

**NATIONAL BUDGET FOR FINANCIAL YEAR
1995 - 1996**

**AND
REPORT ON THE 1994-95 BUDGET**



**MINISTRY OF FINANCE
ROYAL GOVERNMENT OF BHUTAN**

JULY 1995

REVIEW OF THE 1994-95 BUDGET

The fiscal year 1994-95 is the third year of the 7th Plan. Every effort was made to fulfill the policy of maintaining a sustainable balance between revenue and current expenditure. The year, however, witnessed a major increase in current expenditure as a result of the introduction of the Special Government Allowance and increase in the travel allowances of civil servants and also due to the establishment of more schools and health facilities. In view of the rapid increase in current expenditure over the years and the limited scope for revenue enhancement, expenditure control was strictly enforced. While revenue was sought to be increased through enhanced efficiency, there were no changes in the tax rates or coverage.

The highlight of the 1994-95 budget was the introduction of the SGA for all categories of the civil service. The last pay revision was carried out in 1988 and as there was no system of compensation for the rise in cost of living, most of the civil servants particularly those at the lower levels were facing immense hardship in meeting even the basic necessities of life. The Royal Government therefore approved increases in the salary of civil servants ranging between 56 % at the lowest level and 4 % at the highest level. Ministers and Deputy Ministers were not granted any increase in the salary. The increase in the salary became an urgent necessity even though the Royal Government was facing serious budgetary difficulties as the cost of living had increased significantly over the years.

The daily allowances for travel within Bhutan also had to be enhanced to make it possible for civil servants particularly technical and professional manpower to undertake tours in connection with project

implementation and other field visits which are necessary for monitoring, supervision and generally improving the delivery of services.

In order to improve the well being of the national work force, the Royal Government also reviewed and enhanced the basic minimum wages for both skilled and unskilled workers. It was hoped that this would encourage Bhutanese nationals to work on projects and acquire skills so that the dependence on outside work force could be gradually reduced. The minimum wage was fixed keeping in mind the cost of living as well as the likely impact on private sector employment.

A summary of the approved budget and revised estimates for 1994-95 is presented below :-

<u>OUTLAY</u>	Original	Revised
	(Nu in millions)	
i) Current Expenditure	1720.152	1825.432
ii) Capital Expenditure	2996.513	3205.232
iii) Net Lending	-8.827	-7.050
iv) Repayments	301.669	188.120
TOTAL	5009.507	5211.734

SOURCES OF FINANCE

I. DOMESTIC RECEIPTS		
i) Internal Revenue	1633.225	1685.507
ii) Miscellaneous Receipts	0.000	109.189
SUB-TOTAL	1633.225	1794.696

II. GRANTS			
i)	GOI Program Grant	300.000	300.000
ii)	GOI Project Grants	633.984	647.783
iii)	Grants from Other Int. Agencies	1828.998	1996.430
III. ADJUSTMENT OF PRIOR YEAR			
	ADVANCE	0.000	9.970
IV. FINANCING			
i)	Borrowings from Other Ext. Sources	231.513	295.165
ii)	Resource Gap	381.787	167.690
	TOTAL	5009.507	5211.734

The overall budgetary outlay of Nu 5009.51 m increased by 4 % to Nu 5211.73 m by the end of the fiscal year. The increase in the capital budget was 7% and the increase in the current budget was 6.1 %. The increase in the capital budget has more or less been matched by increase in resources from international agencies. The current budget increased from Nu 1720.15 m to Nu 1825.43 m while the revenue projected at Nu 1633 m has increased to Nu 1794.69 m. The difference between the revised current expenditure budget of Nu 1825.43m and the total estimated domestic receipts of Nu 1794.69 m is Nu 30.74 m. Domestic receipts was therefore able to cover 98.3 % of the current expenditure.

The 1994-95 budget was marked by a major increase in the current expenditure on account of the Special Government Allowance and increase in Daily Allowances. In spite of the considerable budget increase, the overall budgetary deficit on account of both current and

capital cost as well as debt servicing, has been reduced to Nu 167.69 m from the projected amount of Nu 381.78 m. As indicated earlier, the gap between domestic receipts and current expenditure was Nu 30.74 m and hence the remaining amount of Nu 136.95 m was mainly on account of expenditure towards capital costs. The total budgetary deficit was the equivalent of only 2.1 % of the GDP. The Ministry of Finance is therefore pleased to report to the Hon'ble members of the National Assembly that the fiscal year 1994-95 has been yet another year of successful financial management for the Royal Government of Bhutan.

While the overall pace of development continued to progress steadily during the fiscal year, it is highly regrettable that the persistence of security problems have seriously impeded the implementation of the 7th plan projects and programmes in the Southern Dzongkhags. The frequent terrorist raids have not only disrupted development works but have jeopardized the very safety of project personnel as well as the villagers. The Royal Government, notwithstanding the precarious security situation, has however been able to keep 74 schools and 89 health facilities open for the benefit of the people in the five Southern Dzongkhags. Road, telecommunication and power supply have been kept operational and all industries and commercial activities in the Southern Dzongkhags have not been seriously affected. We fervently hope that peace and tranquility will return as soon as possible to the whole of Southern Bhutan so that the common people will be able to live without fear and pursue the path of development as in the past.

THE 1995-96 BUDGET

The fiscal year 1995-96 is the second last year of the 7th Plan which concludes on 30 June 1997. Hence the financial and economic situation during this fiscal year will provide an important basis for the formulation of the 8th Plan which commences on 1st July 1997.

The year itself starts on a positive note with substantial increase in revenue and improvement in the coverage of current expenditure by domestic revenue from 98.3 % in fiscal year 1994-95 to 100 %. While the achievement is laudable, we must not become complacent but be constantly on guard to ensure a sound and sustainable balance between revenue and current expenditures. Investment in the social sector, where there is no financial return in the near future, is still very high, exceeding 30 %, whereas the revenue base is still very small.

The Royal Government remains committed to bring about further improvements in the well being of the people of Bhutan. With the additional increase of service facilities and the general inflationary pressures, the cost of upkeep of schools, hospitals, agriculture and animal husbandry extension centres, roads, telecommunication, etc. is becoming more difficult to manage year by year. It is therefore, of utmost importance to enhance government productivity, curtail expenditures wherever possible, and increase revenue through improved efficiency.

Presented below is a summary of the 1995-96 Budget :-

	Budget Estimates (Million Nu)	% of Total
<u>OUTLAY</u>		
i) Current Expenditure	1872.055	36.3
ii) Capital Expenditure	3003.517	58.3
SUB-TOTAL	4875.572	94.6
iii) Net Lending	59.488	1.1
iv) Repayments	220.188	4.3
TOTAL	5155.248	100.0
<u>SOURCES OF FINANCE</u>		
I. DOMESTIC RECEIPTS		
i) Internal Revenue	1850.000	35.9
ii) Interest from on-lending	41.418	0.8
SUB-TOTAL	1891.418	36.7
II. OTHER MISC RECEIPTS		
	7.500	0.1
III. GRANTS		
i) GOI Program Grant	300.000	5.8
ii) GOI Project Grants	1145.219	22.2
iii) Grants from Other Int. Agencies	1388.445	27.0
SUB-TOTAL	2833.664	55.0

IV. FINANCING

i) Borrowings from Other Ext.		
Sources	266.136	5.2
ii) Resource Gap	156.530	3.0
SUB-TOTAL	422.666	8.2
TOTAL	5155.248	100.0

The total outlay for the fiscal year 1995-96 is Nu 5155.24 m. The current expenditure budget outlay is Nu 1872.05 m and the capital expenditure budget outlay is Nu 3003.51 m.

On the external assistance front, Indian aid disbursement is expected to increase to Nu 1445.22 m from the revised outlay of Nu 947.78 m in 1994-95. This is mainly on account of expected expenditure on Kurichhu Power Project and Paro Airport terminal building. Grants from other international agencies is expected to be Nu 1388.44 m. While donor commitment has remained steady and positive, the level of aid disbursement varies significantly from year to year depending upon project readiness and phase of implementation of on-going activities.

Over the years, Bhutan has been able to achieve highly satisfactory levels of aid disbursement. With the streamlining of the aid coordination system and improved project implementation, aid utilization has become more effective. Moreover, the impact of donor assisted projects, especially in the social sectors like health, education, water supply, rural development, etc. have been significant and highly visible. In spite of immense difficulties presented by shortage of skilled and unskilled manpower and communication problems, the Royal

Government has spared no efforts to ensure successful implementation of donor assisted projects. The Ministry of Finance is proud to report that Bhutan's record on aid management and utilization is amongst the best in the developing world.

Many of the externally financed projects started only in 1994-95 and are being continued in 1995-96. Hence, during the remaining years of the 7th Plan, the budget outlay will continue with the same trend without major fluctuations. During the fiscal year 1995-96, the increase in the current expenditure outlay over 1994-95 is only Nu 46.62 m which is quite insignificant. On the other hand, internal revenue estimate increased by 10 % to Nu 1850.00 m. Total domestic revenue is therefore expected to cover 100 % of the current expenditure.

REVENUE

Bhutan is today a social welfare state where health and education are free and all other development services are provided on highly subsidized basis to the people. In other welfare societies, people pay for the benefits through very high taxes. In Bhutan, tax rates remain negligible, and user charges or fees are subsidised and well below actual costs. In its quest for ensuring the well-being of the people and at the same time minimizing the financial burden particularly on the poorer people, the Royal Government had consciously avoided increasing the tax rates. In fact, taxes on the common people, particularly the rural population, have not been increased for the last 34 years even though there has been significant increases in the income levels of the people during the same period.

In spite of significant improvement in the administrative capacity of the Division of Revenue and Customs and enhanced efficiency, tax

collection while increasing steadily remains rather low. The following shows the position of tax revenue over the 7th plan period.

1992-93	1993-94	1994-95	1995-96	1996-97
447.2 m	503.22 m	650.88 m	681.31 m (proj.)	718.70 m (proj.)

As is evident from the table, tax revenue has not increased much over the years. Rural taxes in particular continue to be extremely low. The level of rural taxes in 1994 was Nu 5 m which is only about 0.3 % of total revenue. This is especially glaring given that over 80 % of the people are farmers. Even business income tax is only 3 % of total revenue indicating that business people pay hardly any taxes. Moreover, most of the tax revenue comes from public or joint sector corporations and consumer taxes like sales tax and excise duty. The total tax revenue is only 39 % of the overall revenue of the Royal Government. The bulk of the Government's revenue comes from earnings from public enterprises, dividends, etc. It is very clear from the above that the Bhutanese people continue to be amongst the least taxed in the world. The tax revenue forms only 9 % of the GDP which is extremely low.

In keeping with the Government's policy of streamlining the tax administration and recognizing the inefficiency of quantitative restrictions, the Ministry of Finance proposes to introduce a comprehensive custom's regulation and tariff structure during 1995-96 fiscal year. This will make customs duty realization easier for the Government and standardise and simplify the rules for the benefit of the general public. The new customs rules and regulations will take into account the needs of the Bhutanese economy as well as administrative convenience. The Division of Revenue and Customs of the Ministry of Finance has already reached an advanced stage of preparation for this important policy initiative.

BALANCE OF PAYMENTS

In a country like Bhutan where the rapid pace of development inevitably brings about increases in imports, the balance of payments and particularly the current account situation is an important indicator of financial sustainability and general economic management. The level of exports has more than doubled over the last 6 years. The total exports in 1994 were of the order of Nu 2098 m. Imports on the other hand also increased substantially over the same period and reached Nu 3064 m. The balance of trade deficit in 1994 was therefore Nu 966 m.

Due to the judicious policy and constant efforts of the government, Bhutan today has a convertible currency reserve of US\$ 115 m which is adequate to cover more than one year's requirements of imports. The level of reserves is, by international standards, considered good. On the Rupee front, however, there is no reserve and current requirements are being supplemented through borrowings from the State Bank of India and the Government of India.

EXTERNAL DEBT

The Royal Government had always pursued a policy of caution regarding external loan even where the terms and conditions are extremely soft. With the exception of the financing of the first aircraft, Bhutan has not resorted to any commercial loan. The Government's policy is to avoid loans to the extent possible and to avail of loans only for income generating activities. As a result of this wise and cautious approach, Bhutan's external debt situation is still comfortable.

The total loan outstanding in convertible currency is US\$ 80 m and the annual debt servicing requirement is US\$ 7 m.

External Rupee loan borrowed for the Chukha Power Project, is currently Rs 1155 m. The debt servicing on account of this loan is Rs 141 m p.a. In addition, the Royal Government has also availed of an overdraft facility from the Government of India upto a limit of Rs 250 m to tide over balance of payments difficulties. The Royal Monetary Authority also has a line of credit with the State Bank of India for a limit of upto Rs 800 m to meet the Rupee demand for imports from India.

The total external debt of Bhutan, hard currency plus Rupee, stands at Nu 3703 m. The total annual debt servicing cost is Nu 364 m, and the Royal Government continues to service the debts in keeping with the repayment schedules without a single case of default. The Ministry of Finance is pleased to inform the National Assembly that the bulk of the external debt has been utilized to establish highly successful and profitable projects including power, which have become the main backbone of Bhutanese industry. These industries today are the most important contributors to revenue, export earnings and non-agricultural employment. Bhutan should be proud that the external loans have been used productively to strengthen the economy and to generate revenues.

ECONOMIC PROSPECTS

Despite the late start in development and given the small size of the economy, the GDP growth rate for 1994-95 was 7%. In view of the substantial revenues expected from the Ferro Alloys industry, the PCA expansion and revision of power tariff, the fiscal year 1995-96 is expected to register a high growth rate. The balance of payments position with India is also poised to improve within this fiscal year.

Economic growth in the near future will be influenced mainly by the Basochhu and the Kurichhu Power Projects. The cost for the Kurichhu Hydro-Electric Project is estimated at Nu 2,860 m. The large investment of funds during the project construction period will greatly stimulate the economy and increase the income of the people. Once the project is completed, it will generate considerable revenue from the sale of electricity to the State of Assam in India.

PRIVATE SECTOR DEVELOPMENT

The promotion of private sector development is one of the main objectives of the 7th Plan. The effort to not only support private sector development but also to privatize public sector commercial undertakings continue unabated. The private sector was given added encouragement and a good opportunity with the raising of the entire capital for the Penden Cement Authority expansion programmes from the market through the Royal Securities Exchange (RSE). The Royal Government avoided making any direct investment in this venture and even the investments of the Army Welfare Project were made only after the entire demand of the general public for shares had been fully met.

In order to facilitate private sector growth and to develop a well regulated and equitable share market, the Royal Securities Exchange was established. In spite of the initial teething problems, the RSE is making steady progress and is becoming an important agency for mobilization of resources and providing opportunities for the small investors who do not have adequate capital or managerial capabilities to establish other income generating businesses. In 1995, the RSE was given the responsibility to handle the issue of 26,667 shares worth Nu 40 m for the PCA expansion programmes. The share issue received an overwhelming response from the market with an over-subscription of more than 50 %.

This augurs well for the RSE as well as private sector development in the future.

The private sector development on the whole continues to be rather slow. This is mainly the result of lack of capital, managerial skill and the shortage of skilled manpower. Private sector capacity is particularly weak in the construction business where ample opportunities exist in view of large numbers of developmental programmes initiated by the Government. In spite of the short-comings of the private sector, the Government continues to follow a policy of encouraging the private sector to take up construction activities.

LOAN REPAYMENT PROBLEMS

The Hon'ble members of the National Assembly may already be aware of the serious problems being faced by the financial institutions on account of non-repayment of loans provided to the public. At the end of 1994, there were over 579 serious default cases with total loan outstanding of Nu 279 m. This has placed great pressure upon the four financial institutions, namely the Bank of Bhutan, the Royal Insurance Corporation of Bhutan, the Unit Trust of Bhutan and the Bhutan Development Finance Corporation. It is very fortunate that the Royal Government took timely action and adopted corrective measures to prevent possible collapse of some of the financial institutions. While the borrowers over the years have been irresponsible in not repaying their debts, the financial institutions are also to be held equally responsible for granting loans carelessly and for not monitoring loan utilization. Many of the borrowers had used the loans for unproductive personal expenditures.

In view of the serious implication of such problems on economic progress and private sector development in particular, the matter was carefully reviewed by the Government. The Royal Government, while concerned about the negative impact on the viability of the financial institutions, was equally keen to avoid a situation where a defaulter would be completely ruined. During an audience granted to the business community, His Majesty the King expressed his serious concern and commanded the establishment of a Commission to resolve the "bad debt" cases taking into account the interest of the financial institution as well as those of the defaulters. The Commission has already made steady progress in resolving many of the serious cases. Loans have been rescheduled to the maximum extent possible and taking over of assets placed as security were resorted to only as the last measure. Many of the assets are of far less value than the loan outstanding and are of very little or no use specially in the case of houses, vehicles and machinery. The financial institutions are therefore able to recover only a small fraction of the loans and lose heavily as assets taken over from the defaulters can be sold only at great losses.

It is of utmost importance that the people of Bhutan understand the importance of proper utilisation and repayment of loans. Unless loans are repaid in time, the financial institutions' ability to lend more money to the private sector for economic activities will be greatly reduced. It is also not fair to those who consciously make efforts to repay in the event defaulters are not penalized. Moreover, the money borrowed from financial institutions belong to the depositors whose savings must be protected. Non-repayment of loans jeopardises not only the viability of the financial institutions but that of the whole system of mobilizing savings and channeling such savings into productive investments for economic growth and well-being of the people.

CONCLUSION

The first 3 years of the 7th Plan have been successful as far as the Royal Government's financial management is concerned. We have not incurred substantial external debt nor did we resort to unmanageable domestic borrowing to meet budgetary deficits. Bhutan has successfully maintained a sustainable balance between current expenditures and revenues. While financial discipline has been ensured and expenditures minimized, there is the inherent risk of compromising the quality of services in the future and the danger of not being able to meet the maintenance cost of development facilities.

The maintenance cost is increasing rapidly with new additions to the service facilities and growing inflationary pressures. The rapid expansion of social infrastructures threatens to jeopardize future sustainability. Facilities may be established with donor assistance but the maintenance thereafter becomes the full responsibility of the Royal Government. Most facilities are provided either free or on highly subsidized basis to the general public. Therefore, the current expenditure of the Royal Government will continue to increase rapidly.

Given the experience of the past 3 years and the current situation, the 8th Five Year Plan must take serious account of the realities of the situation and ensure that sustainability is not undermined. The existing trend of development particularly needs to be reviewed so that unnecessary or superfluous programmes or service facilities are done away with, freeing scarce financial and human resources for the development and prosperity of the nation.

The question of sustainability must be examined from the point of sustainability at the micro level of a particular facility and at the overall national level. At the project or service facility level, the

beneficiary must assume as much of the responsibility as possible for the upkeep of the facility, be it primary schools, basic health units, irrigation channels, drinking water supply, feeder roads, etc. At the national level, the total current cost should be manageable within the total domestic revenue. As mentioned earlier, the current cost will continue to increase rapidly. Hence priority should be on increasing revenues and reducing the pace of expansion if at all necessary. Revenue however can be increased only if there is adequate investment and resultant growth in the economy. There is thus an urgent requirement to make concerted efforts to promote investments particularly in the private sector.

Over the last 34 years of development, Bhutan has made impressive strides in all aspects of social and economic growth. We now have a wide variety of service facilities spread evenly throughout the nation. All basic social infrastructure are available within easy reach of the vast majority of the people of Bhutan. We must now try to improve the quality and utilization of these social infrastructure.

The success with which Bhutan has been able to achieve social and economic goals have to a large extent been made possible by the continued support of the donors. The Royal Government of Bhutan is therefore deeply grateful to all the donors for their generous technical and financial support towards improving the well-being of the Bhutanese people. We are especially grateful to India, our closest neighbour and largest donor for her continued support since the inception of planned development.

While resource is a vital ingredient, the most important factor which has enabled Bhutan to progress rapidly is the dynamic and enlightened leadership provided by His Majesty the King. Under His Majesty's wise guidance, the Government and people of Bhutan were

able to work hand in hand in harmony towards the socio-economic development of the nation. We must all continue to work together wholeheartedly to successfully implement the 7th Plan development programmes and make every effort to ensure the prosperity, happiness and well-being of the nation.

		INCOME	
Population growth rate	7.20%	GDP in million Ru	5,106
Sex Composition		Per capita GDP in US\$	250
Male	52%	GDP growth rate	5.2%
Female	48%	Share of agriculture to GDP	52%
Life expectancy at birth	55.7	Saving as % of GDP	46
		Inflation rate	68

		EXTERNAL ACCOUNT	
		Export as percent to GDP	14.2%
		Import as percent to GDP	10.7%
		Balance of payment (million Ru)	133.73
		Foreign exchange reserves (million US\$)	14.21
		PUBLIC FINANCE	
		Government revenue receipts (million Ru)	250
		Tax Revenue (million Ru)	133.7
		Government expenditure (m.Ru)	250
		Current (million Ru)	304.0
		Capital (million Ru)	454.4

**COMPARATIVE SOCIAL AND ECONOMIC INDICATORS
FOR BHUTAN**

	1984	1994
<u>INCOME</u>		
GDP in million Nu	2,106	7,905
Per capita GDP in US\$	220	425
GDP growth rate	5.5%	7%
Share of agriculture to GDP	55%	40.7%
Saving as % GDP	-5.8%	17%
Inflation rate	7.1%	8.2%
<u>EXTERNAL ACCOUNT</u>		
Export as percent to GDP	9.8%	27.6%
Import as percent to GDP	39.2%	45.8%
Balance of payment (million Nu)	133.73	646.66
Foreign exchange reserves (million US\$)	14.21	115
<u>PUBLIC FINANCE</u>		
Government revenue receipts (million Nu)	250 11.9% to GDP	1794.69 22.7% to GDP
Tax Revenue (million Nu)	133.7 6.4% to GDP	650.88 9.1% to GDP
Government expenditure (m.Nu)	758.4	5211.73
Current (million Nu)	304.0	1825.43
Capital (million Nu)	454.4	3205.23

	1984	1994
HUMAN RESOURCE		
Population		600,000
Population growth rate	2.3%	3.1%
Sex Composition		
Male	52%	51.2%
Female	48%	48.8%
HEALTH		
Life expectancy at birth		
Male	46	65
Female	49	66
a. Infant mortality rate	14.2%	7.07%
b. Crude birth rate	3.91%	3.99%
c. Crude death rate	1.93%	0.9%
d. Maternal mortality rate	0.77%	0.38%
e. Health coverage	65% (1987)	90%
Health institutes (Nos)	123	541
1. Hospitals	25	27
2. Training institutes	1	3
3. Basic health units	61	82
4. Dispensaries	36	54
5. Malaria centres	-	19
6. Outreach clinics	-	356

	1984	1994
Rural population with access to pipe water	31% (1987)	58%
Rural population with access to latrines	-	70%
Universal child immunization	-	84%
EDUCATION		
School enrolment (70%)	58,116 Students	77,276 Students
Literacy rate	23% (1980)	54%
Number of educational institutions	182	288
1. High schools	8	9
2. Junior high schools	22	19
3. Primary schools (including community schools)	145	245
4. Private schools	-	7
5. Other institutions (Including Sanskrit Pathshalas)	7	8
OTHERS		
Length of road (km)	1,755.1 (1985)	3,100
Number of Telephone exchanges	13	22
Number of Telephone connections	1,880	9,126
Electricity Generation	31 million units	1,676.6m.units
Number of villages electrified	113	282
Number of towns electrified	19	37
Number of electricity consumers (Households)	9,262	19,901
Forestry cover	64%	72.5%