

**NATIONAL BUDGET FOR FINANCIAL YEAR
1996 - 1997
AND
REPORT ON THE 1995-96 BUDGET**



**MINISTRY OF FINANCE
ROYAL GOVERNMENT OF BHUTAN**

JULY 1996

REVIEW OF THE 1995-96 BUDGET

The fiscal year 1995-96, which is the fourth year of the 7th Plan, has witnessed a marked improvement in the performance of the economy particularly in the balance of payments position. The real growth rate achieved was 7% while inflation remained below 10%. The favourable economic conditions also enabled the achievement of the revenue targets. The sound fiscal policy followed by the Government made it possible to keep the budget deficit below 2% of GDP inspite of substantial increases in the cost of basic social services like health and education which are provided free of cost to the general public.

Two projects of great significance for the future of Bhutan, namely the 1,020 MW Tala Hydro Electric Power Project and the 1,500 tons per day Dungsum Cement Project were also finalised with the actual signing of the agreements with the Government of India during the visit of His Majesty the King in March 1996. These two landmark projects financed by India are expected to make substantial financial contributions to the revenues of Bhutan.

The budget approved for 1995-96 fiscal year also underwent some minor increases in light of unforeseen requirements and due to implementation of additional development programmes. A summary of the original estimates and revised estimates for 1995-96 is presented below:-

OUTLAY		Original	Revised
		(Nu in millions)	
i)	Current Expenditure	1,872.055	1,995.025
ii)	Capital Expenditure	3,003.517	3,262.364
iii)	Net Lending	59.488	11.743
iv)	Repayments	220.188	287.392
	Total	5,155.248	5,556.524

SOURCES OF FINANCE

I.	DOMESTIC RECEIPTS		
i)	Internal Revenue	1,850.000	1,850.724
ii)	Other Receipts	48.918	47.322
	Sub-Total	1,898.918	1,898.046
II.	GRANTS		
i)	GOI Program Grant	300.000	300.000
ii)	GOI Project Grants	1,145.219	1,161.626
iii)	Grants from other Intl. Agencies	1,388.445	1,667.109
	Sub-Total	2,833.664	3,128.735
III.	Adjustment of Prior Year Advance	-	5.246

IV. FINANCING

i) Borrowings from External

Sources	266.136	363.158
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ii) Resource Gap	156.530	161.339
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Total	5,155.248	5,556.524
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The overall outlay increased from the original estimate of Nu 5,155.25m to Nu 5,556.52 m reflecting mainly increased aid disbursements. The current expenditure increased by 6.6% while capital expenditure increased by 8.6%. Such changes between projections and actual expenditure are quite normal in a situation like ours where domestic resources are inadequate and external aid disbursements difficult to forecast accurately. On the whole, the increase in the outlay is only 7.8%.

The increase in the outlay has been almost matched by positive developments on the resource side. The domestic revenue target has been achieved. Under external grants, increase has been reflected mainly due to incorporation of more accurate aid data during the year. External borrowings also increased on account of improved disbursements on existing loans. The increase in the disbursement of both grants and loans is the result of good project implementation and improved aid management by the Royal Government.

The current expenditure outlay increased to Nu 1,995.02 m which exceeds the total domestic revenue receipts by Nu 96.98 m. Domestic revenue was therefore able to cover 95% of current expenditure. The

increase in the current expenditure came mainly from employment of additional manpower, increase in the food subsidy to the monastic institutions and granting of Special Government Allowance to police personnel as already done in the case of other civil servants. While every effort was made to control Government expenditure, no additional taxes were levied during the 1995-96 fiscal year.

The total resource gap reached a level of Nu 161.34 m which was borrowed from domestic financial institutions. Almost all of this borrowing was however used to finance productive capital costs of projects like the Basochhu Power Project and the Urban Sewerage and Water Supply Project etc. The budget deficit remained close to the projected level and was contained at 2% of the GDP.

The progress of developmental activities continued at a rapid pace particularly in health, education and agriculture. The primary health and education projects in the six eastern Dzongkhags entered implementation stage during the year. The renovation of the Punakha Dzong as well as the flood protection works were also carried on as scheduled. The Thimphu and Phuntsholing Urban Sewerage and Water Supply Projects were completed and are expected to improve the health and sanitation in these two important towns. The 2.2 megawatt Rangjung Hydro Power Project was also completed and works on expansion of the distribution network in Tashigang and Tashiyangtse Dzongkhags are already in progress. The domestic telecommunication network has also been completed in twelve Dzongkhags, except for the western region, where installation works are about to begin.

THE 1996-97 BUDGET

The Ministry of Finance is pleased to report to the Hon'ble Members of the National Assembly that the fiscal year 1995-96 has come to a successful conclusion and we are now launching the final year of the 7th Plan. The year starts on a positive note with improved economic performance and a favourable balance of payments situation. The objective of covering the current expenditure from domestic revenue would have been achieved had there been no increase in the salary of civil servants.

The most important feature of the 1996-97 budget is the increase in the pay of civil servants. Since the pay revision in 1988, there had been no increases in the salary till 1994 when the Government, as an interim measure, sanctioned Nu 500 per month to all civil servants. This went a long way in alleviating the difficulties of the lower level civil servants for whom the increase in the salary level was as much as 56%. The effect on the highest levels was 4%. Considering the increased cost of living and the subsequent difficulties faced by civil servants in meeting even basic needs, His Majesty the King approved an increase in the salary of civil servants by 25% over the salary level of 1995-96. In view of their important role in promoting people's participation and decentralisation, His Majesty the King further approved an increase of 50% in the pay of Gups and Chimis. The pay and allowances of the Royal Bhutan Police was also revised, resulting in additional outlay of Nu 30.27 m in the Police budget. The revision of pay scales will result in additional budgetary outlay of Nu 185 m, representing an increase of 9.2% in the current expenditure budget.

The actual increase in the salary of civil servants compared to the 1988 level comes to over 90% at the lowest levels and 25% at the level of ministers. In the event the resource position improves, the Royal Government will consider further increases in the salary of civil servants in the near future. The Royal Government remains committed to the policy of having a compact, efficient and dedicated civil service. In order to have a committed, honest civil service, it is necessary to pay the civil servants well.

During 1994-95, when the civil servants were granted the Special Government Allowance of Nu 500 per month, the Government revised the wage rates for the national work force. The Royal Government also approved a 25% increase in the national wage rates for Gyalyong Lemi during the current fiscal year.

Presented below is a summary of the 1996-97 Budget :-

OUTLAY	Budget Estimates (Nu in millions)	% of Total
i) Current Expenditure	2,198.435	37.0
ii) Capital Expenditure	3,447.433	58.2
iii) Net Lending	17.379	0.3
iv) Repayments	264.074	4.5
Total	5,927.321	100.0

SOURCES OF FINANCE

I.	DOMESTIC RECEIPTS		
i)	Internal Revenue	1,950.095	32.9
ii)	Other Receipts	30.283	0.5
	Sub-Total	1,980.378	33.4
II.	GRANTS		
i)	GOI Program Grant	300.000	5.1
ii)	GOI Project Grants	1,113.356	18.8
iii)	Grants from other Intl. Agencies	1,712.911	28.8
	Sub-Total	3,126.267	52.7
III.	FINANCING		
i)	Borrowings from External Sources	460.312	7.8
ii)	Resource Gap	360.364	6.1
	Total	5,927.321	100.0

The total outlay for 1996-97 is Nu 5,927.32 m, which is an increase of 6.7% over the revised 1995-96 outlay of Nu 5,556.52 m. The increase expected in the current expenditure budget is only 10.2% notwithstanding the 25% increase in the salary of civil servants. It may be noted that almost the entire increase in the current expenditure budget was on account of the salary increase and no significant increase was envisaged in the level of the normal current expenditure budget.

In view of the stringent control over public expenditures, the domestic receipt of Nu 1,980.38 m would be able to cover about 90% of the current expenditure inspite of the substantial increase in the salary of civil servants. This is indeed a noteworthy achievement and the Royal Government would be able to prepare a firm foundation for the first year of the 8th Plan.

The change projected in the level of external grants is quite negligible and in the beginning of the fiscal year difficult to forecast accurately. External loan disbursement is however expected to rise rapidly by 26.75% indicating enhanced project implementation and more efficient aid utilisation.

The overall resource gap to be financed through domestic borrowings is projected at Nu 360.36 m. There is, however, no cause for concern as this entire amount is to be invested in productive projects as local counterpart funds. Moreover, such borrowing by the Government also opens up avenues for lending by the financial institutions which are presently suffering from excess liquidity. The use of Government Bonds as a debt instrument also facilitates the development of a financial market. The projected budget deficit is the equivalent of 4.1% of the GDP, which though higher than in the past, is manageable.

Revenue

The performance on the revenue front continues to be satisfactory. There has been marked improvement in the collections even though tax

coverage and rates have not been enhanced. Moreover, tax as a percentage of total revenue have also been making slow but steady progress.

The following table shows changes in revenue receipts over the 7th Plan period :-

<u>Year</u>	<u>Nu in Millions</u>		
	<u>Tax</u>	<u>Non-Tax</u>	<u>Total</u>
1992-93	456.46	1036.99	1493.45
1993-94	503.22	1070.58	1573.80
1994-95	650.11	1035.41	1685.52
1995-96	789.89	1060.83	1850.72
1996-97	832.72	1117.38	1950.10

The average rate of growth of revenue is 6.5% per annum. Tax revenue constitutes around 42.7% of the total domestic revenue. Rural taxes continue to be a mere 0.3% of the total and would have no impact even if increased several fold. Business income tax is only 3% of the total revenue, indicating that the Bhutanese business people pay very low taxes. The main source of revenue continue to be dividends, royalties, excise duty, corporate income tax, sales tax and receipts from public utilities. It is evident that the Bhutanese people today enjoy a social welfare state where health and education are free and all the other development services are provided on highly subsidised basis as Kidu to the people. Although there has been significant increases in the income levels of the people, it is evident from the above that the Bhutanese people continue to be amongst the least taxed in the world.

In view of the increasing cost of providing basic social services and the consequent growing budgetary deficits, it is now necessary for the Royal Government to rationalise the tax policy and streamline tax administration. In the interest of sound financial management and future security and well-being, the people of Bhutan must learn to contribute, by way of taxes, for the services currently provided free of cost by the Government.

Balance of Payments

The balance of payments and particularly the current account situation is an important indicator of financial sustainability and general economic management in a country like Bhutan. The process of rapid development often necessitates high level of imports for projects as well as growing consumption on account of increasing income levels of the people. In the short run, most of the requirements, even of consumer goods, may have to be met through imports as domestic production is often difficult or not feasible on account of the small size of the market.

Bhutan's foreign trade has increased substantially over the last few years. In 1995, exports were valued at Nu 2225.0 m while imports reached Nu 3562.34 m. Taking into consideration both goods and services, the current account deficit was Nu 1787.94 m. The overall balance of payments however continued to be favourable with a small surplus of Nu 440.88 m.

The Ministry of Finance is pleased to report to the Hon'ble Members of the National Assembly that the foreign exchange reserves of the country has now increased to US\$ 130 m which is adequate to finance import requirements for eighteen months.

External Debt

The Royal Government has always pursued a policy of caution regarding external loans. Therefore, the external debt position of Bhutan has not changed much over the years. Hard currency debts remain at US\$ 80 m. Rupee loans, on the other hand, are poised to increase several fold as the result of the Kurichhu and Tala Hydro Electric Power Projects. Presently, the rupee loan on account of Chhukha Hydro Power Corporation is Rs 1,062 m.

The annual debt servicing on account of the hard currency loan is around US \$ 7 m. The debt servicing for the Chhukha Project loan is Rs 141 m per annum. As reported earlier, loans had been used for setting up highly successful industries which are today contributing significant amounts of revenues to the country. The debt service ratio is about 17% which is considered acceptable and sustainable.

Private Sector Development

The Royal Government of Bhutan remains firmly committed to the development of a broad based private sector and the policy of

privatisation of public sector undertakings. While pursuing the goal of growth in trade and industry, the Royal Government is keen to avoid concentration of wealth in the hands of a few people. The objective is to encourage as many entrepreneurs as possible to engage in business so as to ensure equitable distribution of wealth.

It is also with this objective in mind that the Government carried out the demonopolisation policy and redistributed many dealership licences which in the past were nearly all in the hands of a few business establishments. It was hoped that more dealers/agents would facilitate fair competition and thereby lower the prices of essential items for the benefit of the Bhutanese consumers.

The development activities, especially construction of large projects like the Tala Hydro Electric Project, the Dungsum Cement Project, the Kurichhu Power Project and the Basochhu Power Project will provide great opportunities for private contractors. The private sector must however enhance its capacity by improving management and technical capability to undertake such complex constructions.

While golden opportunities exist, private sector development, unfortunately, remains extremely unsatisfactory. There is hardly any increase in investment in the small and medium industries. In spite of the Government's policy of encouraging and providing opportunities to the larger section of the public, demand for shares in corporations come mainly from bigger business houses.

Recognizing the crucial role of a strong private sector, the Royal Government will continue to initiate measures to promote entrepreneurship development and human resources development, using both internal resources and external assistance. Assistance to private sector development will be a high priority even in the 8th Plan. The private sector must grow and become the main avenue for the employment of the increasing numbers of school leavers and graduates.

Financial Sector Development

Most of the financial institutions are suffering from two serious problems, namely, high level of loan defaults and excess liquidity. The loan defaults were caused by irresponsible lending in the past whereas the excess liquidity is the result of lack of bankable loan proposals reflecting once again the lack of dynamism in the private sector.

The closer supervision and more rigorous application of the Prudential Guidelines issued by the Royal Monetary Authority, coupled with improved control by the respective boards, has now streamlined the management of the financial institutions. The overall performance in terms of loan repayment and appraisal of loan proposals have improved significantly during the last two years.

The Unit Trust of Bhutan will become a full-fledged commercial bank within this year and contribute immensely to the provision of financial services in addition to providing a healthy competition. Shares of the new bank to be known as the Bhutan National Bank will be

floated on the stock market giving the private sector a fair opportunity to enter the banking business.

In the interest of sound monetary policy and effective financial management, the Royal Government has now commenced the issue of Government Bonds as an alternative to direct borrowing from the RMA. This, coupled with the normal RMA bills, may be the beginning of the emergence of a rudimentary financial market in Bhutan.

The financial sector, inspite of its weaknesses, has contributed immensely to the development of the nation, particularly to the emergence of small and medium businesses. The sector has now attained a size and complexity which requires proper, mainly legal, institutional framework. The Royal Government will therefore accord high priority to the improvement of the necessary legislations to regulate and strengthen the financial sector development.

Economic Prospects

The economy is improving with an upsurge in the transport business indicating increasing economic activity and hence growth. The GDP grew by 7% and the balance of payments with India, our main trading partner, improved significantly. Inflation continued to be at single digit level. Moreover, the labour market is also improving considerably with many young Bhutanese graduates and school leavers being available for training and employment.

On the resource front, Bhutan is in a comfortable situation with increased mobilisation of internal resources, growing external assistance and high level of liquidity of domestic financial institutions. What is important now is to channel these resources into highly productive investments to ensure sustained growth. Unless investments are made and domestic production base increased, it would not be possible to enhance income levels, increase revenues, reduce trade deficits and ultimately sustain the provision of basic social services.

The size of the national economy is however too small for domestic demand based industries. Small scale business particularly in the service sector would be suitable for the local market. Hence the main strategy for industrial development must be export oriented.

The economy is now poised for another decade of very high growth and prosperity. The construction of the Kurichhu Power Project, the Tala Hydro Electric Power Project, the Basochhu Power Project and the Dungsum Cement Project will pump in large amount of resources and create vast avenues for trading, transport, construction contracts and employment in general. Once completed, these projects will contribute immensely to the revenues of the country and enable the Royal Government to achieve the national goal of economic self-reliance. Bhutan can look forward to growth rates well in excess of 10% per annum during the 8th Plan and beyond.

Environment

Throughout the centuries, the Bhutanese have treasured their natural environment and looked upon it as the source of all life. This traditional reverence for nature has delivered us into the twentieth century with our environment still richly intact. The continued conservation and preservation of our rich biological diversity and natural resource base remains one of Bhutan's most important achievements.

His Majesty, King Jigme Singye Wangchuck has ensured that the processes of economic development and environmental and cultural integrity are not mutually exclusive, but critical to the long-term viability of Bhutanese development. As eloquently summarised by His Majesty himself, "Gross National Happiness is more important than Gross National Product". This has been and will be the principal guiding force for Bhutan's sustainable development strategy.

As a result of the enlightened leadership and the strong tradition of environmental conservation and preservation, Bhutan now has over 26% of its land area under protected area management and over 72% of the country under forest cover. While many parts of the world have suffered from alarming deforestation rates, the forest cover in Bhutan has actually increased in the last decade. The 73rd session of the National Assembly in 1995 has mandated that the country must at all times keep 60% of the country under forest cover.

Bhutan has little to sell to the outside world to pay for its numerous needs. Foremost amongst these needs is the cost of financing

development. The Royal Government is committed to providing a wide range of comprehensive free services to its people, e.g. education, public health, and public safety. These services are very costly to provide and more so the maintenance of the infrastructure. The same forces that make Bhutan so rich in natural beauty, make it relatively poor in those commercially valuable raw materials upon which most national development schemes are based.

The Royal Government has strong conservation policies that discourage indiscriminate commercial extraction of forest and other natural resources. The Mining Act, 1995 requires environmental impact assessments to be conducted for all mining projects. The Royal Government has chosen to forego immediate economic gains and has placed a higher priority on the conservation of natural resources. Although Bhutan is a small country with rich biological diversity and vast forest coverage, it is contributing significantly to the global environment.

Conclusion

The fiscal year 1996-97 is the final year of the 7th Five Year Plan which began in 1992-93. The 7th Plan began in a period when the peace, security and development of the nation was seriously threatened by anti-national activities in Southern Bhutan. In spite of this extremely grave situation, the Royal Government, under the able and magnanimous leadership of His Majesty the King, spared no efforts to ensure the security of the nation and continuation of the development process for the well-being of the Bhutanese people. In spite of the many problems

and difficulties, the development plans were implemented as scheduled with impressive results which can be seen in the socio-economic indicators.

The economy performed very well and the per capita GDP reached US\$ 470 which is among the highest in our region. The school enrolment level has reached 72% and primary health care coverage is almost 90%. The Royal Government continues to provide free health and education services and spends nearly 30% of its entire budget on the social sector.

While dependence upon external assistance especially for capital expenditures is still significant, Bhutan has been very successful in raising domestic revenues in spite of the Royal Government's stringent control of the use of natural resources with a view to preserve the environment. We have been able to achieve the important objective of meeting the cost of essential services from internal revenues thus moving closer towards our goal of national self-reliance. The budgetary deficit, on the average, has also been maintained at less than 3% of GDP.

During the 7th Plan period, the position of external assistance have been very positive. The Royal Government on its part have spared no efforts to ensure successful implementation of all donor supported activities. Aid disbursement and utilisation levels are highly satisfactory and success rate of projects in Bhutan are among the very best anywhere in the world. Impact of donor assisted projects and programs are not only obvious but clearly visible.

Though only a small country, Bhutan continued to progress from year to year mainly due to the blessings of the Guardian Deities of the Pelden Drukpa and the sacrifice, hard work and able leadership of His Majesty the King and the good fortunes of the people. We must also thank all our development partners for their goodwill and support without which Bhutan would not have been able to make such rapid strides. We are particularly grateful to our close friend and neighbour, India, for the continued support since the inception of planned development in our country.

Bhutan can look forward to not only the successful implementation of the 7th Plan but greater achievements during the 8th Plan and beyond. A lot of the basic infrastructure is now in place and several large investment projects are already under advanced stage of readiness for implementation. What is required now is an environment of continued peace and stability within which development can take place. The people of Bhutan must not become complacent but remain ever alert and work hand in hand with the Government to ensure peace, prosperity and a secure future for our nation. We are confident that under the wise and able leadership of His Majesty the King, Bhutan would continue to develop and prosper to ensure the well-being and happiness of the Bhutanese people.

**COMPARATIVE SOCIO-ECONOMIC INDICATORS
FOR BHUTAN**

	1985	1995
<u>INCOME</u>		
GDP in million Nu	2,392	8,742
Percapita GDP in US\$	220	470
Average GDP growth rate	6.8% (1980-85)	6.7% (1980-94)
Share of agriculture to GDP	53%	40%
Saving as % of GDP	0%	30%
Investment as % of GDP	45%	52%
Inflation rate	4.4%	8.2%
<u>EXTERNAL ACCOUNT</u>		
Export as % to GDP	11.4%	27%
Import as % to GDP	43.5%	43%
Foreign exchange reserves (million US \$)	20.6	130
<u>PUBLIC FINANCE</u>		
Government revenue receipts (million Nu)	233.0	1,898.0
Tax Revenue (million Nu)	135.9	789.9
Government expenditure (million Nu)	1,217.7	5,556.5
Current (million Nu)	441.5	1,995.0
Capital (million Nu)	776.2	3,262.4

	1985	1995
<u>HUMAN RESOURCE</u>		
Population		600,000
Population growth rate	2%	3.1%
Sex Composition		
Male	52%	51.2%
Female	48%	48.8%
<u>HEALTH</u>		
Life expectancy at birth		
Male	45.8	65.9
Female	49.1	66.1
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%
<u>Health institutes (Nos) :</u>		
1. Hospitals	28	27
2. Training institutes	1	3
3. Basic health units	65	85
4. Dispensaries	44	55
5. Malaria centres	11	19
6. Outreach clinics	360	466

	1985	1995
Rural population with access to piped water	31% (1987)	58%
Rural population with access to latrines	-	70%
Universal child immunization	16%	90%
<u>EDUCATION</u>		
School enrolment (No.of Students)	51,835	77,276
Enrolment rate	-	72%
Literacy rate	23% (1980)	54%
<u>Number of educational institutes :</u>	183	288
1. High schools	8	9
2. Junior high schools	22	19
3. Primary schools (Including community schools)	145	245
4. Private schools	0	7
5. Degree College	1	1
6. Other institutions (Including Sanskrit Pathsalas)	7	7
<u>TRANSPORT & COMMUNICATIONS</u>		
Length of road (km)	1,755.1	3,216.97
Number of Telephone exchanges	13	22
Number of Telephone connections	1,880	5,428
Number of Post Offices	54	103
Number of WT Stations	18	51
Rural Water Supply Schemes	150	1,753
Number of Suspension Bridges	175	296

	1985	1995
<u>RNR (COMMON SERVICES)</u>		
RNR Centres	-	27
Natural Resources Training Institute	-	1
RNR Research Centres	2 (1980)	4
RNR Research Sub-Stations	-	5
Soil & Plant Analytical Laboratory	-	1
<u>AGRICULTURE</u>		
Agriculture Extension Centres	121 (1980)	157
Agricultural Seed Production Farms	9 (1980)	11
Plant Protection Centres	-	3
Farm Mechanization Centres	-	3
Farm Mechanization Training Centre	1	1
National Mushroom Centres	1	1
<u>ANIMAL HUSBANDRY</u>		
Veterinary Hospital	18	20
Livestock Extension Centres	87	112
Regional Veterinary Laboratory	-	4
Satellite Veterinary Laboratory	-	1
Livestock Farms	14	10
Fodder Seed Production Centres	1	2
Vaccine Production Centres	-	1

	1985	1995
<u>FORESTRY</u>		
Territorial Division HQs.	-	10
Range Offices	25 (1982)	35
Beat Offices	83 (1982)	53
Forestry Training Institute	1	1
Forest Cover	64%	72%
Protected Area	-	26%
<u>POWER</u>		
Electricity Generation (million units)	40.5	1,632.878
Number of Villages Electrified	95	297
Number of Towns Electrified	23	38
Electricity Consumers (Households)	9,750	29,080