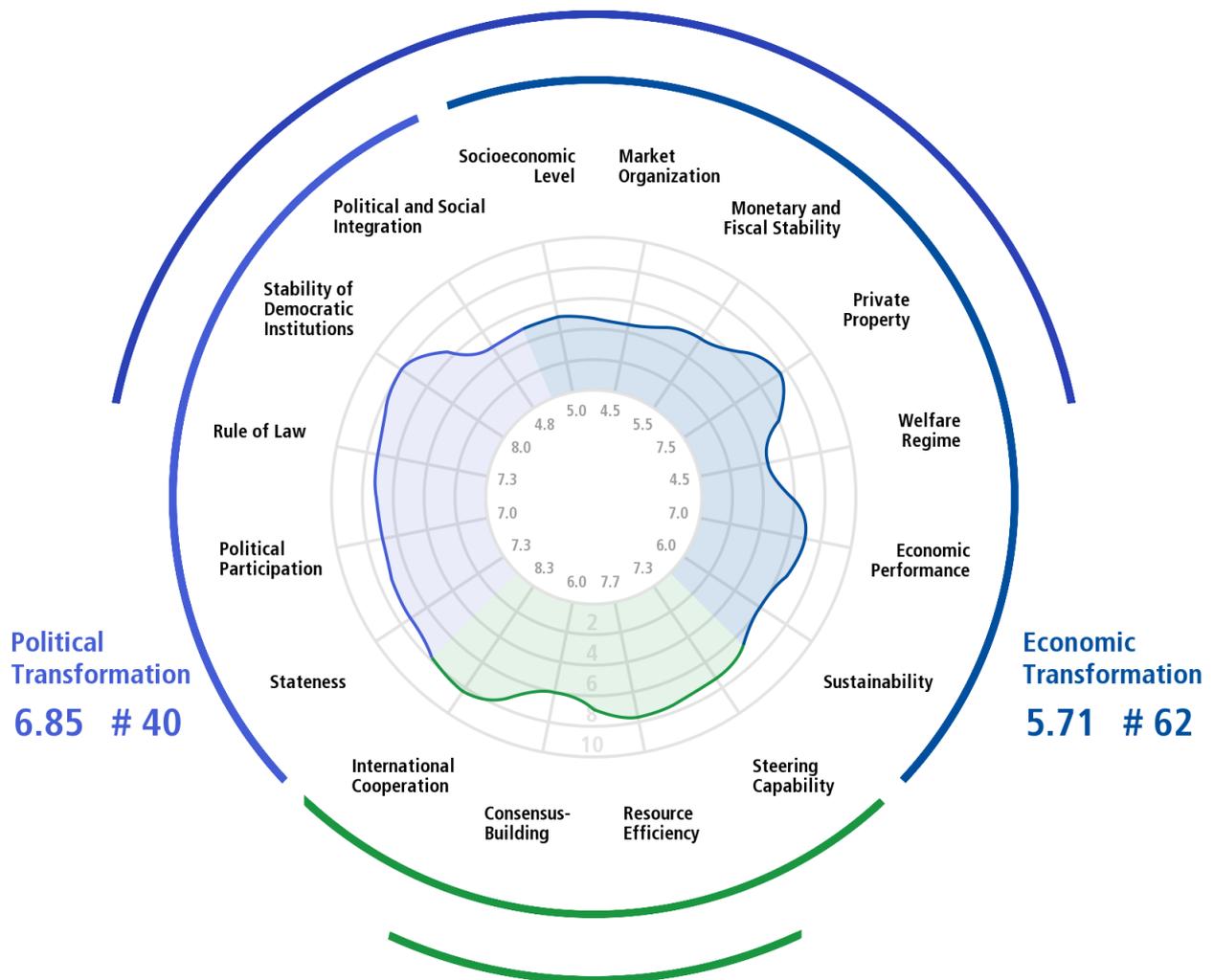


# Bhutan

## Status Index

**6.28 # 47**

on 1-10 scale out of 137



**Political Transformation**  
**6.85 # 40**

**Economic Transformation**  
**5.71 # 62**

## Governance Index

**6.67 # 13**

on 1-10 scale out of 137

This report is part of the **Bertelsmann Stiftung's Transformation Index (BTI) 2020**. It covers the period from February 1, 2017 to January 31, 2019. The BTI assesses the transformation toward democracy and a market economy as well as the quality of governance in 137 countries. More on the BTI at <https://www.bti-project.org>.

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**Key Indicators**

Population	M	<b>0.8</b>	HDI	<b>0.617</b>	GDP p.c., PPP \$	<b>10516</b>
Pop. growth <sup>1</sup>	% p.a.	<b>1.2</b>	HDI rank of 189	<b>134</b>	Gini Index	<b>37.4</b>
Life expectancy	years	<b>71.1</b>	UN Education Index	<b>0.441</b>	Poverty <sup>3</sup>	% <b>12.0</b>
Urban population	%	<b>40.9</b>	Gender inequality <sup>2</sup>	<b>0.436</b>	Aid per capita \$	<b>159.0</b>

Sources (as of December 2019): The World Bank, World Development Indicators 2019 | UNDP, Human Development Report 2019. 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

Bhutan's democracy consolidated further following the third elections to National Council and National Assembly in 2018. In the primary round of National Assembly elections, voters favored a newly established third party, Druk Nyamrup Tshogpa (DNT), followed by the opposition in the last parliament, Druk Phuensum Tshogpa (DPT). The incumbent People's Democratic Party (PDP) failed to advance to the general round. As the political parties have become more competitive, oppositional politics has taken a more adversarial tone with political rivals accusing each other of corruption and calling for greater transparency and accountability. While political parties remained highly deferential to the king and the Gross National Happiness policy, the performance of the previous government drew criticism.

Bhutan's Anti-Corruption Commission (established in 2008) saw a sharp rise in the number of investigations and remained constrained by a lack of resources. During the election campaigns, income inequality, access to health care, a shortage of drinking water and unemployment figured prominently. Concerns over constraints on press freedoms and freedom of expression continued as media operatives exercised self-censorship in order to avoid prosecution and the loss of revenue from government advertising. The number of women elected to the National Council and National Assembly increased in 2018. Though, nevertheless, women account for only two members in the National Council and seven out of 47 members in the National Assembly.

Bhutan's economy maintained a healthy growth rate of around 7%. Bhutan launched its 12th five-year plan (2018–2023) with an estimated cost of over BTN 300 billion. Effective project implementation to achieve policy targets and a larger role for local bodies, with 50% of the planned budget promised to local bodies, were the two key highlights. The continuing trade deficit with India and the rising number of unemployed young people challenged policymakers to expedite hydroelectric projects and improve the manufacturing sector. The implementation of a General Service Tax (GST) in India forced Bhutan to recalibrate its tax policy in order to meet the shortfall from the loss of excise tax that India collected on Indian exports to Bhutan; India will stop

collecting those taxes in 2020. The shortage of Indian rupees continued to be a challenge as 80% of Bhutan's imports are from India.

In 2018, Bhutan met two of the three eligibility thresholds to graduate from the status of Least Developed Country (LDC) – the Gross National Income (GNI) Index and the Human Asset Index. Bhutan's GNI per capita of \$2,400 in March 2018 exceeded the required three-year average threshold of \$1,242. Bhutan also improved its Human Asset Index from 45 to 73 in 2018, as a result of higher secondary school enrollment. The government, however, requested that the country's graduation from LDC status be postponed until 2023 to better prepare the country for the shortfall in financial aid that would result from the loss of its LDC status. The Population and Housing Census of Bhutan (PHCB) 2017 raised concerns that population growth had dropped below the replacement rate of 2.1 to 1.7. At this rate, population growth will turn negative by 2025. The standoff between India and China in Bhutan's North Doklam region in 2017 exposed the country's geopolitical vulnerabilities arising from growing tensions between the country's two giant neighbors.

## 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 and a cabinet of ministers was appointed. In 2005, a draft constitution was publicly released and on July 18, 2008, after public consultations, the constitution was formally enacted.

The constitution established a parliamentary system with the right to form political parties. The country's first 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).

In the first-past-the-post elections, the PDP received 33% of the votes but won only two out of 47 seats, while the DPT took the other 45. The country's second general elections (for both the National Council and National Assembly) took place in 2013 but recorded lower voter turnouts than the 2008 elections. Four political parties, including two new ones led by women, competed in a primary 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 incumbent DPT won only 15 seats, with the PDP (35 seats) emerging as the new governing party.

In 2018, Bhutan held its third parliamentary elections. National Council elections in April saw voter turnout of over 54%, a substantial increase from 45% recorded in the 2013 elections. On September 15, 2018, the primary round of elections was held for the National Assembly. The surprise winner in the primary round was a new party Druk Nyamrup Tshogpa (DNT) led by Dr. Lotay Tshering, a physician. The DPT secured the second most votes and the two parties advanced to the general round held on October 18, 2018. In the general round, the DNT secured about 60%

of the votes and won 30 of the 47 seats. Voter turnout, about 71%, was far higher than the 66% turnout for the 2013 National Assembly elections.

In 2018, there were significant gains in women's representation. Two female candidates were elected to National Council. Women also did better in the National Assembly where seven of the 10 women candidates won. In 2013, no women were elected to the National Council and only three were elected to the National Assembly.

Economic and social changes 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 138,736 in 2017, 19.1% of the total population. The least populated district (dzongkhag) is Gasa with a population of 3,952 or less than 1% of the total population. 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. In 1960, 91% of the population lived rurally. Since the 1980s, migration from rural to urban areas has accelerated.

Traditionally, the Royal Civil Service 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 underscored the difficulty in generating strong private sector development in the country. Even higher growth in 2017/18 has not reduced the problem of unemployment.

Recent reports from Thimphu suggest increasing social problems associated with the effects of urban life on the structure of Bhutanese families, especially owing to youth unemployment. Drug offenses and property crimes have spiked. Although Bhutan continues to make improvements in providing infrastructure, health care 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 issue has lost salience. 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 8,500 refugees remained in camps in Nepal at the beginning of 2019. As the resettlement program in Nepal ends in 2018, the fate of most of these remaining refugees remains in limbo.

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

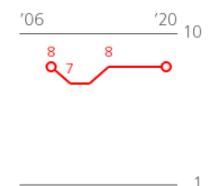
The state has the monopoly on the use of force throughout the country. Political unrest can sometimes spill over from the Indian state of Assam, when insurgents flee over the border into Bhutan to escape the Indian military. Responsibility for patrolling the border areas and forests rests with the Royal 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. In 2017, Bhutan was caught in the middle of a 75-day standoff between India and China in Doklam, a disputed territory between China and Bhutan. The standoff followed China's attempt to extend an existing road in North Doklam into southern Doklam claimed by Bhutan. India has a security treaty with Bhutan under which the Indian military is obligated to defend Bhutan's territorial integrity. The standoff ended after China halted the construction and Indian troops withdrew.

The concept of Bhutan as a nation-state is widely accepted. 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. Bhutan's policy regarding thousands of ethnic-Nepali Lhotshampas who remain in the country after the forced mass expulsion remains discriminatory. The 2017 census contained no questions about language, ethnicity and religion, which makes it difficult to establish the exact number of Lhotshampas still in Bhutan. Access to citizenship is determined by the 1985 Citizenship Act. The rules are strict. People whose parents are both Bhutanese qualify for citizenship as do those domiciled before December 31, 1958.

Question  
Score

Monopoly on the  
use of force

8



State identity

7

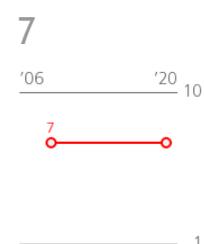


Otherwise, applicants for citizenship should have at least 15 years (public servants) or 20 years (others) proof of residence and proficiency in the national language. Some external organizations have commented on the “very strict criteria” facing “ethnic-Nepali Bhutanese” when trying to obtain citizenship 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

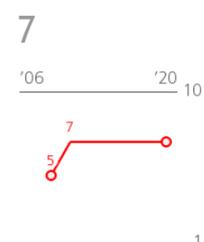
The constitution declares that religion is separate from politics and that religious institutions and personalities must remain above politics. Thus, the state is officially secular. Certainly, there is no political activity by the Buddhist establishment in a country where Mahayana Buddhism is the dominant 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. Bhutan’s One Nation, One People policy has since 1980s sought to promote uniform religious and cultural identity. The national flag and emblem also draw from Buddhist symbolism. 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 are not formally recognized by the government and have 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). In recent years, there have been efforts to modernize the civil service using foreign aid and technical assistance. 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 with more than 98.4% of 6- to 12-year-old children enrolled in schools in 2017. Secondary enrollment has also increased from 12% in 1985 to over 70% in 2017. According to the WHO, Life expectancy has risen from 52.4 years in 2000 to 70.6 in 2017 and 98% of households now have electricity (as recently as 2008 only 60% of households had electricity). As of 2017, 98% of the

No interference of religious dogmas



Basic administration



population have access to an improved water source and 81% to improved sanitation, although 18% reported irregular water supplies. Poverty levels were recorded at 23% of the population in a 2007 survey, but halved to 12% in 2013 and dropped to 8.2% in 2017; most poor people live in rural areas of the country. Tax as a percentage of GDP rose from 5% in 2004 to 19% in 2016. 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

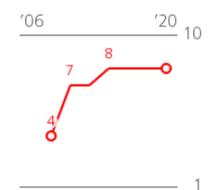
In 2018, Bhutan held the third round of elections to the National Council and National Assembly, the two chambers of its national parliament. Bhutan also has non-party elections at the local block (gewog) level. For the National Council, which is seen as a house of review, one member is elected for each district (dzongkhag) regardless of the population size.

For the National Assembly, the primary election serves to select the two parties for the general election. In both 2013 and 2018, four parties took part in the primary round. In 2013, 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). In the 2018 elections, the ruling party was again replaced by a third party, which was not party to the outgoing parliament. In the primary round elections for National Assembly held on September 15, 2018, a newly established party, the Druk Nyamrup Tshogpa (DNT), and the opposition in the last parliament, DPT, advanced to the general round of the third National Assembly election on October 18, 2018. In the general round, DNT won 30 seats, giving its leader, Dr. Lotay Tshering, the mandate to head the next government. Voter turnout in both National Council and National Assembly elections were higher than 2013.

Elections in Bhutan have been free and fair with no serious complaints concerning irregularities. The Electoral Commission has run elections strictly and impartially. Electronic voting across the whole country allows for the results to be revealed a few hours after the polling stations close. In 2018, voters also used postal voting to cast their votes. There were few cases of infractions of the electoral rules. However, low numbers of women competing and winning in the elections, and the weakness of parties due to strict rules, especially with regard to their funding, remain concerns.

Free and fair elections

8

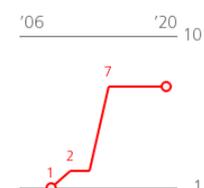


Bhutan's political elite is small and has demonstrated consistent loyalty to state and king. The military has no record of challenging the state, the clergy do not participate in politics, and there is to date neither a trade union movement nor a powerful business lobby. In short, there are no active 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 80% 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. A 75-day military standoff between India and China in Bhutan's Doklam area in 2017 exposed Bhutan's security vulnerabilities in the context of rising India-China tensions. 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. In 2018, four parties contested the primary round of parliamentary elections. Membership in political parties in 2013 was low, numbering between 135 and 799 members in 2013. However, political party membership has grown. In 2018, the DNT listed over 11,000 members, while the smallest political party reported over 1,000 members. 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

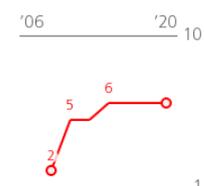
Effective power to govern

7



Association / assembly rights

6

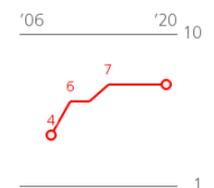


government. However, it seems that only one “solidarity march” has ever taken place, and that was in sympathy with the families of seven children who were swept away and drowned in a flood. Public protests are portrayed as a non-Bhutanese mode of behavior. Freedom of association has the proviso that 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. 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.

Bhutan’s constitution guarantees freedom of expression but its exercise in practice remains constrained. Journalistic expression has been hampered by Bhutan’s Defamation Act that can be used to harass journalists. In 2016, the famous Bhutanese journalist Namgay Zam was indicted under this act before the case was withdrawn. Namgay Zam complained that restrictive conditions for journalists had led to self-censorship and an exodus of talent. Another case that drew critical attention was the month-long suspension from his job of the managing editor of *The Journalist* in 2018. He was apparently suspended in response to a complaint by the Office of Media Arbitrator that the paper had violated the Election Commission’s oral directive not to run profile stories on National Council candidates. The Journalist Association of Bhutan (JAB) expressed concern that such practices may prevent journalists from performing their duties free from fear and bias. Bhutan will soon have a Media Council that will regulate journalists’ code of conduct and accreditation and certify journalist practitioners in the country. The council is mandated by Bhutan’s Information and Communications Act. The council will have representatives from the Journalist Association of Bhutan and from the media houses. All the political parties of Bhutan have pledged to defend and promote professional journalism in the country. In the 2018 World Press Freedom Index, Bhutan’s ranking fell to 94th position from 84th position in 2017. Still, Bhutan’s media environment was ranked the best among its South Asian counterparts. According to Info-Comm and Transport Statistics report 2018, the number of internet subscribers increased by 28% between 2016 and 2017 to 700,000. The rapid expansion is explained in terms of affordability of internet and cheap smartphones.

Freedom of expression

7



### 3 | Rule of Law

Separation of powers between the executive, legislative and judiciary is laid out in Bhutan's constitution, and is evolving in the context of its new democratic framework. Under Bhutan's parliamentary system, Bhutan's government has the support of a majority in the National Assembly. In all three recent elections, the governing party won a majority of seats.

The judicial branch functions independently of the executive and legislative, and judges are appointed by the king on the recommendation of the judicial council. As political and legal contests grow in a democratic system, demands for judicial adjudication of issues is on the rise, especially involving cases of corruption and abuse of power. The Anti-Corruption Commission plays an important role in the system of checks and balances on the exercise of power.

A National Law Review Task Force formed in 2015 to harmonize and consolidate legislation made several recommendations in 2018 to strengthen the separation of powers. For example, the Royal Civil Service Commission under the existing act remains the central agency for recruiting, training and transferring civil servants. But this provision of the act contradicts the constitutionally defined independent power of the judiciary and the Anti-Corruption Commission to recruit new employees and manage their own personnel.

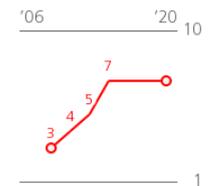
The constitution clearly sets out a separation of powers. The constitution places a strong emphasis on the rule of law, and the judiciary is empowered as the guardian of the constitution and final authority on its interpretation. The Supreme Court sits at the top of the court hierarchy. Below it are the High Court in the capital Thimphu, 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 gained credibility both domestically and internationally as the guardian and interpreter of the constitution. Courts at all levels of the judicial system have 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.

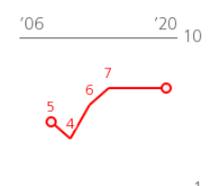
Separation of powers

7



Independent judiciary

7



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). In 2016, for example, 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 Chief Justice and that his actions challenged democratic freedoms. The defamation case was dropped in January 2017 but there were no comments by the judiciary. In 2017, in response to complaints by the defendant in this case concerning possible bias resulting from the plaintiff's relationship to the judge, the Supreme Court of Bhutan drafted a Judicial Accountability Guidelines 2017. The guidelines allow individual citizens to file complaints of bias against High Court and Supreme Court decisions. The Judicial Services Act 2007 only allowed for complaints and investigations against district-level judges.

The DPT's domination of the first National Assembly (controlling 45 out of 47 seats) has raised questions about the ability of the judiciary to counter executive power. The opposition PDP, however, 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 outcome. In the second parliament and now the third parliament, the opposition improved its strength by winning 15 or more seats. 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 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 was concerned about the message this judgment transmitted to public officials. In 2017 to 2018, Bhutan's courts have tried members of Bhutan's army and convicted Bhutanese diplomats in corruption cases.

There is a low incidence of corruption in Bhutan but there is considerable official and public concern about potential adverse effects from it. The Anti-Corruption Commission (ACC) 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%. 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 offense concerning land allocations committed before their election to office. In 2016, the ACC was involved in a case against the foreign minister.

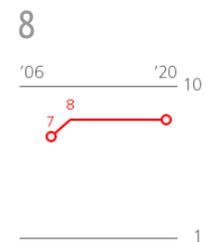
The Office of the Attorney General received 1,348 cases for prosecution in 2017, the highest so far. Of that number, 1,318 were forwarded by Royal Bhutan Police, 23 by the ACC, and seven by the Royal University of Bhutan, the Ministry of Agriculture, and the Ministry of Works and Human Settlement.

Demands for greater accountability on the part of government officials as well as politicians were frequently made in 2018. For example, as of March 2018, the Royal Audit Authority reported unresolved irregularities involving BTN 407 million. In May 2018, Thimphu District Court convicted the Former Head of Chancery of the Bhutanese Embassy in Thailand for embezzlement, official misconduct and deceptive practices while in office, and sent him to jail for nine years. In January 2018, the Prime Minister's Office sought an investigation against the former minister of works and human settlement under the previous DPT government. The minister's decision to revise the list of incentives for tourist standard hotels in 2013, just three days before the DPT government was dissolved, was seen to be suspicious. The DPT, in turn, accused the prime minister of corruption in relation to the building compound walls and security infrastructure at the prime minister's private residence. In view of further allegations of corruption, in 2018, Bhutan's National Assembly made several recommendations to review and amend the Anti-Corruption Act 2011 with the aim of more clearly defining various types of corruption.

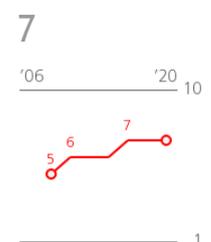
The fundamental civil rights are set out in Article 7 of the constitution, but refer in most cases to citizens only, like the freedoms of speech, opinion, expression, movement and religion and the right to vote, and equality of access to public services and before the law. However, according to Article 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 well-being are judged to be threatened.

There is no capital punishment. According to the U.S. State Department, there were no incidents of disappearances, arbitrary killings or torture in 2018. Prisons have been

#### Prosecution of office abuse



#### Civil rights



judged to generally meet international standards. 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.

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. In 2018, Bhutan rose slightly to the rank of 122 out of 149 countries.

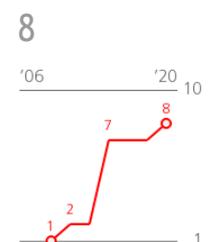
The report showed considerable gender disparities in health, education, economy and politics. There have been media reports indicating a rise in the incidence of domestic violence and sexual assaults. The government acknowledged the seriousness of the issue by passing the Domestic Violence Prevention 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 that focus on women's and children's issues.

#### 4 | Stability of Democratic Institutions

As a young democracy, Bhutan's democratic institutions function well. All three elections have seen alternation of power from the ruling party to another party. Political parties, though respectful of each other, face growing opposition from their rivals. For example, during the 2018 election campaign, opposition parties questioned the ruling party's performance in office and the improper use of government resources. Parties have become more attentive to the electorate's concerns (e.g., income inequality, and access to health care and drinking water), making democracy more relevant to people's common problems. The election of two women as members of the National Council in 2018 and seven women to the National Assembly also marked an improvement.

Bhutan's parliament will have the strongest opposition presence following the 2018 elections. The Druk Phuensum Tshogpa (DPT), which formed Bhutan's first democratic government after 2008 elections, won 17 seats in the new parliament. In 2008, the opposition won only two seats and 15 seats in 2013. The new government has promised to narrow the income gap and make health care more accessible. Government departments in Bhutan have a problem in coordinating in the

Performance of democratic institutions



formulation and implementation of policies and programs. Bhutan's judiciary and the Anti-Corruption Commission have been dealing with the growing number of corruption and abuse of power cases.

Bhutan's democratic institutions have progressively consolidated since the first national democratic elections in 2007 and 2008. There are no active veto players and no individuals or organizations advocating significant change to the political system. All political parties are uniformly supportive of the democratic system, and the ruling parties in both the 2013 and 2018 elections smoothly handed over power to the new majority parties. Higher voter turnouts in elections for both houses of parliament in 2018 than in 2013 showed increased support for the electoral process. Increasing use of electronic voting machines and postal votes has helped streamline the voting process.

## 5 | Political and Social Integration

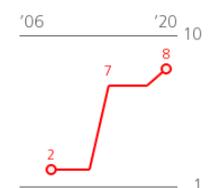
Bhutan's party system is young, without strong links to or deep roots in society, and low ideological and programmatic polarization. Parties have small memberships, which ranged from 142 to 799 members for those in the 2013 National Assembly election. In the 2018 election cycle, the four political parties that participated in the primary round reported higher memberships. The newly established DNT, which has formed the new government, reported over 11,000 members. The other three parties ranged from 1,275 to 5,520 members. In March 2018, the Druk Chirwang Tshogpa (DCT) dissolved to merge with the Druk Phuensum Tshogpa (DPT), with the new party offering a strong force for the upcoming elections.

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. Party platforms were not much different in 2018. All four parties in the primary round pledged to improve income, employment, access to health care and drinking water.

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. The amount in U.S. dollar terms remained the same in the 2018 elections. Political parties contest seats only in the National Assembly. The National Council elections are non-partisan and political parties are also banned from participating in local-level elections.

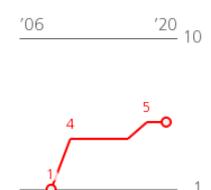
Commitment to democratic institutions

8



Party system

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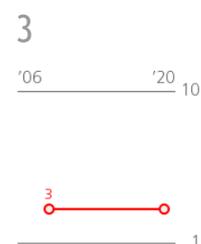
Clientelist networks have not developed in Bhutan. Voters are unconstrained in making their electoral choices. This was demonstrated in the 2013 and 2018 elections. In 2013, many incumbents stood but were not returned and the opposition party from the first parliament became the governing party. In 2018, a newly formed party surged ahead and won a majority in the National Assembly elections, beating both the ruling and opposition parties from the previous parliament. As the general round of National Assembly election is between the top two parties, the runner-up party is recognized as the only opposition in parliament, making the other parties in the primary round largely irrelevant in the governing process.

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.

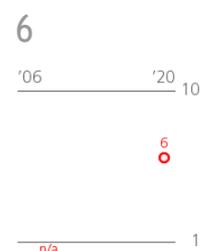
Opinion poll survey data is very limited. In the 2010 Gross National Happiness survey, 92% of respondents indicated an intention to vote in the next election, which survey reporters interpreted as a commitment to democracy. It may equally indicate a recognition of civic duty. Questions on political freedom 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. In the 2015 survey, the proportion of people who rated the performance of the government as either "very good" or "good" declined significantly from 2010, especially with regard to the government's performance in creating jobs, narrowing the gap between the rich and poor, and fighting corruption.

A December 2012 survey of 416 individuals for a book on democracy in Bhutan found that 45% of respondents preferred the "new" system, 21% the "old" and 31% perceived the two systems to be the "same." There was a substantial decrease from 2008 in preference for the "old" system. In addition, 91% of respondents described democracy as a "means to influence decisions and a way of bringing about change" by voting, indicating a basic understanding of the concept of democracy. Meanwhile, 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 round of the National Assembly election, indicating that voter intentions were not carried through

#### Interest groups



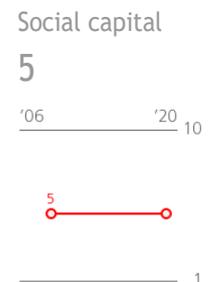
#### Approval of democracy



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. Compared to 2013, voter turnout was higher in both National Council and National Assembly elections in 2018. In April 2018, 54.3% of the registered voters cast their ballots in the National Council elections, an increase of nine percentage points from 2013. In the primary round of the 2018 National Assembly elections, voter turnout was 12 percentage points higher at 66%, an encouraging sign of greater participation. In the general round of the National Assembly election in October 2018, voter turnout was 71.46%, an increase of five percentage points from 66% voter turnout in the 2013. These figures could be seen as greater awareness and support for democracy.

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. The rise of competitive political parties and elections have increased personal contacts between political leaders and the public. The rapid increase in internet penetration and access to social media in the country has also reportedly increased discussion of politics and policy matters.

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.



## II. Economic Transformation

### 6 | Level of Socioeconomic Development

In 2018, Bhutan's GNI per person was \$2,400. The improved GNI has qualified Bhutan to graduate from its LDC status according to the United Nation's Committee for Development Policy (UNCDP). The GNI threshold of three-year average for graduation is \$1,242 per person. Bhutan has also improved its Human Asset Index, another indicator of vulnerability associated with LDC status, from 45 in 2000 to close to 73 in 2018, driven mainly by an increase in gross secondary education enrollment. Bhutan's graduation date from its LDC status has been postponed to 2023 following Bhutan's request for more time to prepare for this transition.

Bhutan's 2017 Human Development Index (HDI) of 0.612 as compared to 0.510 in 2005 marked a significant improvement resulting from increased life expectancy, greater number of students staying in school, and an increased per capita income. Since 2005, Bhutan's life expectancy at birth increased from 64.9 years to 70.6 years in 2017. The expected number of years of schooling also almost doubled in the same period. In 2017/18, Bhutan maintained an impressive economic growth rate of over 7.5%, making it the fastest growing economy in the developing Asia region, according to the Asian Development Bank (ADB). The ADB projection for 2018 was 7.1% and 7.4% for 2019. With slower growth in industry and agriculture, the service sector remained the engine of growth.

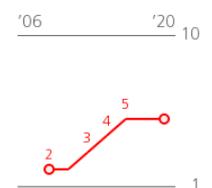
According to the Population and Housing Census of Bhutan (PHCB) Report 2017, 96.6% of the country's households reported using electricity for lighting, an increase of approximately 40% over 2005. More than 98% of households also reported having access to improved sources of drinking water. However, 18% of households reported that the source of drinking water was not reliable.

Income and gender inequalities remained major challenges. Bhutan ranked 134 out of 189 countries in the latest Human Development Index (HDI) released by the United Nations Development Program (UNDP). Poor female representation in the parliament has remained a major concern. The proportion of women in secondary education and the labor force is also well below the equivalent proportion of men. The gap in education is starker at secondary and higher education as the enrollment of girls in primary education has leveled with that of boys. Only 6% of women in Bhutan have attained at least a secondary-level education as compared to 13.7% men. Compared to 29.6% female representation in Nepal's parliament, women comprise only 8.3% of members of parliament in Bhutan, while the average in the South Asia region is 17.5%. Female participation in the labor force stands at 58%, whereas the

Question  
Score

Socioeconomic  
barriers

5



male participation rate is at 83%. Bhutan ranks 117 out of 160 countries in the Gender Inequality Index (GII). High unemployment among young people remains another challenge, with the youth unemployment rate 10.6% in rural areas and 16.7% in urban areas. Since the last census in 2005, Bhutan's population growth rate has declined well below the replacement rate of 2.1. At this rate, Bhutan's population growth would become negative in the next seven years, a concern noted by Bhutan's government.

Economic indicators		2015	2016	2017	2018
GDP	\$ M	2059.8	2219.7	2528.0	<b>2535.0</b>
GDP growth	%	6.6	8.0	4.6	<b>2.3</b>
Inflation (CPI)	%	4.5	4.3	3.9	<b>2.7</b>
Unemployment	%	2.5	2.3	2.2	<b>2.2</b>
Foreign direct investment	% of GDP	0.3	0.5	-0.7	<b>0.1</b>
Export growth	%	-3.5	-9.1	11.6	-
Import growth	%	16.2	-12.4	3.7	-
Current account balance	\$ M	-548.3	-622.7	-540.4	<b>-497.6</b>
Public debt	% of GDP	95.7	109.2	108.0	<b>102.4</b>
External debt	\$ M	2011.1	2289.7	2607.9	<b>2549.2</b>
Total debt service	\$ M	128.9	110.6	82.5	<b>87.4</b>
Net lending/borrowing	% of GDP	-0.9	-1.2	-4.0	-
Tax revenue	% of GDP	12.8	12.5	12.0	-
Government consumption	% of GDP	17.8	16.8	16.4	-
Public education spending	% of GDP	7.4	6.8	7.0	<b>6.6</b>
Public health spending	% of GDP	2.7	2.6	-	-
R&D expenditure	% of GDP	-	-	-	-
Military expenditure	% of GDP	-	-	-	-

Sources (as of December 2019): 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

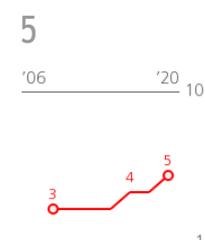
In Bhutan's economy, the state plays a major role through state-owned enterprises that contribute 50% of tax revenue. Hydropower accounts for 85% of that revenue. There is government involvement in pricing in such items as gasoline, bus fares, propane and even meat. There are few large private companies and a small, unregulated commercial informal sector. Generally, market access, and demand for Bhutan's goods and services are rather favorable due to the country's completely open access to the Indian market as part of one of the most liberal trade agreements in the world. However, market-based competition is still at a rudimentary level in a very small economy.

Formally, foreign investment is given the same treatment as similar domestic investment. Foreign ownership is allowed in education services (except technical and vocational institutions), private health care, five-star hotels, infrastructure, research and development, head office services, and information technologies. Up to 51% foreign ownership is allowed in the financial services industry, while up to 74% foreign ownership is allowed in all other activities. Exceptions to this liberal policy include media and broadcasting, the distribution of services in wholesale, retail and micro trade, and mining and the sale of minerals in primary or raw form. 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 informal sector dominates the economy, with only 23.1% of employment 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 worked in agriculture in 2015, agriculture accounted for only 16% of GDP. There is still a strong subsistence character to much agricultural production.

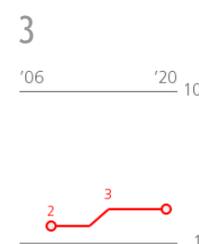
Bhutan has continued to introduce regulatory reforms to improve the business environment and access to foreign finance for the private sector. In the "starting a business" category of the World Bank's Doing Business report 2019, Bhutan ranked 91 out of 190 countries. Since 2013, the time it takes to start a business has been cut by two-thirds. Starting a business takes 12 days and eight procedures with a cost of 3.5% of GNI per capita. The shortage of Indian rupees is the main hurdle for businesses.

Market  
organization



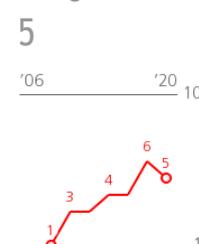
With the absence of a significant private sector, the state has founded a number of enterprises. Some of these have been privatized and others corporatized. A substantial state-owned enterprise sector remains, presiding over some monopolies such as television, electricity, sand, timber and postal services. There is a limited number of large private sector corporations. There are no laws on anti-competitive 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 Protection. There appears to be low awareness of the act and there are 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. In 2015, instead of a competition law the government of Bhutan decided to adopt the National Competition Policy. The decision was taken after a careful evaluation of enforcement capacity within the country under the active assistance of UNCTAD. The National Competition Policy was drafted to create fair competition, prevent business monopolies, and encourage small- and medium-sized enterprises (SMEs) via the prerequisite for the government to conduct an impact assessment for new legislation with regard to competition, and existing laws and practices. Infrastructural facilities and public services are explicitly excluded from the rules of the National Competition Policy. Bhutan has moved up slightly on World Economic Forum's Global Competitiveness Index. It was ranked 97 out of 138 economies on the 2016 to 2017 index, a rise from 103 of 144 in 2015 to 2016 and 109 of 148 in 2014 to 2015. In the 2018 Competitiveness Index, Bhutan ranked 82 out of 140 countries. Among its South Asian counterparts, Bhutan ranked second behind India.

### Competition policy



Bhutan has made modest efforts to promote trade liberalization. It enjoys observer status in the WTO. A WTO reference center was established in Bhutan in 2016 to provide information on the WTO and international trade issues. In 2017, Bhutan's government decided not to join the WTO at this time; Bhutan had also refused to become a member of WTO earlier in 2009. The impact of WTO membership over Bhutan's Gross National Happiness (GNH) program and doubts over Bhutan's ability to benefit from WTO membership are some of the major concerns. 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). Bhutan has yet to join the land transport agreement known as Bangladesh, Bhutan, India and Nepal (BBIN) Motor Vehicle Agreement. 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. A 2013 Asian Development Bank (ADB) report classified Bhutan's 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. Bhutan scores low on the Logistics Performance Index, ranked 135 out of 160 countries in 2016. The landlocked situation of Bhutan creates difficulties shared by

### Liberalization of foreign trade



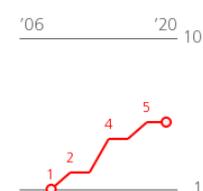
comparable Asian countries such as Nepal and Mongolia, but Bhutan has the added issue that it has no direct cross-border trade link with its northern neighbor, China. The bulk of Bhutan's imports and exports are from countries with which Bhutan enjoys free trade or preferential trade, notably India, 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. There are now five banks including four commercial banks and the Bhutan Development Bank, which is concerned with financing rural development. 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 2015 to 79 in 2016 to 2017. The banking sector has been advancing "steadily" according to the Asian Development Bank. 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 Indian 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. According to World Bank, as of March 2018, the gross non-performing loan (NPL) ratio was 14.6%, two percentage points higher than a year ago, which in turn, lowered the profits of financial institutions. However, the assets of banks have increased by a greater amount; according 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.

According to the Royal Monetary Authority's (RMA) financial sector review the total deposit base of the banking sector increased from BTN 97 billion in 2016 to BTN 109 billion in December 2017, an increase of 17.6%. Compared with 2016, saving accounts deposit increased by almost BTN 4 billion. Similarly, the current deposits that are mainly maintained by private businesses also increased from BTN 23 billion in 2016 to BTN 30.7 billion in 2017, reflecting an increase of more than BTN 7 billion. The banks also met the mandate to set aside a certain proportion of deposits and quick assets to ensure they meet their day-to-day obligations.

#### Banking system

5



## 8 | Monetary and fiscal 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 directly by the rate of inflation in India. Inflation in 2012 was the highest ever at 10.32%. The shortage of Indian rupees resulted in temporary bans on certain imports such as cars, and the scarcity of some goods such as building materials. Since 2012, inflation has dropped steadily to reach its lowest level ever at 3.22% in 2016. In 2017, inflation remained around 5%. The Indian rupee is recognized as legal tender in Bhutan although only for notes up to INR 100. The introduction of GST in India has had a positive impact on lowering inflation; GST removes all levies on goods exported out of India.

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 that maintains its independence from government.

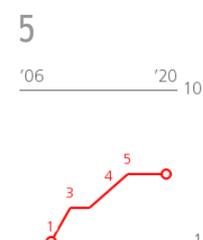
In 2017 to 2018, Bhutan recorded a government budget deficit equal to 4.10% of the country's GDP. Bhutan's budget since 2002 has ranged from an all-time high surplus of 4.10% of GDP in 2014 to a record deficit of -12.8% of GDP in 2002. The World Bank and Asian Development Bank estimated a much higher deficit due to the impact of GST, the delay of hydropower projects and other economic problems.

Bhutan reduced its trade deficit in 2017 to BTN 29.7 billion from BTN 32 billion in 2016. In 2017, its imports totaled BTN 67 billion whereas export reached BTN 37.3 billion. Bhutan's main exports include electricity, silicon products, other mineral-based products and cement. Electricity was its biggest export, totaling BTN 12 billion.

About 80% of Bhutan's trade is with India. The trade deficit with India was over BTN 22 billion, a slight drop from 2016. Bhutan's imports consist of diesel, petrol, rice, meat, fish and dairy produce. In recent years, the country has also been importing a growing number of vehicles and accessories, many from India. Prime Minister Dasho Tshering Tobgay expected to see a decrease in the trade deficit with the renewal of the India Bhutan Agreement on Trade, Commerce and Transit in 2016. Bhutan also expected to increase its electricity exports to improve its trade balance.

Bhutan's public debt has risen rapidly in recent years from 66.6% of GDP in 2010 to a projected 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

### Monetary stability



### Fiscal stability



judged Bhutan's external debt as only a "moderate risk" 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. 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. In 2017, the current account deficit was recorded as 24.4%. 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.

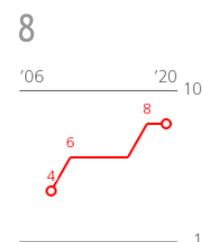
## 9 | Private Property

The constitution guarantees Bhutanese citizens the right to hold property. 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 and 82 in 2019. 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.

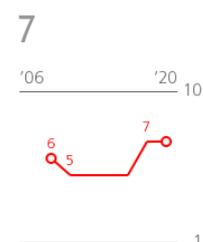
Bhutan recognizes people's rights in relation to their intellectual property and, according to the World Intellectual Property Organization (WIPO), has 24 legal texts related to the safeguarding of intellectual property. These range from the Copyright Act and Legal Deposit Act through to the Seeds Act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

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 number of state-owned enterprises (SOEs) operate in commercial sectors, such as television, electricity, sand, timber, postal services, finance and aviation. According to the World Bank, strong linkages between government officials and management of the SOEs privileges public firms over private enterprises. Bhutan has few large private sector corporations. There are no laws on anti-competitive practices, monopolies or cartels. Bhutan does offer some competitive advantages for private sector development

Property rights



Private enterprise



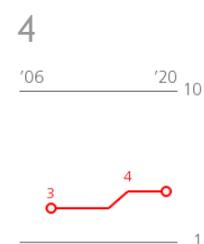
including political stability, good governance, low levels of corruption, access to electricity, an abundance of natural resources and preferential access to the huge Indian market. The World Bank's 2017 Investment Climate Assessment (ICA) pointed to the persistence of many constraints on private sector development. Based on a survey of 130 Bhutanese firms, the report highlighted limited access to finance and the lack of skilled labor as major hurdles for higher productivity and increased investment in the private sector. The report also found that private sector access to both domestic and international markets were limited by deficiencies in transport, logistics and customs procedures. Bhutan released the National Intellectual Property Policy 2018, which includes a new system called the geographical indication to protect product designs.

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. Government efforts to boost innovation in the private sector have met with low levels of success. About 28,000 registered businesses in Bhutan. 92% are micro businesses. 76% employ less than five persons. 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. In 2019, its rank declined to 82. The improvement in ratings, however, has yet to be reflected in increased foreign direct investment (FDI) or a strong small- and medium-sized enterprise (SME) sector. Bhutan's ranking of 82 out of 140 countries in the Global Competitive Index 2017/18 shows significant improvement but the country still remains well inside the bottom half of the rankings.

## 10 | Welfare Regime

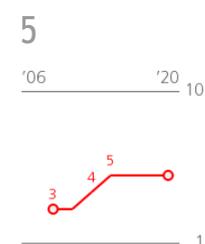
The state provides free education and health care to all citizens. It does not provide other welfare benefits such as social security payments, conditional cash transfers or food subsidies. Public servants, the military, employees of state-owned enterprises and some private sector employees do have access 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 people 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. The new government led by the DNT has pledged to establish another national referral hospital, provide free Wi-Fi, launch the Sung Joen app (a free chat app), and pay breast-feeding allowances as part of its 2018 campaign pledge to reduce the gap between rich and poor.

### Social safety nets



Bhutan fell from rank 93 to 124 between 2013 and 2017 in the World Economic Forum's Global Gender Gap report. Leadership positions are still dominated by men. In 2013, 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. In 2018, a party led by a woman participated in the primary but failed to advance to the general election. In the 2013 – 2018 parliament, only four of 47 members of the National Assembly were women and there were only two women in the 25-member National Council, with both women in the National Council appointed by the king. In the 2018 elections, seven women were elected to National Assembly. Two women were also elected to the National Assembly. 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). ILO model estimates this rate to have reached 67% in 2018. More women continue to work in agriculture than men. Discrimination based on language and religion is common among the few minorities. The U.S. State Department's 2017 Human Rights Report on Bhutan, which cited informed sources, estimated the number of stateless families to be 1,000, mostly Nepali-speaking people in the south. Stateless persons are denied access to many state services including health care, education and employment opportunities.

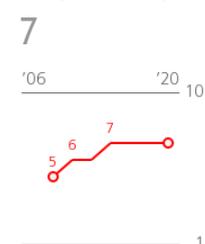
#### Equal opportunity



## 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 had predicted GDP growth for 2017 to be 8.6%. However, Bhutan's GDP grew by an average of a little over 7% in 2017–2018, which still made it one of the fastest growing economies, according to the Asian Development Bank (ADB). Growth in agriculture has been low or stagnant despite over 50% of the population depending on agriculture 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. According to the FDI annual report 2017, Bhutan approved five projects in 2016. The current account deficit in 2017 was 24.4%.

#### Output strength

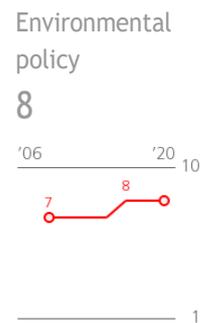


Public debt measured increased from 94.8% of GDP in 2015 to 107% of GDP in 2017. According to the latest statistical bulletin of the Royal Monetary Authority (RMA), outstanding external debt has increased by almost BTN 50 billion between the 2013/14 fiscal year and September 2017. Most of Bhutan's external debt is owed to India. There has been a substantial inflow of grants and loans from multilateral and bilateral donors. Inflation, mostly determined by the inflation rate in India, was 10.9% in 2012 but dropped to 2.95% in 2018, the lowest since 2004. The unemployment

rate remained steady ranging between 2.5% and 3.5% between 2005 and 2015. Youth unemployment was 9.5% for men and 11.6% for women, and is a major policy concern, with rates in urban areas twice as high as in rural ones.

## 12 | Sustainability

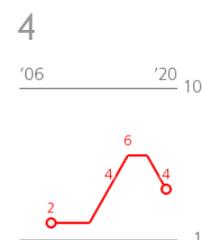
The constitution declares that it is “a fundamental duty of every citizen to contribute to protection of the natural environment, conservation of the rich biodiversity of Bhutan and prevention of all forms of economic degradation.” The importance of the environment in Bhutan is also emphasized in the national development philosophy of Gross National Happiness (GNH) and features strongly in the five-year national development plans. Bhutan ratified the U.N. Framework Convention on Climate Change (UNFCCC), as well as the Kyoto Protocol in 1997 and the Paris Agreement in 2015. 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, livestock in excess of the land’s carrying capacity in some areas, and a growing number of vehicles. In 2018, the World Bank granted \$4.8 million to support the country’s efforts to reduce greenhouse gas emissions. Since 2015, Bhutan has imported an average of 20 new vehicles per day and, by June 2018, there were 96,307 vehicles in the country. 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 the 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. In 2017, the adult literacy was 66%, up from 63% in 2012. These figures reflect the late development of mass education in the country. Among young people aged 15 to 24 year, the literacy was 93% in 2017. The amount spent on education was equivalent to 7.1% of GDP in 2017.

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 to 12 school-leavers, there has been rising pressure to create appropriate jobs. The Bhutan Education Blueprint 2014 to 2024 identifies education as the highest priority, and seeks to enhance access, quality, equity and system efficiency. Books 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 2017 to 2018, 18% of the national budget was allocated to education. The government also introduced measures to improve education by providing greater opportunities for teacher training and more standard exams for students. In 2018, Bhutan also announced a policy to provide a laptop to every teacher in the country and a drive to connect all schools to the internet by 2023. Bhutan is reviewing its national education policy to recalibrate various areas of teaching and evaluation, and better accommodate children with special needs. Bhutan ranked 136 out of 187 countries in the U.N. Education Index of 2013 with a score of 42. Bhutan will need to substantially improve the quality of its school and college education in order to reduce youth employment.

#### Education policy / R&D



## Governance

### I. Level of Difficulty

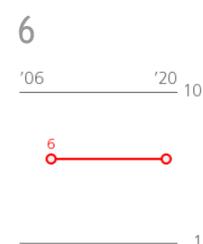
Bhutan is a landlocked country with a small market spread across the country's complex and largely mountainous terrain. Road infrastructure is constantly being improved and the east-west axis across the country is motorable and used by buses, trucks and private cars. However, landslides are a hazard 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. Climate change has raised the risk of flash floods and landslides.

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 traveling 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.

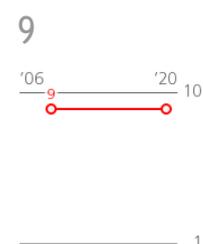
Bhutan has been successful in fighting poverty, cutting the rate from 23% in 2007 to 12% in 2012 and down to 8.2% in 2017. Poverty has been reduced in rural areas where living conditions, amenities and dietary behaviors have improved during the period of 2007 to 2017. However, many rural households subsist 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 development of modern civil society has been gradual. In 2010, the CSOA website listed ten public benefit organizations

Structural  
constraints



Civil society  
traditions



(PBOs) and one mutual benefit organization (MBO). By 2018, the number of PBOs had grown to 35. There were nine MBOs in 2018. 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. 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. Still, the issue of minority-majority relations could lead to future tensions in Bhutan’s society. 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.

Conflict intensity

2

'06 '20 10



## 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. GNH 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 long-standing utilization of five-year plans to give strategic direction to national development in the context of GNH. In 2018, Bhutan completed the 11th five-year plan (2013 – 2018) and began its 12th five-year plan (2018 – 2023). The 11th five-year plan focuses on strengthening institutions, systems, capacity-building and enhancing the quality of goods and services. According to the Gross National Happiness Commission (GNHC), the 12th plan will emphasize the three Cs (i.e., coordination, consolidation and collaboration) to ensure that the plan achieves its goals.

As with the previous five-year plan, India remains the largest financial backer for the plan with a commitment to provide BTN 45 billion in assistance for the 12th five-year plan. The advent of democratization has not disturbed 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

Question  
Score

Prioritization

7

'06 '20 10



they advocate to achieve it. The increasing costs of funding the five-year plans, over BTN 300 billion for the 12th five-year plan, present a challenge for government finances. Meanwhile, some of the outputs, most notably, the growing number of educated but out-of-work young people, are creating new policy problems. In 2017, the World Bank funded five development projects in Bhutan to promote economic growth. Projects included the Bhutan Living Standard Survey; the Preparation of Strategic Program for Climate Resilience; the Food Security and Agriculture Productivity Project, which aims to reduce reliance on food imports; and the Youth Employment and Rural Entrepreneurship Project, which aims to create more jobs.

The opposition in the first National Assembly was numerically weak with just two as compared to the government party's 45 members. In the second National Assembly, the opposition party had a much greater numerical presence with 15 members compared to the government party's 32. In the current National Assembly, the opposition DPT holds 17 seats compared to the governing DNT's 30 seats. The National Council is explicitly non-partisan.

Little or no internal strife within the previous or current cabinets has been reported. Though this is to be 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 and members cannot switch parties, 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. The 12th five-year plan seeks to better target achievement through improved coordination and, for the first time, allocating 50% of the planned budget to local bodies.

Implementation

8



1

Bhutan has demonstrated a capacity to learn from its own experiences and from those of other countries (not only neighboring India). The most remarkable item of policy learning has been the transition from a long-standing authoritarian political regime to a constitutional monarchy. The transition has been smooth and reflects the country's ability to adapt imported institutions to fit the Bhutanese context. However, some authoritarian practices remain, such as the difficulty of obtaining information from the government and constraints on the media.

From multilateral organizations (e.g., 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 guidance on good practices. However, this technical assistance is not always of the best or most appropriate quality. It has sometimes lacked an adequate depth of understanding of the Bhutanese situation. This raises the possibility of misguided policy transfer.

Government officials travel overseas to boost their own knowledge and understanding of particular issues and practices. A considerable number of students relative to the country's population have been going overseas for training and education. These activities 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. The government continually engages in a search for innovative policies. For example, the 10-year Bhutan Education Blueprint (BEBP 2014–2024) aims to increase access, quality, equity and efficiency in education. The 12th five-year plan (2018–2023) aims to improve coordination between government organizations. The adoption of this goal is rooted in the government's experience from the implementation of the previous plan.

## 15 | Resource Efficiency

Bhutan's public administration system has been traditionally bureaucratic, focusing on hierarchy, seniority and process. The government has engaged in a process of public management reform to improve the performance of its bureaucracy. 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

### Policy learning

7



### Efficient use of assets

7



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 a problem. As of March 2018, Bhutan's external debt stood at \$2.6 billion or 115% of its estimated GDP. Around \$1.7 billion (INR 118 billion) worth of the total debt comprises outstanding Indian rupee loans. Of the total Indian rupee debt, 94.1% was outstanding public debt on hydropower projects. The rest of the debt was incurred in financing Bhutan's balance of payments deficits with India. India remains Bhutan's largest creditor with 73.53% of overall external debt. This points to a moderate risk of debt distress. For the fiscal year 2017/18, the budget deficit was 4.1% of the GDP. It was expected to increase during the 12th five-year plan period due to the DNT's plan to spend more on welfare schemes.

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 2023. Bhutan relies on India for considerable budgetary support. In 2017 to 2018, Bhutan received 48% of India's foreign aid budget (e.g., total foreign aid); this was a decline from 63% in 2015/16. 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.

Bhutan's public administration system has traditionally been highly 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 upward accountability. This has contributed to low levels of corruption.

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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

Policy  
coordination

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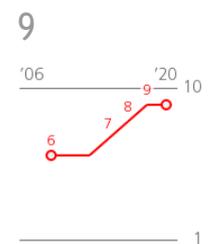
still work according to clearly delineated functional responsibilities that may sometimes hamper more whole-of-government approaches. There is administrative decentralization to the country's 20 dzongkhags. Appointed officials from the civil service are posted by central government agencies to work in dzongkhag administrations with locally elected officials to produce plans at dzongkhag and gewog levels, which 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 by government officials in the dzongkhags. Hierarchy is still a major organizational principle in Bhutan.

The government of Bhutan has a good record in containing corruption. 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. In recent years, the ACC has been very active in investigating and prosecuting corruption cases against civil servants and politicians. Bhutan's courts are also becoming increasingly active in adjudicating corruption cases. Sixth, the Royal Audit Authority (RAA) has been a leading force for financial accountability. 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.

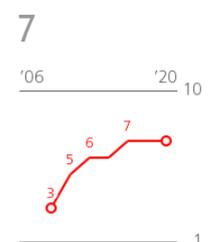
## 16 | Consensus-Building

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. There is broad agreement among political elites and the bureaucracy on the overarching policy directives set in the country's Gross National Happiness plan. The third national elections in 2018 marked the further 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, the same number as in 2013. Unlike in 2013, when voter turnouts were lower than in 2008, the turnout in

### Anti-corruption policy



### Consensus on goals



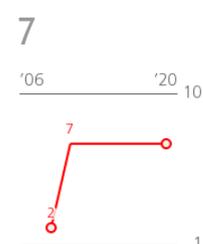
2018 was higher in elections for both National Council and National Assembly. Discussion of politics and policy issues among the educated population in urban areas is common, but whether democratic ideas are a topic of concern in the highly populated rural areas remains unclear. The rural population 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.

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. Both the outgoing government and the new DNT government have underlined the need to strengthen the market economy by easing regulation, and access to the market and capital.

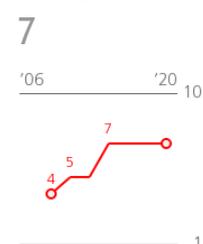
Democratization is widely supported. The monarch's solid support for democratic rule and high levels of deference to the monarchy among political parties and the public ensures stability. The monarchy is the only potential domestic veto player in Bhutan, but the king has remained indefatigable in his 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 the government is to be found among exiled populations but, so far, such opposition groups have had no impact on politics inside Bhutan.

Bhutan withstood a critical challenge to government authority in the early 1990s, which came from the Lhotshampa population in the south of the country. This resulted in up to 100,000 members from this group being expelled or fleeing to refugee camps in Nepal. Most have now been resettled in third countries, especially the United States. 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. Currently, there is no incidence of class-based conflict in Bhutan, although socioeconomic disparities are widening. In the 2018 elections, growing income inequality was highlighted by the DNT, the party that won the general election. The

Anti-democratic actors



Cleavage / conflict management

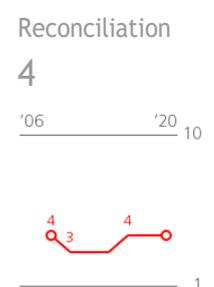
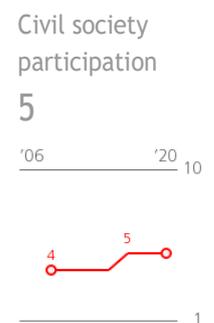


Gross National Happiness survey 2015 revealed a very slight increase in overall happiness from 2010 with 8.4% deeply happy, 35% extensively happy, 47.9% narrowly happy and 8.8% unhappy. There were inter-regional differences with seven dzongkhags recording low happiness, five with medium happiness and nine with high happiness, although the range was 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 endeavor 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 35 in 2018. There were nine MBOs in 2017. 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.

Explicit opposition to the Bhutanese government and political regime comes entirely from Lhotshampa exile communities, although this opposition is waning in influence. Since the departure of an estimated 100,000 people from the south of the country in the early 1990s, a variety of organizations, often based in refugee camps in Nepal, 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 people from the refugee camps. There is no process of reconciliation, but – with the resettlement of most refugees – the salience of this issue has dwindled.



## 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. Bhutan is the largest recipient of India's foreign aid budget, receiving 48% of it in 2018/19 and 57% in 2017/18. India also underwrites Bhutan's five-year plans. India provided INR 45 billion for Bhutan's 11th five-year plan – about 68% of the total external assistance received. In December 2018, India committed INR 45 billion for Bhutan's 12th five-year plan (2018–2023). India has provided the financial assistance for Bhutan's hydropower construction. Other aid suppliers include the major international financial institutions, the World Bank and the Asian Development Bank, as well as some U.N. 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. Bhutan's transition from LDC to a middle-income country has been postponed from 2021 to 2023 at the request of Bhutan's government in view of the greater challenges posed by the less favorable terms and conditions for international financial assistance that come with middle-income country status. In December 2017, Bhutan's National Assembly adopted the Anti-Money Laundering and Countering Financing of Terrorism Act. The act aims to prevent money-laundering and the financing of terrorism.

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. Over 90% have resettled in third countries, especially the United States, with less than 10,000 people remaining in the camps in 2018. Some refugee groups and their supporters in foreign countries maintain criticism of Bhutan's political system and the government's treatment of Lhotshampas, especially those who have been denied citizenship rights and are rendered stateless.

Effective use of support

9



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Credibility

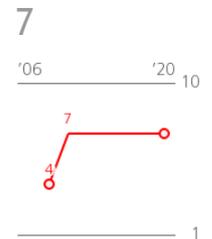
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In 1985, Bhutan was a founding member of the South Asian Association for Regional Cooperation (SAARC) and has played an active role in its affairs ever since. Together with the other SAARC members, it signed the South Asian Preferential Trade Arrangement (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 Center 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

With the third successful parliamentary elections in 2018, Bhutan's democracy has undergone further consolidation. Increased voter turnout in the national elections and the rise of a new political party to power indicate greater public interest in the democratic process as well as a greater willingness on the part of the electorate to try new leadership. The increased strength of the opposition in the new parliament could also enhance coordination between the ruling and opposition parties in policy-making as well as in holding the ruling party accountable. The overarching and unifying role of the king of Bhutan continues to bolster Bhutan's political and economic stability.

Bhutan's economy remains in good shape with sustained GDP growth. As Bhutan seeks domestic sources to fund 80% of the 12th five-year plan outlay of BTN 300 billion, diversifying the revenue base will be critical. Bhutan will need to reduce its excessive reliance on hydroelectricity in order to generate more jobs as the number of unemployed people is expected to reach 70,000 in the next five years. Growing inequality, especially between urban and rural areas, and the strain on cities due to the rapid migration of people from rural to urban areas will require the government to respond quicker to expand economic opportunities and infrastructures.

Despite its status as a carbon neutral country, Bhutan will also need to prepare itself for climate change-related disasters such as flash flooding and landslides with greater institutional resources and capabilities. Increasing agricultural productivity is equally important to contain rural migration and reduce Bhutan's reliance on food imports. The declining birth rate presents a looming challenge to Bhutan. Both the rising labor force participation rate of women and migration to cities are factors that contribute to the declining birth rate. Hence, the government will need to develop innovative policies to maintain a healthy population replacement rate. Bhutan's focus on Gross National Happiness provides key directives for development. The rise in drug dependency, property crimes and cases of corruption will need to be addressed effectively to keep GNH from losing its relevance for significant sections of Bhutan's population.

Bhutan's external relations, following the 2017 standoff between India and China over Bhutan's North Doklam area, will require substantial caution on the part of Thimphu to prevent Bhutan from being dragged into a future test of will between its two giant neighbors in its own territory. The realities of Bhutan's economic and defense dependencies on India will leave fewer desirable options for the country. Engaging both India and China to achieve a speedier resolution to border issues, and a recognition of Bhutan's neutral status from both of its neighbors will bolster the public's sense of security. Achieving this, however, will require sustained efforts.