncontested. Only two women were elected as gups (council chiefs) out of 205 positions at that level. Councils are responsible for local-level planning but reportedly depend heavily on locally based public servants and centrally determined priorities and procedures.

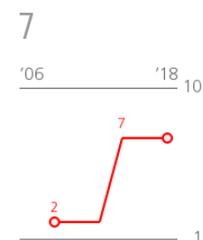
The Election Commission is seen to be neutral, while the judiciary has been strengthened through the appointment of younger judges with modern legal training. This has given the judiciary a better understanding of the rule of law in a democratic system and the role of the judiciary in it. The Supreme Court has demonstrated its commitment to its role as the guardian of the constitution. However, there are concerns about the uneven distribution of justice and judicial transparency.

Performance of democratic institutions



The legitimacy of Bhutan's democratic institutions has been established since the first national democratic elections in 2007/2008. There are no active veto players and no individuals or organizations advocating significant change to the political system. However, political power was initially concentrated in the governing DPT following the 2008 election. In the 2013 elections, competition had increased for political office and necessitated a primary election for the National Assembly, leaving only two of the four parties to compete in the ensuing general election. This political engineering is designed to stop the occurrence of potentially unstable coalition governments. The overarching principal of Bhutan's electoral system is stability. Declining turnouts for all national elections in 2013 as compared to 2007 and 2008 raise the issue of people's commitment to democracy. If this trend continues in the 2018 national elections, popular commitment to democracy will be brought into question. Local government election turnouts have remained stable but low, at around 55% in 2011 and 2016. There are few organized interest groups in the Bhutanese political landscape, and those that exist are weak in comparison to the state.

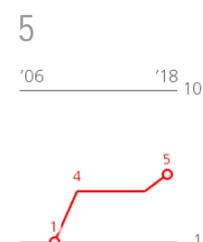
Commitment to democratic institutions



5 | Political and Social Integration

Bhutan's two-party system is young, without strong links to or deep roots in society, and low ideological and programmatic polarization. Parties have small memberships ranging from 142 to 799 members for those in the 2013 National Assembly election. The policy platforms of parties have differed little as the Election Commission ensures that parties must follow the principle that "national interest prevails over all other interests" and demonstrate that they are promoting national unity. They must also be seen to be pursuing the national development philosophy of Gross National Happiness. The policies of the four parties in the 2013 elections were distinguishable only by differences in the strategies advocated to achieve Gross National Happiness and varying emphasis on elements of it. Political parties can only raise funds from a small amount given by the Election Commission to each candidate – \$2,167 in 2013 – and from members' contributions with a ceiling of \$8,333 in 2013. This means that parties have very limited funds and are of the electoralist type, springing to life close to the elections but dormant or operating with limited staff between elections. Political parties only contest the seats in the National Assembly. The National Council is explicitly non-party in character and parties cannot participate in local-level elections. Thus, much of the political system is explicitly non-partisan.

Party system



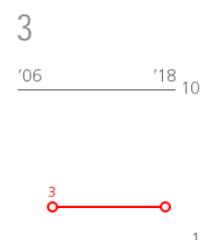
Parties are recent organizations in Bhutan and are weakly institutionalized. They have not developed strong grassroots presence as evident in their low memberships. The strict financial restrictions on parties adds to their weakness. The ban on parties promoting ideology or anything that might threaten national unity means that parties do not polarize the electorate. Clientelist networks have not developed in Bhutan. Voters are unconstrained in making their electoral choices. This was demonstrated in the 2013 elections, where many incumbents stood but were not returned, and where

the opposition party from the first parliament became the governing party in the second parliament. Media reports suggest that the number of parties contesting the 2018 National Assembly election will be higher than the four which competed in 2013.

There are few interest groups in Bhutan and they are of marginal importance in a country where the state has such a commanding presence. There is some influence from business organizations such as the Bhutan Chamber of Commerce and Industry and especially the Association of Bhutanese Tour Operators. However, the state still dominates in policy-making and implementation. NGOs have been developing but remain few in number and focused on the environment and women and children's affairs. Some NGOs, such as the National Women's Association of Bhutan and the Royal Society for the Protection of Nature, receive royal patronage. There are no trade unions while the only political mobilization of ethnic interests occurs outside the national boundaries in refugee camps in Nepal.

Opinion poll survey data is very limited. In the 2010 Gross National Happiness survey, 92% of respondents indicated an intention to vote in the next election, which survey reporters interpreted as a commitment to democracy. It may equally indicate a recognition of civic duty. Questions on political freedom found 61.7% of respondents acknowledging the existence of "sufficient" political freedoms. However, there was a significant share in the "don't know" category, an indication that democratic concepts have not yet been fully understood and internalized by citizens. Equivalent questions were not included in the 2015 Gross National Happiness survey. A December 2012 survey of 416 individuals for a book on democracy in Bhutan found 45% of respondents preferring the "new" system, 21% the "old" and 31% perceiving them to be the "same". There was a substantial decrease from 2008 in preference for the "old" system. Ninety-one percent of respondents described democracy as a 'means to influence decisions and a way of bringing about change' by voting, thus indicating a basic understanding of the concept of democracy. 86% of respondents said they would vote in the 2013 election and 78.9% indicated they were happy with the DPT government. However, only 45.2% of registered voters turned out for the National Council election and 66.1% for the General Election, indicating that voter intentions were not carried through in practice. Furthermore, DPT received only 31.9% of the votes in the General Election - hardly a reflection of the high level of satisfaction reported for the DPT government. Hence, opinion poll survey data cannot be viewed as providing an accurate estimation of citizens' level of support for democratic norms and procedures. Traditionally, decision-making focuses on building consensus using mediation. This occurs in both the policy process and in the operation of the judiciary. The traditional acquiescence of society to the state and its acceptance of the state's legitimacy may have been transferred to the new democratic institutions as its latest manifestation. Personal contacts have reportedly

Interest groups



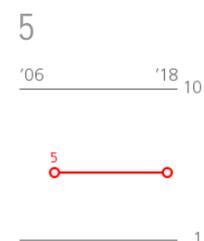
Approval of democracy



increased discussion of politics and policy matters and internet activity in these fields by individual citizens has increased.

Traditional rural Bhutanese society had a variety of civil society organizations. These were locally based, often around the monasteries, and focused on community functions such as mutual support, water management and religious festivals. Some of these survive today although urban-rural migration and modernization have led to the disappearance of some of these organizations or at least hampered their work. Kinship networks retain an importance even in urban areas and are characterized by close interaction and the provision of help in times of crisis. However, traditional rural community solidarity has not been replaced by new autonomous organizations in urban areas. There are some NGOs and sports clubs but modern forms of voluntary association are still few in number. The 2015 Gross National Happiness survey recorded a small but statistically significant increase in happiness since 2010 but the scores on community relationships and psychological well-being were “significantly worse.” For example, in 2015, only 26% of respondents reported that they trust most of their neighbors compared to 46% in 2010. There was a corresponding rise in respondents who trusted a few of their neighbors - from 14% in 2010 to 34% in 2015. A strong sense of belonging was expressed by 71% of respondents in 2010 falling to 64% in 2015. “Community vitality” has worsened the most in urban areas while actually strengthening in rural areas.

Social capital



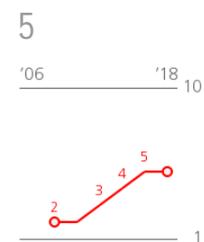
II. Economic Transformation

6 | Level of Socioeconomic Development

Bhutan has made steady progress in improving the welfare of its population and in growing the economy. The country’s Human Development Index (HDI) has improved from 0.525 in 2010 to 0.606 in the 2015 report, placing Bhutan in the Middle Human Development category of UNDP, ranked 132 out of 185 countries. Life expectancy at birth rose from 55 years in 1993 to 69.5 in 2015. There is now universal primary education, and gross enrollment for secondary education has risen to 74% with no differences between the levels of enrollment for boys and girls. Bhutan is ranked 97 of 155 countries on the UNDP gender inequality index and has made only modest progress in recent years.

Question
Score

Socioeconomic
barriers



The economy has performed well and had a long-term average growth rate of 8.5% until 2011. However, GDP growth fell to 5.0% in 2012 and 2.1% in 2013 but recovered slightly to 5.5% in 2014 and is expected to recover further with the International Monetary Fund (IMF) predicting an 8.6% growth rate in 2017, and Bhutan’s central bank predicting a more optimistic 10.2% if hydro projects are on

schedule. Previously high poverty rates have declined significantly in recent years on some measures. UNDP's Multidimensional Poverty Index (MPI) showed 27.2% of the population below the poverty line in the 2015 Human Development Report. But persons below the national poverty line have fallen from 23.2% of the population in 2008 to 12% in 2015. Poverty is concentrated in rural areas where approximately 65% of the population reside, many earning their living from subsistence-based agriculture. However, there is little growth in the agriculture sector. Hydropower and tourism largely account for the country's strong economic growth rates. Urbanization has been proceeding rapidly, notably in the national capital, with problems such as housing provision, environmental deterioration and unemployment emerging as a consequence. Inequality is rising, and the World Bank have estimated the Gini Index as 38.7, which indicates a slightly higher level of economic inequality than in other SAARC members

Economic indicators		2013	2014	2015	2016
GDP	\$ M	1798.3	1958.8	2057.9	2236.9
GDP growth	%	2.1	5.7	6.5	6.2
Inflation (CPI)	%	7.0	8.2	4.5	3.3
Unemployment	%	2.9	2.6	2.5	2.4
Foreign direct investment	% of GDP	1.1	1.5	0.5	0.4
Export growth	%	3.9	-5.8	-4.6	-0.4
Import growth	%	-1.8	-3.2	10.1	-3.2
Current account balance	\$ M	-472.2	-483.5	-571.7	-619.7
Public debt	% of GDP	93.6	93.8	94.4	110.2
External debt	\$ M	1603.2	1836.1	2013.1	2348.2
Total debt service	\$ M	78.5	82.7	129.0	77.0

Economic indicators		2013	2014	2015	2016
Net lending/borrowing	% of GDP	-5.1	4.4	-	-
Tax revenue	% of GDP	14.4	13.3	-	-
Government consumption	% of GDP	17.3	16.9	17.8	17.9
Public education spending	% of GDP	5.6	5.9	7.4	-
Public health spending	% of GDP	2.8	2.6	-	-
R&D expenditure	% of GDP	-	-	-	-
Military expenditure	% of GDP	-	-	-	-

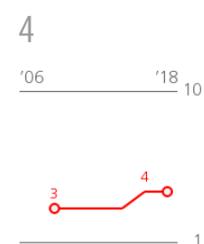
Sources (as of October 2017): The World Bank, World Development Indicators | International Monetary Fund (IMF), World Economic Outlook | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database.

7 | Organization of the Market and Competition

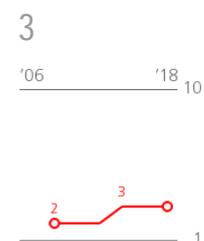
The informal sector is dominant, with only 23.1% categorized as “regular paid” in the Labor Force Survey Report 2015. Agriculture remains the principal source of income and employment for the majority Bhutan’s population. Although 58% of the labor force was in agriculture in 2015, agriculture accounted for only 16% of GDP. There is still a strong subsistence character to much agricultural production. The state plays a major role in the economy through state-owned enterprises which contribute 50% of tax revenue. Hydropower accounts for 85% of that revenue. There is government involvement in pricing in such items as gasoline, bus fares, propane and even meat. There are few large private companies and a small, unregulated commercial informal sector. Market-based competition has been developing but is still at a rudimentary level in a very small economy. The country has difficulty attracting foreign direct investment due to its landlocked nature, small domestic market, distance to global and regional markets, weak economies of scale, narrow economic base and vulnerability to natural disasters. Local businesses report difficulties in gaining access to finance. There has been some modest liberalization of foreign direct investment rules in 2014 but entry and exit barriers to domestic markets remain especially high for foreign companies.

The state has played a dominant role in modernizing Bhutan. With the absence of a significant private sector, the state has founded a number of enterprises. Some of these have been privatized and others corporatized. A substantial state-owned enterprise sector remains, presiding over some monopolies such as television, electricity, sand, timber and postal services. There is a limited number of large private sector corporations. There are no laws on anticompetitive practices, monopolies and cartels but the Consumer Protection Act was passed in 2012. It sets out the rights and responsibilities of consumers and is administered by the Office of Consumer

Market-based competition



Anti-monopoly policy

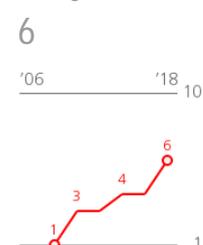


Protection. There appears to be low awareness of the act and reports of goods being sold above the maximum retail price. Nevertheless, the act has given a slight boost to competition in the economy. However, some private sector organizations feel that there is still no level playing field. A National Competition Policy was drafted in 2015 to create fair competition, prevent business monopolies and encourage small and medium enterprises (SMEs). Bhutan has moved up slightly on World Economic Forum's Global Competitiveness Index. It was ranked 97 out of 138 economies on the 2016-2017 index, a rise from 103 of 144 in 2015-2016 and 109 of 148 in 2014-2015. Bhutan's score has risen from 3.7 to 3.9 on a scale of 1-7, where seven is best.

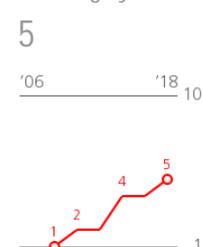
Bhutan has made modest efforts to promote trade liberalization. It enjoys observer status in the WTO and has engaged in negotiations for full membership. A WTO reference center was established in Bhutan in 2016 to provide information on the WTO and international trade issues. Bhutan is also a founding member of the South Asian Preferential Trade Area (SAPTA), the South Asia Free Trade Association (SAFTA) and a member of the Bay of Bengal Initiative for Multi-Sectoral Technology and Economic Cooperation (BIMSTEC). On the bilateral front, Bhutan has a free trade agreement with India, a preferential trade agreement with Bangladesh and a trade and cooperation agreement with Thailand. The country was described by UNCTAD in 2011 as having a "fair degree of openness" in terms of tariffs and quantitative restrictions, while a 2013 Asian Development Bank (ADB) report classified the effective tariff rate as "very low." This situation is reflected in the World Bank's "trading across borders" ranking of Bhutan at 26 out of 190. The main impediments to trade are high transaction costs, for instance bureaucratic and logistics. Bhutan scores low on the Logistics Performance Index, ranked 135 of 160 countries in 2016. The landlocked situation of Bhutan creates difficulties shared by comparable Asian countries such as Nepal and Mongolia, but Bhutan has the added issue that it has no direct cross-border trade link with its northern neighbor, China. The bulk of Bhutan's imports and exports are from countries with which Bhutan enjoys free trade or preferential trade, notably India, which accounts for over 80% of Bhutan's trade. The government manages trade matters through the Department of Trade, which is one of nine departments in the Ministry of Economic Affairs.

Until 2010, state banks held a monopoly in Bhutan. Since then two private banks have commenced operations. Financial market development has improved markedly in recent times according to the World Economic Forum, from a rank of 111 out of 144 economies in 2014 to 79 in 2016 to 2017. The banking sector has been advancing "steadily" according to the Asian Development Bank. There are now five banks including four commercial ones and the Bhutan Development Bank, which is concerned with financing rural development. There have been high rates of credit growth in recent years and an increase in non-performing loans, especially after the government enforced restrictions on rupee credits in 2012. This led to the ratio of bank non-performing loans to total gross loans to rise from 3.9% in 2011 to 11.38% in 2016. However, the assets of banks have increased by a greater amount; according

Liberalization of foreign trade



Banking system



to the World Bank, the bank capital to assets ratio was 17.8% in 2015. Access to financing has been consistently identified as the biggest problem for small and medium enterprises (SMEs) in surveys by the World Bank and World Economic Forum. Most lending is collateral-based, requiring up to 2.5 times the value of the loan in such items as land, equipment and personal assets. Such requirements are the highest among SAARC countries and among the highest in the world. Loan rates were cut in 2016 following recommendations of the World Bank's Financial Development Action Plan. The central bank gave greater flexibility to banks by replacing the Base Rate System with the Minimum Lending Reform. The government is considering other reforms from the report's 200 recommendations but will weigh these up against the demands of the Gross National Happiness (GNH) requirements for development. The report also noted a low level of banking innovation, inadequate competition and reluctance to engage in high risk priority lending. There has been very limited mobile banking development, but the widespread use of mobile phones suggests that there are good opportunities for mobile-phone banking.

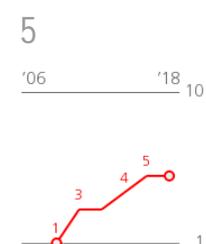
Rural areas, as well as women and youth represent untapped market segments for financial services. There is a wider demand for less complex and time-consuming banking services including more accessible deposit and withdrawal procedures, flexible loan requirements, and small periodic savings and loans services. Greater consumer protection is also required in the area of finance and many Bhutanese households would benefit from greater financial literacy that would enable them to profit from formal banking services.

8 | Currency and Price Stability

The Bhutanese currency (ngultrum) is pegged to the Indian rupee and is a source of vulnerability, as the country's inflation rate is influenced by that of India. Inflation in 2012 was the highest ever at 10.32%. In addition to imported Indian inflation and local factors, a rupee shortage resulted in inadequate rupee reserves covering imports from India. The rupee shortage resulted in temporary bans on certain imports such as cars, and the scarcity of some goods such as building materials. This placed further upward pressure on prices. Since 2012, inflation has dropped steadily to reach its lowest level ever at 3.22% in 2016. The Indian rupee is recognized as legal tender in Bhutan although only for notes up to 100 rupees.

The Royal Monetary Authority (RMA) is Bhutan's central bank. It is separate from government and is empowered to regulate the availability of money and its international exchange, to promote monetary stability, to supervise and regulate banks and other financial institutions, and to promote credit and exchange conditions and a financial structure conducive to the balanced growth of the economy. The RMA is generally viewed as a sound, professionally run institution which maintains its independence from government.

Anti-inflation /
forex policy



Bhutan's public debt has risen rapidly in recent years from 66.6% of GDP in 2010 to a projected 105.8% in 2016 and peaking at 113% in 2017, according to the Royal Monetary Authority. Construction of hydroelectric infrastructure is the main driver of this growth. In 2016, the IMF noted that external debt ratios breached all indicative thresholds, but nevertheless judged Bhutan's external debt as only a "moderate risk." This was due to "unique and mitigating circumstances" that include most hydropower loans deriving from India with the Indian government covering all financial and construction risks. All surplus electricity is bought by India where there continues to be large unmet demand. As the hydropower projects come on stream debt is expected to decline substantially to below 50% of GDP by 2026. However, it does constrain the fiscal space in which the government operates. The government is expecting to borrow more as grant income declines and will face hardening loan terms from the present concessionary lending. Bhutan has a growing current account deficit reaching 26% of GDP in 2014 to 2015. The country is highly dependent on imports, and in recent years the balance of payments has been deteriorating mainly because of large volumes of imports of construction materials for hydropower projects.

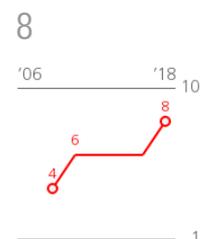
Macrostability



9 | Private Property

The constitution guarantees Bhutanese citizens the right to hold property. A full cadastral survey was completed in 2003 and enabled the clear definition of land holdings. A resurvey program was undertaken 2008 to 2013. There are well-maintained records of land holdings and ownership. The Land Act of 2007 provides comprehensive coverage of the regulation and administration of land and is administered by the National Land Commission. There are few large landowners and foreign ownership of land is not permitted. The World Bank ranked Bhutan 51 out of 144 economies in registering property in 2016 and 2017, well above its overall doing business ranking of 73 in 2017. Property rights are viewed as secure in all surveys, and the acquisition of property is not mentioned as a problem by businesses. However, the ACC has expressed concern about possible corrupt actions relating to land matters. The Lhotshampa, that is, people of Nepalese origin who cannot become citizens, do not enjoy these rights.

Property rights



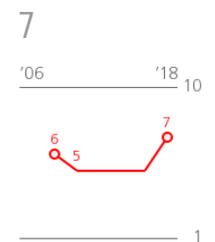
Bhutan recognizes the rights of persons in relation to their intellectual property and, according to the World Intellectual Property Organization (WIPO), has 24 legal texts related to the safeguarding of intellectual property. These range from the Copyright Act and Legal Deposit Act through to the Seeds Act and the Industrial Property Act. Bhutan is signatory to a large number of international treaties that WIPO identifies as governing intellectual property rights.

While the private sector is officially portrayed as the engine of growth in Bhutan, it remains relatively small and underdeveloped. Corporatized state-owned enterprises are the largest businesses in the country, controlling power generation and distribution, postal services and television. In recent years, private sector competition has entered the airline industry, banking and the media. There is virtually no private health service and only few private schools exist. Private sector development is challenged by limited access to finance; inadequate infrastructure, particularly in transport; small markets; and a mismatch between workforce demand and its availability. It has been difficult to attract foreign direct investment in industries other than tourism. These disadvantages resulted in low rankings in the global ease of doing business survey until 2012 when Bhutan was ranked 148. Due to changed methodology and incremental regulatory reform, Bhutan climbed rapidly to 70 in 2014 and 73 in 2016, but this was not reflected either in increased foreign direct investment (FDI) or a strong small and medium enterprise (SME) sector. Bhutan has made gradual improvement in the Global Competitiveness Index rising from 109 of 148 in 2013 to 2014 to 97 of 138 in 2016 to 2017, but still remains well inside the bottom half of the rankings. A government-established IT park has achieved modest success but the development of the planned Education City was shelved. Bhutan does have some competitive advantages for private sector development including political stability, good governance, low levels of corruption, access to electricity, an abundance of natural resources and preferential access to the huge Indian market.

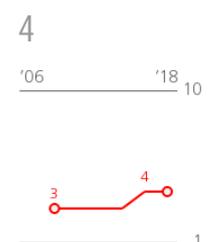
10 | Welfare Regime

The state provides free education and health care to all citizens. It does not provide other welfare benefits such as social security payments, conditional cash transfers or food subsidies. Public servants, the military, employees of state-owned enterprises and some private sector employees do have access to pension programs, but the rural population and those in small-scale enterprises do not. The king gives the traditional gifts of kidu (land and citizenship) to some vulnerable persons on a regular basis. The most important social safety net in both rural and urban areas is the family. Obligations to look after kin are strong but may be weakening with urbanization. Local religious institutions may provide some assistance to individuals and communities while NGOs and external organizations sometimes give temporary relief for particular categories of the needy. In the Eleventh Five-Year Plan (2013-2018), the government has directed the Ministry of Labour to institute a social protection system involving a social protection policy and pension policy for the private sector. A draft policy has been circulated, but has not been discussed in parliament.

Private enterprise



Social safety nets



Bhutan has fallen from 93 to 121 between 2013 and 2016 in the World Economic Forum's global gender gap report. Leadership positions are still dominated by men. Two of the four parties contesting the primary election for the National Assembly were led by women but both parties failed to capture enough votes to participate in the general election. Only four of 47 members of the National Assembly are women and there are only two women in the 25-member National Council. Both were appointed by the king. No woman was elected to the National Council. A proposal for a quota for women in parliament was rejected by the cabinet in 2017. Women occupy 36% of all public service positions but only 6% at the executive level. Women increasingly participate in the workforce but lag behind men, with ILO estimates used by the World Bank recently (2016) putting the female participation rate at 59% (however, high in contrast to other Asian countries). More women continue to work in agriculture than men.

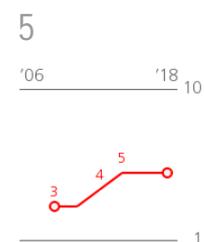
There are improvements in education. Universal primary education has been achieved and roughly equal numbers of girls and boys are enrolled in secondary education at all levels. Participation in tertiary education has increased but is still only 9%. However, adult illiteracy remains high at 37%, despite having fallen significantly. The youth literacy rate is 86%. Tertiary education enrollments are biased toward males and unemployment is higher among women at all levels of education.

Discrimination based on language and religion is common among the few minorities, and there is an urban-rural divide. However, the latter is less pronounced than in many other South Asian countries. No discrimination based on political preferences has been noted by foreign observers, international NGOs or the domestic media.

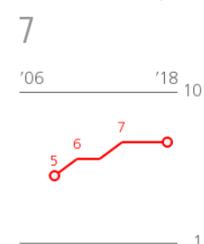
11 | Economic Performance

Quantitative indicators show Bhutan's economy to be performing reasonably well. Growth has generally been strong with an average yearly rate of 8.7% between 2005 and 2010 and 6.5% in 2015 (up from 5.7% in 2014). The IMF is predicting GDP growth for 2017 to be 8.6%. Growth in agriculture has been low or stagnant despite over 50% of the population depending on it for their livelihoods. Foreign direct investment has been low and volatile, ranging from a peak of \$75.3 million in 2010 to \$8.3 million in 2014 to \$33.6 million (1.6% of GDP) in 2015. The current account deficit grew to 25.1% of GDP in 2013 according to the World Bank and has remained high. Public debt measured in % of GDP increased from 84.5% in 2005 to 93.8% in 2014 and 94.8% in 2015, and is estimated to rise to 113% in 2017. International financial institutions have not considered this a cause for concern and believe there is "moderate risk" of debt distress, based on the considerable inflow of income from hydropower exports predicted to take place once the current projects have been completed. There has been a substantial inflow of grants and loans from multilateral

Equal opportunity



Output strength



and bilateral donors. Inflation, mostly imported from India, was 10.9% in 2012 but dropped to 4.5% in 2015. The unemployment rate remained steady at 2.5 to 3.5% between 2005 and 2015. Youth unemployment was 9.5% for males and 11.6% for females and is a major policy concern, with rates in urban areas twice as high as in rural ones.

12 | Sustainability

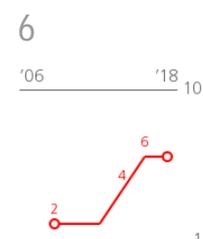
The constitution declares that it is “a fundamental duty of every citizen to contribute to protection of the natural environment, conservation of the rich biodiversity of Bhutan and prevention of all forms of economic degradation.” The importance of the environment in Bhutan is also emphasized in the national development philosophy of Gross National Happiness (GNH) and features strongly in the five-year national development plans. Bhutan achieved the Millennium Development Goal 7 on the environment. About 80% of its land area is covered by natural forests. Bhutan would be a beneficiary of carbon emission trading as it sequesters more than twice the amount of carbon than it emits. Over 50% of the country is designated as protected as national parks, nature reserves and biological corridors. But there are environmental problems including solid waste disposal, impact of road construction, loss of prime agricultural land to urbanization, illegal logging, over-exploitation of non-timber forest resources and livestock in excess of the land’s carrying capacity in some areas. Environmental considerations have been mainstreamed into development policy and programs, and projects must satisfy specified environmental requirements. Responsible government organizations have duties to prevent activities such as illegal logging and to monitor mining operations to ensure environmental regulations are kept. Climate change has been observed in rising temperatures and erratic rainfall. These developments have contributed to dangers such as glacial lake bursts and flash flooding. Some conservationists are concerned about the growing number of hydroelectric projects and their effects on the environment.

There have been considerable improvements in the availability of education. Universal primary education has been achieved and secondary education has grown considerably in recent years with a gross enrollment ratio reaching 78%. Boys and girls are equally represented in all levels of secondary education. Tertiary enrollments are also increasing but account for only 9% of the age group. Many students attend college and university in India. Adult literacy is low at 63% but improving, while youth literacy is 86.1%. These figures reflect the late development of mass education in the country. The amount spent on education was equivalent to 5.5% of GDP 2005 to 2014. In 2014, the Asian Development Bank recommended increased investment in education to support the country’s human capital strength. The government’s Bhutan Education Blueprint 2014-2024 identifies education as the highest priority and seeks to enhance access, quality, equity and system efficiency. Quality of education is a considerable policy concern and requires improvement to make the

Environmental policy



Education policy / R&D



economy more competitive and public service more efficient. Book and equipment supply to remote areas remains a challenge and teaching is not regarded an attractive career choice, leading to a shortage of specialist teachers.

In addition to expanding primary and secondary education, the Bhutanese government upgraded its colleges to become the Royal University of Bhutan in 2003 and, in 2012, the University of Medical Sciences. The private Royal Thimphu College also has degree programs. The number of tertiary graduates has been steadily increasing each year and, together with ever-larger numbers of grade 10-12 school-leavers, there has been rising pressure to create appropriate jobs. The country now has more graduates than it can absorb into the labor market and consequently made initial attempts to place workers within employment sectors abroad.

Through the 2012 Bhutan Education City Act, the government set up a public private partnership (PPP) to establish an education hub in Bhutan involving leading colleges and universities from throughout the world. The project was shut down in 2014 after the National Land Commission questioned the legality of the property contract. Another PPP was formed to build an information-technology park that aims to attract high-tech companies to the country. 'Thimphu Techpark' has struggled to find tenants due to lack of workforce, connectivity problems and high cost. Until now, R&D activities have been limited and largely confined to agriculture.

Governance

I. Level of Difficulty

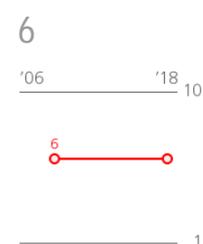
Bhutan is a landlocked country with a small market spread across the country's complex terrain. Road infrastructure is constantly being improved and the east-west axis across the country is motorable and used by buses, trucks and private cars. However, landslides are a hazard in the rainy season while roads can be blocked by snow in winter. Earthquakes have sometimes caused considerable damage to roads. A shorter route through Assam is unsafe.

Domestic air services, begun only in 2012, are very limited and unaffordable to most of the population. International air services have begun to react to the increase in tourist numbers as well as Bhutanese themselves travelling abroad. Until 2013, there was only the government-owned Drukair. A private airline, Tashi Air, began international operations in 2013. However, further growth of air travel is hampered by the limited capacity of the main airport in Paro.

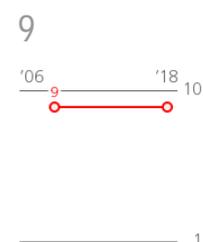
Bhutan has been successful in fighting poverty, cutting the rate from 23% in 2007 to 12% in 2012 and 2016. Poverty has been reduced in rural areas where living conditions, amenities and dietary behaviors have improved during the period of 2007 to 2016. However, many rural households subsist close to the poverty line. About 30% of all households in Bhutan are headed by women who attend to responsibilities that prevent them from taking up employment opportunities. Youth unemployment is increasing (10.7% in 2015) as young people often lack the skills required for modern occupations. Youth unemployment for females is higher than males.

Bhutan has historically been administered under traditional forms of civil society, where organizations undertook functions such as ensuring the security of livelihood, managing water rights or preparing festivities. These organizations were based in local communities and sometimes associated with monasteries. Many still exist today, but struggle under rural-urban migration and the consequent depopulation of remote areas. Modern forms of civil society such as NGOs and professional associations are a recent addition to Bhutan. They are governed by the Civil Society Organizations Authority (CSOA), which operates under the terms of the Civil Society Organizations Registration Act 2007. The purpose of the act and authority was to provide a stronger legal and regulatory framework for civil society organizations. The

Structural
constraints

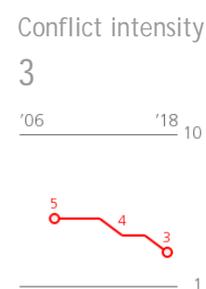


Civil society
traditions



development of its resulting modern civil society has been gradual. In 2010, the CSOA website listed ten public benefit organizations (PBOs) and one mutual benefit organization (MBO). In 2017, the number of PBOs had grown to 38, one of which was suspended. There were 12 MBOs in 2017, one of which was suspended and two which were engaged in a merger. PBOs included organizations for women, youth, the disabled, senior citizens, environment, animals, sports and health. MBOs are mainly industry-related associations operating in handicrafts or tourism.

Following the expulsion and flight of up to 100,000 Lhotshampa residents, the ethnic tensions and conflicts of the early 1990s have abated. Since then, social, ethnic and religious conflicts are largely absent from Bhutan. Citizenship requirements have been clarified and appear to be widely accepted, although some Lhotshampas still only have resident status. Most of the refugees in Nepal have been resettled to third countries and as a result, their political activities and organizations have little or no effect in Bhutan. At the end of 2016, there were about 10,000 Lhotshampa refugees in Nepalese camps. There are no religious conflicts in Bhutan. Buddhism is perceived to be the religious foundation of the country, and while religious freedom is guaranteed in the constitution, missionary activity is banned and government permission is required for new religious buildings. There is no political mobilization on a class basis. Decision-making is generally consensual in nature and overt conflict is avoided. Citizens accept and expect the guidance of a strong state.

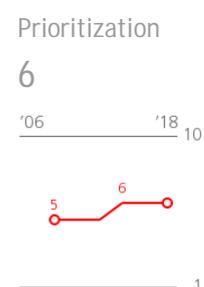


II. Governance Performance

14 | Steering Capability

The state has a guiding philosophy of national development based around the concept of Gross National Happiness (GNH), the idea of which originated from the fourth king and to which all political parties and other domestic political actors adhere. All policies must conform to the requirements of GNH, which is built on the four pillars: sustainable and equitable socioeconomic development; conservation of the environment; preservation and promotion of culture; and good governance. There is a longstanding utilization of five-year plans to give strategic direction to national development in the context of GNH. Bhutan is currently in the period of the Eleventh Five-Year Plan 2013-2018. The Commission for Gross National Happiness, the equivalent of a planning ministry in other countries, looks after the formulation, coordination and administration of the five-year plans and is a capable organization. Planning occurs in a combined top-down, bottom-up process: top-down with instructions and final authorization from the center, and bottom-up from the development plans of the gewogs. The advent of democratization has not disturbed

Question
Score



continuity in the national development strategy and the use of medium-term planning frameworks. Political parties must pursue GNH as decreed in the constitution. They may differ in the means they advocate to achieve it. The increasing costs of plan funding are becoming a challenge for government, while some of the outputs, most notably, the growing numbers of educated but out-of-work youths, are creating new policy problems for the government to address.

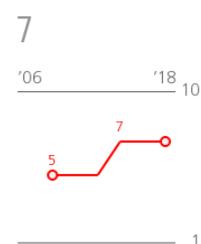
Little or no internal strife has been reported from within the past or current cabinets. The opposition in the first National Assembly was numerically weak with just two as compared to the government party's 45 members. In the current second National Assembly, the opposition party has a much greater numerical presence with 15 members compared to the government party's 32. The lack of disagreement among cabinet members is expected in a country where consensus is valued highly, hierarchy is respected and conflict politics are avoided. The oppositions in both national assemblies have questioned government actions, but the greatest scrutiny has come from the non-party National Council. As the electoral rules only permit two parties to be present in the National Assembly, the numerically superior party forms the government and will always be able to out-vote its opposition. This supports the government in implementing its policies, although rigorous scrutiny from the National Council has ruled out some proposed legislation.

The civil service is responsible for the implementation of policies, and has demonstrated effectiveness in this regard. The steady improvement in welfare indicators can be largely ascribed to the civil service, which assumes most responsibilities for education, health, infrastructure, agriculture and most other services. It is bureaucratic in its organization and procedures, and its component agencies have decentralized staff working in the dzongkhags. There are skill deficits in some areas of civil service operation. Efforts to modernize it have been moderately successful and are continuing. The implementation of policies in remote areas remains a challenge to government employees.

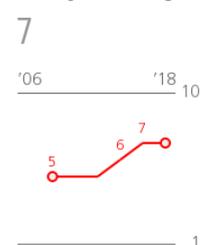
Bhutan has demonstrated a capacity to learn from its own experiences and from those of other countries (not only neighboring India), and appreciates the need to learn. From multilateral organizations such as the UNDP, UNICEF, World Bank and Asian Development Bank, and a small group of bilateral donors and northern NGOs, the government has been able to access international experts who have provided policy advice, program design assistance and demonstration of good practices elsewhere. However, this technical assistance is not always of the best or most appropriate quality, with adequate depth of understanding of the Bhutanese situation. This raises the possibility of misguided policy transfer.

Bhutanese government officials travel overseas to boost their own knowledge and understanding of particular issues and practices that fall within their areas of influence and concern. A considerable number of students relative to the country's population have been going overseas for training and education. These activities

Implementation



Policy learning



range from vocational skills to significant numbers of postgraduate coursework degrees and, more recently, higher degrees by research. Australia's University of Canberra has been offering public administration and business administration programs at the master's level in Thimphu, in association with the Royal Institute of Management. These developments reflect a clear policy goal of increasing the skills and knowledge of public servants, state-owned enterprise employees and others in order to make Bhutan a knowledge-based society, a hub for innovation and education in South Asia. The achievement of these aims is still a long way off.

The most remarkable item of policy learning has been the untroubled transition from a longstanding authoritarian political regime to a constitutional monarchy with well-functioning new institutions determining policy, and where debate is both encouraged and allowed. The transition has been smooth, and reflects the country's ability to adapt imported institutions to fit the Bhutanese context. Some elements of authoritarian practices remain such as the difficulty of obtaining information from government and occasional chiding of media reporters when leading government officials object to their questions.

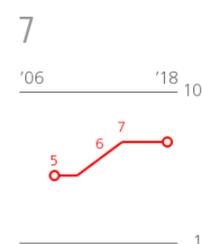
15 | Resource Efficiency

Bhutan's public administration system has been traditionally bureaucratic, focusing on hierarchy, seniority and process. The traditional model has worked reasonably well to produce the outcomes desired by the government. However, the government has engaged in a process of public management reform to improve the performance of its bureaucracy, although the outcomes of this process are difficult to discern. The civil service focuses on upwards accountability. This has contributed to low levels of corruption.

The civil service is governed by the Civil Service Act of 2010, which sets out details of all human resource management activities, including recruitment, duties, remuneration, promotion and discipline. The act is administered through the more detailed Bhutan Civil Services Rules and Regulations, and centralizes human resource management authority in the Royal Civil Service Commission (RCSC). This organization administers human resource functions for all civil service organizations and runs the entry exams for the civil service. Entry is only open to university-level graduates through nationwide common exams.

Bhutan has a record of efficient and professional budget management. However, budget deficits remain. For the fiscal year of 2016-2017, the deficit was equivalent to 5.31% of GDP. Development assistance in the form of grants has played a significant role in the budget, accounting for an average of 13.5% of GDP between 2003 and 2012 but such funds will be harder to come by when Bhutan graduates from the designation of least developed to a middle income country in 2018. Public debt has risen from 66.7% of GDP in 2010 to an estimated peak of 113% in 2017. The trend

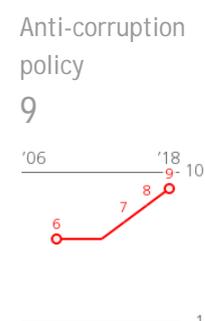
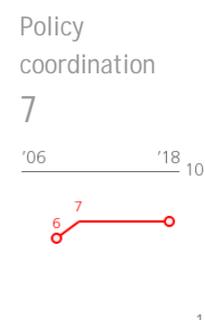
Efficient use of assets



will be reversed once the hydropower projects currently under construction are completed and electricity exports to India can commence. Bhutan relies on India for considerable budgetary support. In 2015-2016, 63% of Indian foreign aid was earmarked for Bhutan. According to the IMF, Bhutan has maintained “comfortable” levels of reserves in recent years, adequate for debt repayments, but may need to change some practices to meet future challenges.

The relatively small scale of government, the preference for consensual decision-making and the guiding frameworks of five-year plans have led to a good degree of policy coherence. The Commission for Gross National Happiness plays a major role in coordinating and managing such coherence. However, government organizations still work according to clearly delineated functional responsibilities that may sometimes hamper more whole-of-government approaches. There is administrative decentralization to the country’s 20 dзонkhags. Appointed officials posted their work with locally elected officials to produce plans at dзонkhag and gewog levels that feed into the overall national plans of action. Despite this decentralization, there is still a strong centralized feel to government decision-making and to the administration of government officials. Hierarchy is still a major organizational principle in Bhutan.

The government of Bhutan has a good record in containing corruption. The incidence of corruption is considerably lower than in neighboring South Asian countries. Several factors explain this. First, smaller governments such as that of Bhutan are easier to monitor and audit. Second, there has been a concerted effort by government over several years to raise the standards of accounting and auditing to international levels. Third, an Accounting and Auditing Standards Board of Bhutan was introduced in 2010 to assist in raising Bhutanese standards in these activities. Fourth, the idea of service to the state and king is ingrained in the civil service and acts to prevent corruption. Fifth, the Anti-Corruption Commission (ACC) established in 2006 has been a notable force in promoting the anti-corruption message and in investigating and prosecuting corrupt officials. In March 2013, the ACC secured guilty verdicts for a case against the speaker of the National Assembly and the minister for home affairs dating back to years before they had been elected to office. Sixth, the Royal Audit Authority (RAA) has been a leading force for financial accountability. At times, it has been highly critical of policy implementation. The RAA reports to the Public Accounts Committee of the National Assembly. Finally, there is widespread concern among citizens about corruption, leading to a low tolerance for activities that are viewed as corrupt.



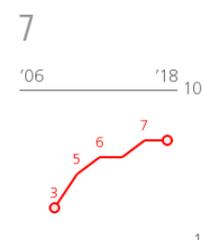
16 | Consensus-Building

The second national elections in 2013 generally indicated progress in the consolidation of democracy. The elections took place at the scheduled time and there were few reports of irregularities in both election campaigning and at the polls. There was an increase in the number of candidates for the National Council while four parties contested the National Assembly elections, as against two in 2008. However, voter turnouts in 2013 were lower than in 2008 and fewer women were elected. Discussion of politics and policy issues among the educated population in urban areas is common, but whether democratic ideas are a topic of concern in the highly populated rural areas remains unclear. The rural population experiences local-level democracy through gewog and thromde elections and participatory planning. Voter turnout for the 2016 local elections was 55.8%, and in some places, a few positions went uncontested. There is no overt opposition to the current democratic system. The major political actors, including elected representatives at all levels, the executive institutions of the state, the king, business leaders and the military all openly express their support for democracy. The king continues to enjoy significant respect and status, which supports his political pro-democracy influence. Supporters of democracy agree on its implementation, and there seem to be no evident opponents to the political process.

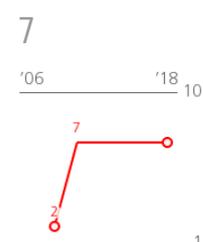
Despite commitment to the establishment of a market economy by government, its implementation proves to be somewhat difficult. Historically, the state has played a major role in development and continues to play this role with the aid of the civil service and government enterprises, despite agreement on the private sector's importance in creating wealth and employment. Restrictions on entrepreneurship, such as credit access, permit acquirement and the costs of trading across borders hamper the establishment of a market economy. Commitment to the philosophy of Gross National Happiness (GNH) also limits how far governments are willing to go in promoting a market economy. In-depth knowledge of the intricacies of a market economy is scarce among the population, and most enterprises are simple and small. There are no significant publicized divisions among relevant stakeholders about what strategy should be adopted to promote the market economy.

Democratization is currently widely supported, either as a preferred mode of governance or because it was introduced by the fourth king and upheld by the fifth king. High levels deference to the monarchy still characterize Bhutan. The monarchy is the only potential domestic veto player in Bhutan. However, as the instigator of democracy, it has remained indefatigable in its support of democratic political arrangements. India is the main potential external veto player and supports democratization in Bhutan, as long as it does not threaten the state's stability or India's strategic interests. India's support is contingent on Bhutan refraining from establishing diplomatic or other relations with China. The main vocal opposition to

Consensus on goals



Anti-democratic actors



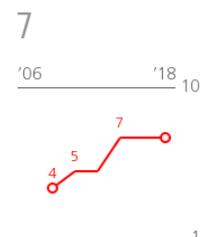
the government is to be found among exiled populations. This opposition sees the current democratic arrangements as flawed and unrepresentative. So far, such opposition groups have had no impact on politics inside Bhutan.

A noteworthy challenge to government authority arose in the early 1990s from the Lhotshampa population in the south of the country, when up to 100,000 members from this group were expelled or fled to refugee camps in Nepal. Most have been resettled in third countries, especially the U.S. Radical organizations continue to exist among the exiles, but have no effect on political life in Bhutan. Other ethnic groups in Bhutan are no cause of conflict. The east of the country is less developed than the west in terms of infrastructure, urbanization, education and economic development, but this has not been a source of dispute or conflict. Finally, there is no incidence of class-based conflict in Bhutan, although socioeconomic disparities are widening. The Gross National Happiness survey 2015 revealed a very slight increase in overall happiness from 2010 with 8.4% deeply happy, 35% extensively happy, 47.9% narrowly happy and 8.8% unhappy. There were inter-regional differences with seven dzongkhags recording low happiness, five as medium happiness and nine as high happiness, although the range is relatively small. There is no evidence to suggest that the distribution of happiness is giving rise to social conflicts. Government policies have been explicitly aimed at eliminating any ethnic tension, removing socioeconomic disparities and addressing poverty.

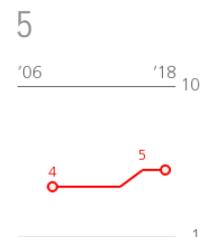
In the 1990s, militant groups from across the border used Bhutan as a sanctuary. They were driven out in a joint action with the India Army in 2003. Since then, Bhutanese vehicles have been attacked in Assam/Bodoland and there have been occasional kidnappings by Indian criminals in Bhutan's southern border regions.

Traditional civil society in Bhutan was community based and dealt with local matters such as water rights, human security and festivities. Modern civil society in the form of NGOs and professional associations is new to Bhutan. The constitution states that the "state shall endeavour to create a civil society." The Civil Society Organizations Act 2007 distinguishes between public and mutual benefit organizations as well as foreign civil society organizations (CSOs). There is no reference to traditional organizations. CSOs are few but their numbers have risen from ten public benefit organizations in 2010 to 38 in 2017, one of which was suspended. There were 12 MBOs in 2017, one of which was suspended and two which were engaged in a merger. CSOs may be consulted by government in their areas of specialization such as women's affairs, youth and environment or because they comprise a professional association. However, their impact on policy may have more to do with their sponsorship than their organizational capacity. At least two NGOs enjoy royal patronage. NGOs have been banned from activities directly relating to politics, and so must pursue any agenda with care. There are no trade unions. For many areas of policy-making there are no NGOs. Thus, the overall impact of civil society on the policy process is very small and selective.

Cleavage /
conflict
management

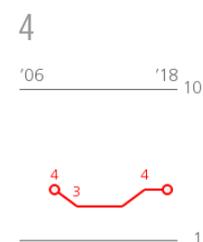


Civil society
participation



Explicit opposition to the Bhutanese government and political regime has come entirely from Lhotshampa exile communities. Since the departure of an estimated 100,000 persons from the south of the country in the early 1990s, following anti-government activities and a democratization movement, a variety of organizations, often based in refugee camps in Nepal, have strongly criticized the Bhutan government. Some international human rights organizations have also been critical of the government on this matter. Despite a series of meetings between the Bhutan and Nepal governments, no agreement was reached regarding resettlement of any of these refugees back in Bhutan. Rather, Western countries, in particular the United States, have taken in about 90,000 persons from the refugee camps. There is no process of reconciliation.

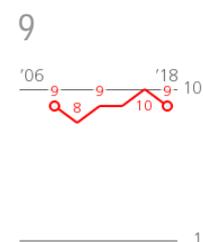
Reconciliation



17 | International Cooperation

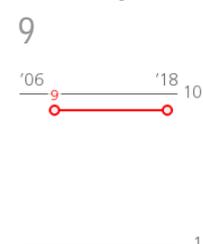
Bhutan's government is strongly dependent on international support, and seeks to align it with targets set under the country's five-year plans. India remains the major supplier of financial and other support to Bhutan with 63% of its aid program in 2016 going to Bhutan. India has provided the financial assistance for Bhutan's hydropower construction. Indian aid has generally made up about 75% of total assistance from abroad. Other aid suppliers include the major international financial institutions, the World Bank and the Asian Development Bank, as well as some UN agencies including UNDP and UNICEF. In addition to India, bilateral donors – including Japan, Norway, Denmark, Austria, Australia and Switzerland – have undertaken small programs in Bhutan. Most of these programs provide aid in the form of grants. The government of Bhutan had pursued the achievement of the Millennium Development Goals (MDGs) under the umbrella of its five-year plans and is doing the same regarding the Sustainable Development Goals (SDGs). Aid is effectively channeled into activities that are specified in the five-year plans and contribute to the achievement of the SDGs. There will be greater challenges in accessing aid with the most favorable terms and conditions as Bhutan graduates into a lower-middle income country in 2018.

Effective use of support



The government of Bhutan has demonstrated a capacity to undertake effective and realistic planning and to achieve targets set. It is considered a very reliable partner by the donor community. As evidence of this perception, the Asian Development Bank rated Bhutan the best performing country in 2012 in terms of the efficient implementation of projects and the effective utilization of funds. In 2014, the World Bank described Bhutan as a “development success,” producing good results from World Bank-funded programs. The country has also generated great international interest and has a good reputation from its novel alternative development philosophy of Gross National Happiness (GNH). Bhutan's only lingering credibility problem relates to the 100,000 refugees who fled the country in the 1990s and who are still being resettled to third countries or remain in the camps. Some refugee groups and

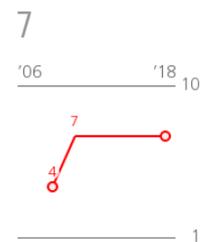
Credibility



their supporters in foreign countries maintain criticism of Bhutan's political system, the government's treatment of Lhotshampas and of human rights more generally in the country.

In 1985, Bhutan was a founding member of the South Asian Association for Regional Cooperation (SAARC) and has played an active role in its affairs ever since. Together with the other SAARC members it signed the South Asian Preferential Trade Arrangement (SAPTA) in 1993. It has hosted a variety of SAARC conferences and events and in 2011 held the organization's chair. The SAARC Development Fund and the SAARC Forestry Centre are based in Thimphu. Bhutan signed the South Asian Free Trade Agreement (SAFTA) in 2004. This seeks zero customs duties between members by 2016 although an extra three years was originally allowed for Bhutan. The government of Bhutan has signed agreements on narcotics, terrorism and human trafficking with its regional partners. It has also joined the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC), which includes India, Nepal, Bangladesh, Sri Lanka, Myanmar and Thailand. However, Bhutan's major cooperative efforts are with India. Approximately 80% of Bhutan's imports and exports are with India. It is financially dependent on India and there are Indian military personnel based in Bhutan. Bhutan has no formal diplomatic relations or cooperation arrangements with China, its northern neighbor although China has increased its soft power approach in recent years through the arts, sports and education.

Regional
cooperation



Strategic Outlook

Bhutan has acquired a good reputation for developmental success, peaceful political change, and responsible stewardship of culture and environment. The problems which the country faces could be exacerbated if environmental conditions changed.

Located between the world's two most populous countries, Bhutan has remained closely tied to and dependent on India. There are no formal diplomatic relations between Bhutan and China despite Chinese soft power efforts toward the contrary.

India is determined to maintain its exclusive alliance with Bhutan. The two countries are intertwined in various ways. Bhutan has been India's closest ally in the UN; all overland transport to and from Bhutan takes place on Indian territory; 85% of Bhutan's foreign trade is with India; Bhutan's currency, the ngultrum, is tied to the Indian rupee at an exchange rate of 1:1; and the rupee is legal tender in Bhutan. India is tapping into Bhutan's hydropower potential, and is providing the loans for additional power plants. Bhutan's strategic importance to India is reflected in 63% of India's foreign aid going to Bhutan. There are regular assertions by leaders in both countries of the prime importance of the Bhutan-India relationship. Relations with China, Bhutan's northern neighbor, appear to be improving as China has deployed soft power tactics to gain favor in Bhutan. However, India's strong opposition to Bhutan opening formal diplomatic relations with China will ensure the maintenance of the status quo because of Bhutan's high level of dependence on India. Tensions on the border are unlikely to decline especially as China has built a rail link near to its border with Sikkim in India and is reportedly planning to extend it closer to Bhutan. It has also been suggested that the border dispute between China and Bhutan is moving toward resolution.

Democratic consolidation has proceeded steadily with a successful second election and government bodies such as the Anti-Corruption Commission and Royal Audit Authority working well. However, the judiciary has received some criticism for the uneven delivery of justice and has pledged to make improvements. The legitimacy of democratic institutions and practices is becoming progressively established, although it remains unclear whether this is due to some traditional acceptance of state authority or active support of the new order. The declining turnouts for all national elections and low turnout for the 2016 local elections, plus the difficulty of attracting candidates for some local elections, could be regarded as worrying trends. The 2018 national elections will be of great significance for evaluating the health of democracy in Bhutan. Bhutan's two democratically elected governments have so far followed the constitution and have placed a high value on maintaining political stability.

The economy has gradually recovered from a shortage of Indian rupees in 2012 that led to a significant decline in growth. In 2017, growth is expected to reach 8% and average around 9% for 2016 to 2021. The large current account deficits and rising debt deriving from the construction of hydro projects are considered manageable. The country is expected to stabilize fiscally once the

new hydroelectric power plants come on stream after 2018 and revenue from electricity sales to India rise considerably.

Inequality is widening and youth unemployment is rising. A landlocked mountainous country with 62% of the population of just 0.75 million residing in rural areas, Bhutan has limited options for the diversification of its economy. Tourist numbers declined for the first time in 2015 due to visitor concerns over earthquakes in Nepal. With rising numbers of tourists anticipated in future years, however, Bhutan may lose its image as an exclusive destination. Climate change may also threaten the viability of hydropower projects and Bhutan's income from the export of electric power.

Tensions over the Lhotshampa refugee issue are expected to relax as more refugees are resettled in third countries. An upsurge of critical political activity among the settlers remains a possibility if they organize politically in countries which promote freedom of speech and association.