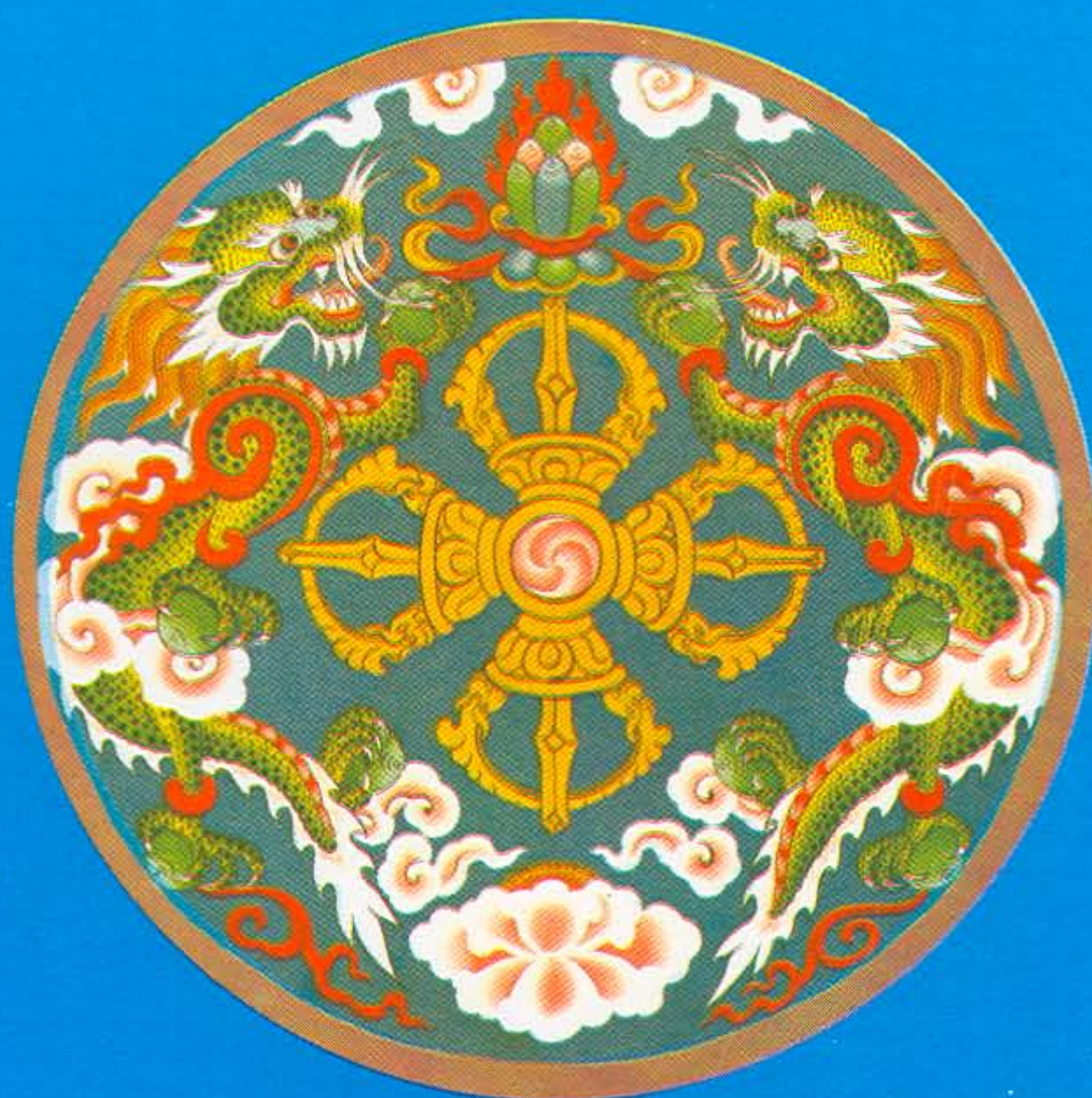


NATIONAL BUDGET FOR FINANCIAL YEAR 2001 - 2002

AND REPORT ON THE 2000 - 2001 BUDGET



**MINISTRY OF FINANCE
ROYAL GOVERNMENT OF BHUTAN**

JUNE 2001

Introduction

The Ministry of Finance has the privilege to present the budget for the financial year 2001-2002 and the report on the financial year 2000-2001 to the honourable members of the National Assembly.

I am pleased to inform the honourable members that we have successfully reached the last year of the 8th Five Year Plan (8FYP). Despite the security problem posed by the presence of ULFA and Bodo militants in Bhutanese territory, we have been able to carry out the planned development works without major disruptions. The preparations for the 9th plan, which commences in July 2002, have been initiated.

The 8FYP review meetings in the 20 Dzongkhags have also concluded successfully. The review meetings provided an excellent opportunity for the government to assess the implementation of the 8FYP policies and programs and to meet the representatives of the GYT, DYT and the business community. During the meeting, we were able to exchange views and understand the future development challenges in the respective Dzongkhags. I am pleased to report that the average financial delivery, for the first three and half years of the 8FYP, reported during the review meetings in the Dzongkhags is 66 percent. The lower than expected expenditure level was a result of heavy rainfall, manpower shortage and delays in disbursement of donor funds.

While our development plans have been successful in ensuring an equitable, balanced and sustainable progress, the rapid pace of development and change occurring within Bhutan and abroad, presents our country with numerous

opportunities and challenges associated with youth employment, rapid urbanisation and globalisation among others.

In order to meet the challenges and capture the opportunities, we need to broaden and deepen our economic base, invest in productive industries and strengthen our exports by seeking a niche in small and medium scale industries. We have to gear towards harnessing the opportunities presented by tourism and information technology.

In view of these emerging challenges and opportunities, this budget will address measures to strengthen our economy through promotion of the private sector. Considering the global dominance of the market economy, the private sector is the key to economic progress, wealth generation, improving trade balance, and employment creation.

The emphasis on the private sector, however, does not mean that rural development will be marginalized. The Royal Government is committed to improving the livelihoods of the rural people and will continue its support to the social sector. The targeted beneficiary of all the projects, initiated by the Royal Government in all the sectors is mainly the rural population.

Economic Performance (2000-2001)

The general macroeconomic conditions were favourable for Bhutan in the past year. The economy has experienced a steady and sustained growth rate of 6 percent. Average inflation rate remained at about 4.5 percent, which is one of the lowest we have had so far. This is a reflection of sound economic management policies of the Royal Government. The exchange rate has been relatively stable and Bhutan continues to experience positive balance of payments. The foreign reserves stand at US\$ 292.5 million, estimated to cover 19 months of imports. The total debt to GDP ratio stands at 39.0 percent and the debt service ratio at 4.1 percent.

The Ministry of Finance would like to inform the honourable members that we have been able to achieve the objective of meeting at least the current expenditure from domestic revenue. In order to meet the capital investments, we have been able to obtain grants from bilateral donors and highly concessional loans from the international financial institutions.

Review of the Financial Year 2000-2001

The revised budget of the Financial Year 2000-2001 stands as follows:

Summary of Financial Year 2000-2001 Budget

Nu. in millions

Expenditure Outlay	Approved	Revised
1. Current Expenditure	4,158.601	4,397.550
2. Capital Expenditure	4,922.623	5,023.352
3. Net Lending	27.124	68.541
4. Repayment	215.363	215.491
Total	9,323.711	9,704.934
Sources of Finance	Projected	Revised
1. Domestic Revenue	4,210.584	4,492.825
2. Other Receipts & Balances	566.365	604.757
3. Grants		
a. GoI Program Grants	800.000	800.000
b. GoI Project Grants	1,420.153	863.446
c. Other Grants	1,345.016	1,647.266
4. Financing		
a. Project-tied Borrowings	817.956	496.622
b. Resource Gap	163.637	800.018
Total	9,323.711	9,704.934

There has been a 4 percent increase in the 2000 – 2001 revised budget. While the objective of controlling expenditures was vigorously pursued during the

year, there were some important requirements for which additional budget allocation had to be considered.

A supplementary budget of Nu. 278 million was provided for restoring bridges, water and power supply and road repair works after the unprecedented monsoon floods. Given the major infrastructure damage in the foothills, it will be another few years before we can complete the restoration works.

The Royal Government also approved Nu. 260 million for the purchase of embassy buildings in New York, Geneva, and Bangkok. The purchase of these buildings will help us to save costs in the long run as well as strengthen our representation in these important cities. Furthermore, we were able to obtain favourable deals in all the purchases considering that real estate prices have been the best so far.

In order to ease the traffic flow in and out of Thimphu city, the Royal Government approved the construction of the Tashichho Dzong - Babesa Expressway, for which Nu. 79 million was provided. In addition, Nu. 42 million was approved for the appointment of additional personnel, for already approved posts, in the civil service.

As part of the Royal Government's contribution for the additional financing of the Basochhu project Nu. 78 million was also approved in the past year.

The increase in net lending, as indicated in the revised budget reflects the temporary loan provided for the corporatisation of Bhutan Telecom, and the

increased disbursement of on lending to the Bhutan Development Finance Corporation.

The Royal Government has raised the wage rates for the national workforce from Nu. 50 to Nu. 100 per day. The wages of skilled craftsmen have also been raised accordingly. These wage increases have been approved in view of the high cost of living and to encourage Bhutanese nationals to participate in development projects.

The Ministry of Finance would like to make it clear that this wage increase applies only to Bhutanese nationals employed under the National Workforce by the Royal Government. This is not a minimum wage and does not bind the private sector or other agencies operating in Bhutan.

The Royal Government has also raised the DSA and sitting fees for the members of the DYT's considering the high costs incurred in discharging their responsibilities. In view of the decentralisation process that is well underway and the increasing roles and responsibilities of such institutions, it is important that we encourage the participation of people who are competent to serve the communities they represent.

While there was a substantial increase in expenditure, the revenue also increased beyond the projected amount and helped to narrow the resource gap. It is, however, important to keep in mind that the resource gap at Nu. 800 million is far larger than the initially projected amount of Nu. 163.6 million.

Financial Year 2001-2002 Budget

The budget for the Financial Year 2001-2002 is as summarised in the table below:

Summary of Financial Year 2001-2002 Budget

Nu. in millions

Expenditure Outlay	Amount	Percent
1. Current Expenditure	4,611.099	45.89
2. Capital Expenditure	5,202.574	51.78
3. Net Lending	2.050	0.02
4. Repayment	231.421	2.30
Total	10,047.144	100.00
Sources of Finance	Projected	Percent
1. Domestic Revenue	4,613.271	45.92
2. Other Receipts	527.317	5.25
3. Grants		
a. GoI Program Grants	800.000	7.96
b. GoI Project Grants	540.343	5.38
c. Other Grants	1,578.088	15.71
4. Financing		
a. Project- tied Borrowings	941.024	9.37
b. Resource Gap	1,047.101	10.42
Total	10,047.144	100.00

In order to maintain fiscal discipline and keep the resource gap within manageable levels, the proposed budget for the year 2001-2002 at Nu. 10,047.144 million, is only 3.5 percent higher than the revised budget of Nu.

9,704.934 million for the previous year. This increase is reasonable considering inflation and cost of new establishments.

The national revenue forecast is Nu. 4,613.271 million, which is 2.7 percent higher than in the previous year. As in the past, we will be able to cover our current expenditure with the domestic revenue. The grant projection for the coming year stands at Nu. 2,918.431 million (29.05 percent). Project-tied borrowings is expected to be Nu. 941.024 million, (9.37 percent of total expenditure) marking a substantial increase from the revised budget of the past year mainly on account of the expected increase in disbursement for the numerous loan projects that are underway. The resource gap is anticipated to be Nu. 1,047.101 million (10.42 percent).

In order to cope with the anticipated resource gap, the Ministry of Finance has initiated measures to encourage financial discipline and control expenditure. We would like to assure the honourable members that the Ministry of Finance would continue to monitor the size of the resource gap and keep it at an affordable level.

Sector-wise allocation

In terms of sectors, the allocations are as summarised below:

Sector Allocation of Financial Year 2001-2002 Budget

Sectors	Nu. in millions	
	Amount	Percent
Health and Education	2,504.358	24.93
Agriculture	1,184.972	11.79
Human Settlements	715.204	7.12
Communications	183.312	1.83
Roads	1,138.377	11.33
Energy (excluding mega projects)	1,289.194	12.83
General Public Services	1,732.991	17.25
National Debt Service	316.866	3.15
Others	981.870	9.77
Total	10,047.144	100.00

Social Sector

The Royal Government has allocated a quarter of its budget to the health and education sector. This is an indication that the Royal Government continues to accord the highest priority to the social sector. A well educated and a healthy population are the most important requirements for the development and security of the nation.

Recognising the important role of teachers in educating and upbringing of our children, it is important to attract capable people to join the teaching profession. The Royal Government has, therefore, enhanced the teaching allowance for primary school teachers from 15 percent to 30 percent. This is expected to result in the improvement of the quality of education particularly in the rural areas where most of the primary education facilities are located.

Additional incentive of 30 percent to 45 percent of the basic pay for medical doctors have also been approved in recognition of their difficult jobs and also to attract and retain the best people in this profession.

We would like to inform the honourable members that our effort at fund mobilisation for the Health Trust Fund is making good progress. The total fund today stands at US\$ 10 million.

Communication

Effective communication, road access in particular, is an important factor in enabling economic development and enhancing national security. The Royal Government is committed to keeping the major highways open throughout the year and improving rural feeder roads in order to improve accessibility for people living in the remote areas of the country. This is evident in the relatively high allocation (11.33 percent) for the roads sector.

Given the importance of motor roads for development as well as national integration, the Royal Government continues to spend large amounts of money on the maintenance and improvement of the East-West Highway as well as other national and district roads. Programs have also been initiated to improve the access of rural areas to markets by constructing farm roads. In view of the heavy investments, particularly in the purchase of machineries, the Royal Government had to resort to loans from multilateral financial institutions.

The Royal Government will, as announced during the 8th plan review meetings, embark on a major rural telecommunications project. This project will not only

facilitate communication between people but also bring the benefits of internet to rural schools and hospitals.

Human Settlements

In the area of urban development and human settlements, we would like to report that the projects for the development of several Dzongkhag towns are in various stages of implementation. The government housing project towards partially alleviating the housing shortage in Thimphu and Puntsholing is progressing well. A budget of Nu. 228 million has been earmarked for this purpose in the 2001-2002 budget.

Energy

Considering the immense hydropower potential, the Royal Government continues to place priority to the energy sector allocating 12.83 percent of the outlay to this sector (excluding the mega projects). The Ministry of Finance would like to inform the honourable members that the works on the 1,020 MW Tala Hydroelectric Project is progressing well despite the disruptions caused by the monsoon rains last year. The management is working on an acceleration measure, which will allow the completion of the project by March 2005, if further unforeseen incidents do not occur. The Tala Project is estimated to cost a total of Nu. 36,383 million (excluding interest charges during construction).

As the honourable members may be aware, the first turbine of the Kurichhu Hydro Power Project has been commissioned. The project will be completed in June 2002 with the commissioning of the remaining three turbines. The cost of the Kurichhu Project currently stands at Nu. 5,685 million. This project will bring about unprecedented economic opportunities for the people of Eastern

Bhutan and will fulfil His Majesty's aspiration to bring about regionally balanced development and upliftment of the socio-economic lives of the people living in Eastern Bhutan.

In order to distribute the benefits of hydroelectric power to the rural people, the Royal Government is continuing to undertake several electrification projects. The Eastern transmission grid consisting of 120 kms of 132 kV transmission lines will connect Kurichhu with the six Eastern Dzongkhags. The Government of India has presently committed Nu. 800 million to finance the transmission grid. A 131 km long transmission line connecting Nganglam-Tingtibi-Gelephu is being constructed at a cost of Nu. 450 million. The Royal Government intends to extend the Tingtibi line to Trongsa and Bumthang as well.

The first phase of the Basochhu Hydro Power Project will be completed in October 2001 with the commissioning of the 22.2 MW turbine. The cost of the project currently stands at Nu. 1,434.30 million. Preparatory works for the 40 MW Basochhu Phase II project have already been initiated, and we expect to begin the works by the end of this year. The Royal Government will construct a 220 kV transmission line connecting Basochhu with the Semtokha switchyard. This will meet a major part of the electricity requirement of Western Bhutan and greatly enhance the reliability of power in the country.

The rural electrification program continues to be given priority. The second phase of the Asian Development Bank assisted project is progressing well, bringing benefits to thousands of rural households.

I would like to inform the honourable members that the Royal Government has decided to raise the power tariff for urban, commercial, institutional and industrial consumers from Nu. 0.70 to Nu. 0.80 per unit with effect from 1st July 2001. Such incremental increases are necessary in view of the high delivery cost of electricity, which ranges from an estimate of Nu. 2.50 to Nu. 7 per unit. The power tariff for the rural consumers will, however, remain unchanged at Nu. 0.50 per unit.

Agriculture

The agriculture sector will receive 11.79 percent of the total outlay in the coming year. Since agriculture is the major occupation of the Bhutanese people, the Royal Government is committed to increasing agricultural productivity and economic profitability. The construction of feeder roads will enable the farmers to market their produce and enhance their incomes. We hope that these efforts at making rural life more attractive will help to overcome the problems associated with rural-urban migration.

The Second Eastern Zone Agricultural Project funded by an IFAD loan, is now fully operational. This project covering six Eastern Dzongkhags aims at supporting rural livelihoods by pursuing an integrated approach to agricultural development that includes rural credit schemes and infrastructure works among others.

The Wang Watershed Management Project has also become operational in the past year. This project will support agriculture, forestry and livestock activities in Thimphu, Chukha, Paro and Haa Dzongkhags.

Domestic Revenue

The domestic revenue forecast is as summarised below:

Summary of National Revenue Forecast: FY 2001-2002

Nu. in millions

Source of Revenue	Amount	Percent
A. Tax Revenue	2,475.439	53.66
1. Direct Tax	1,512.095	32.78
Corporate Income Tax	939.174	20.36
Business Income Tax	201.650	4.37
Salary Tax	62.000	1.34
Health Contribution	21.630	0.47
Royalties	278.966	6.05
Rural Tax	8.675	0.19
2. Indirect Tax	963.344	20.88
Bhutan Sales Tax	330.377	7.16
Export Tax	12.666	0.27
Excise Duty	458.820	9.95
Motor Vehicle tax	59.860	1.30
Import Duty	78.375	1.70
Business & Prof. Licenses	8.428	0.18
Other Tax Revenue	14.818	0.32
B. Non -Tax Revenue	2,137.832	46.34
Transfer of Profits	438.435	9.50
Dividends	1,258.607	27.28
Admin. Fees and Charges	64.156	1.39
Capital Revenue	37.660	0.82
Revenue from Govt. Divisions	334.469	7.25
Other Non-Tax Revenue	4.505	0.10
Total	4,613.271	100.00

The domestic revenue forecast for the 2001-2002 financial year stands at Nu. 4,613.271 million. Tax revenue accounts for Nu. 2,475.439 million (54 percent) of the domestically generated revenue. As evident in the forecast table above, most of the revenue is dependent on corporate income tax and other non-tax sources. As the honourable members may already be aware, the rural people who constitute 80 percent of the population contribute less than one percent of the total revenue. At the same time, the Bhutanese people continue to enjoy free or highly subsidised access to a wide range of services. The Royal Government has been able to support such generous welfare programs largely due to the kind support we have received from our development partners and the effective utilisation of their assistance by the Royal Government.

However, we cannot continue to be dependent on external assistance indefinitely. It is important that we work towards our goal of attaining self-reliance and reduce our dependency on external assistance. In this regard it is vital that we continue to strengthen our economy and expand our revenue base by broadening the tax base and streamlining the tax system to ensure its efficiency and effectiveness.

As the honourable members may recall, the Ministry of Finance raised the issue of the Personal Income Tax in the last session of the National Assembly. We would like to take this opportunity to reiterate that such taxes are important at this stage of development not only to expand the revenue base but also to ensure that the income gap between the rich and poor do not widen considerably.

For a small developing country like ours, social cohesion and harmony, through equitable development, are essential in fostering citizen solidarity and national security. Experiences in many countries in the world have shown that a fast pace of development and change can create social discontent and instability due to widening income gaps. Therefore, the need to ensure equity, a basic social tenet, is more relevant to Bhutan today than ever before.

Personal Income Tax is a widely used means to ensure social equity in most progressive countries. The tax revenue generated is used to fund government expenditure on essential services like health, education and other publicly beneficial services. While the monetary value of the Personal Income Tax may be nominal in the earlier years, there is no doubt that it will instil a greater sense of participation, and responsibility among the people. We are confident that as in the past the Bhutanese people will place the interest of the nation above personal interests and support the process of nation building with deep loyalty and integrity.

Tax Policy Amendments

The Ministry of Finance is pleased to announce some revisions to the sales tax and customs tariff schedule. The revisions in the indirect tax rates have mainly been done in view of the changing economic and social circumstances in Bhutan. We are confident that these proposed changes will have positive social, economic and environmental impact. We propose to review these rates every year to keep up with the changes in the domestic and international economic environment.

The sales tax and customs duty on a wide range of domestic electrical appliances have been abolished. We hope that with rural electrification taking place, our people in the rural areas will be able to take advantage of time and labour saving devices. This will not only make life easier for our people but also help in environment conservation efforts.

Both sales tax and customs duty on the import of computers have also been abolished given the importance of enhancing computer knowledge in a world that is increasingly driven by information technology. We hope that the Bhutanese will also be able to benefit from the immense employment and income generating opportunities that this sector holds.

Customs duties on yarn have been abolished in order to encourage local weaving industries.

Sales tax on CGI sheets have been abolished, keeping in mind the difficulties that rural people face in re-roofing their houses every few years and the pressure it places on the natural environment.

The sales tax and customs duty on passenger buses have been abolished. At present only passenger buses procured by the passenger transport operators are exempted from both sales tax and customs duties. This benefit will now be extended to other agencies like tour operators also. Furthermore, customs duties on spare parts for all types of vehicles have also been reduced from 30 percent to 10 percent in order to encourage proper maintenance of vehicles and make transportation safer.

On the other hand, taxes on non-essential items such as confectionery and sweets have been raised to 45 percent and for betel nut to 20 percent. A sales tax of 30 percent has also been introduced for cable television services; same as that of cinemas, as this is a luxury that does not benefit the ordinary people.

In order to strengthen employment in the private sector, the monthly tax-deductible salary limits for companies and other businesses have been increased to more realistic levels as indicated in the table below.

Category	Companies	Other Businesses
Large	Nu. 60,000	Nu. 30,000
Medium	Nu. 35,000	Nu. 20,000
Small	Nu. 25,000	Nu. 15,000
Cottage	---	Nu. 5,000

It is expected that this would act as an incentive to hire competent managers, which is essential to enhance professionalism, profit and growth of the private sector.

External Assistance

External assistance continues to finance a major part of our development budget. In the past year, Bhutan received Nu. 3,310.712 million as grant aid. We would like to thank our development partners for their generous assistance. In particular, we are grateful to India, our friend and neighbour, for their unfailing support since the inception of planned economic development in the 1960s.

Bhutan has been fortunate to have numerous development partners who have provided generous assistance in our development endeavours. Such good will shown by our development partners is largely a reflection of their friendship and their confidence in the transparent and judicious utilisation of their assistance.

In order to further strengthen our relationship with our development partners, Bhutan hosted the 7th Round Table Meeting (RTM) in November 2000. The Ministry of Finance is pleased to inform the honourable members that the RTM was a great success. Seventy-eight representatives from thirty-two development partner countries and organisations attended the three-day meeting. Such representation at very senior levels is a testament of their friendship and good will towards Bhutan.

This meeting provided the development partners an opportunity to see for themselves the outcome of their assistance. The RTM, held in a true spirit of openness and friendship, also enabled fruitful dialogue on the possible areas of future cooperation with our development partners. Our discussions included emerging issues such as poverty, urbanisation and youth employment as well as the opportunities presented by globalisation and developments in information technology among others. We would like to thank the UNDP for their technical and financial support in organising this highly successful meeting.

Borrowings

The Royal Government continues to abide by very prudent borrowing norms. The total outstanding debt is US\$ 107.777 million and Rs. 3,957.386 million. The Ministry of Finance would like to inform the honourable members that

these loans have been taken to finance important projects in the roads, power, urban infrastructure, education and agriculture for which grant aid was not forthcoming. The rupee loan is mainly on account of Chhukha, Tala and Kurichhu projects. We are confident that investments in these areas will contribute significantly to the socio-economic development of the country.

The total debt service projected for 2001-2002 is Nu. 316.8 million and the debt service ratio at about 6 percent. Our financial analysis shows that we can comfortably meet the debt servicing obligations. The Ministry of Finance will continue to carefully assess loan projects in order to ensure that these projects have sound financial and economic returns.

Other initiatives

The Department of Telecommunications has been corporatized to enhance efficiency and improve the quality of telecommunication services for the general public.

We have also started the preliminary work to corporatize the utility functions of the Department of Power. This is to ensure that the services are efficiently run and financially sustainable.

In order to rationalise costs and ensure the long-term sustainability of health care in Bhutan, user fees have been introduced for selected dental services. We would like to assure the honourable members that basic health care will continue to be provided free of cost.

As many of us are aware, Druk Air plays an important role in facilitating international travel as well as tourism in Bhutan. Although there is currently only one plane in service, the Corporation has done extremely well in meeting the transportation demands, especially during the peak tourist seasons. The second plane, which is undergoing repairs, will be delivered in August this year. In addition, orders have been placed for two additional planes to be delivered in 2002. One of the planes will be domestically financed while the other will be purchased on external financing.

Private Sector Development

The development of the private sector has been one of the major objectives of the Royal Government since the inception of the 5th Five Year Plan.

Although numerous steps were initiated in the past to promote the private sector, the results have not met our expectations. Our production base remains dependent on a few natural resource based industries and economic diversification has been limited. All indications show that our private sector is still weak and vulnerable.

In a world that is increasingly driven by market economics, national security is not dependent on military strength alone. Economic strength is an equally important determinant of national security. While the government will continue to provide the infrastructure and the enabling environment for private sector development, it cannot be the engine of growth.

We need a dynamic private sector that plays a central role in income generation, improving the trade balance and creating employment among

others. The need for greater dynamism and innovation in the private sector is even greater when considering the various challenges and opportunities presented by globalisation. The Royal Government is, therefore, more committed than ever to promote the private sector in Bhutan.

The following steps have been taken to boost the dynamism of the private sector.

1. Establishment of a Private Sector Development Committee: This is a joint committee comprising of government and private sector representatives established to coordinate private sector development activities.
2. Divestment: In order to encourage private sector development, the Royal Government has been divesting its shares in the publicly held corporations to encourage private sector participation. In the past year, the Royal Government sold 20 percent of its shares in Royal Insurance Corporation of Bhutan to the general public reducing the government shareholding to less than 40 percent. The Royal Government's divestment policy is guided by the ability of the market to absorb the shares. Such periodic sale of shares has been well received by the public and the returns on the shares have been very good.
3. Industrial Estate Development: In order to facilitate industrial development and overcome the space and infrastructure constraints, the Royal Government has identified and approved the following industrial estate sites:

- Singhi Gaon for South Western Region
 - Chuwabari for South Central Region
 - Tingtibi for Central Region
 - Bodima for North Eastern Region and
 - Samdrup Jongkhar for South Eastern Region
4. The Royal Government has recently approved two joint ventures in the tourism industry to develop hotel infrastructure catering to the high-income tourists groups. We are confident that such partnerships will pave the way for high value tourism and improve the hotel infrastructure as well as the quality of services.
 5. The Royal Government has decided to establish dry port facilities in Phuentsholing and Gelephu. This will facilitate import and export businesses, reduce transaction costs and greatly enhance efficiency.
 6. Various legislations, directly related to the private sector have been passed in the 78th Session of the National Assembly. These Acts will provide the private sector a stable and predictable legal environment to operate in.

In addition, the Royal Government has set up a multi-sectoral committee to propose tax incentives to stimulate investment and growth. The Ministry of Finance would like to inform the honourable members that the following proposals for tax incentives are being considered:

1. Tax Holidays for industries set up in the interior: At present many industries are being set up on the border due to ease of transportation and availability of cheap labour. In order to encourage industries in the interior parts of the country, the Royal Government is considering

the provision of tax holidays, of three to five years. This is mainly to ensure regionally balanced development and enhance employment opportunities for people living in other parts of the country.

2. The multi-sectoral committee has also proposed to continue the existing tax exemption on plant, machinery and raw materials procured for manufacturing industries.

The Ministry of Finance will study these proposals and draw up detailed rules on the proposed incentives.

In addition, the Royal Government is also currently studying a Foreign Investment Policy in order to attract international capital, technology and managerial skills. Foreign investment will be sought through collaboration, joint ventures, and foreign direct investment. Foreign investment will help us overcome the capital and technology gap as well as provide access to international markets. The experience in many countries has shown that foreign investment is one of the most effective mechanisms to accelerate development, especially in the export sector.

Bhutan is also preparing the Memorandum on Foreign Trade Regime, as the first step towards membership in the World Trade Organization. Membership in the WTO will enable us to benefit from trade in a stable and predictable environment. However, we have to remember that such benefits will be forthcoming only if we have a dynamic export sector. Therefore, we need to make continuous efforts to identify and promote niche industries in Bhutan.

In view of our unique cultural heritage, strong traditions and pristine natural environment, Bhutan continues to be a popular tourist destination. Tourism is important for the economy, as it is the single largest source of hard currency. In the previous year, 7,559 tourists visited Bhutan and the gross earnings from the tourism industry accounted for US \$10.5 million marking an increase of about 18 percent in gross earnings from the previous year.

While the Royal Government will always ensure the policy of high value, low volume tourism, there is immense potential for growth in this sector considering that tourism is the largest industry in the world. In order to boost this sector, major initiatives are being taken to expand the infrastructure as well as improve the quality of services by introducing greater professionalism. As mentioned earlier, the Royal Government has approved joint ventures with foreign firms in the hotel business so that the Bhutanese can benefit from capital and knowledge transfer.

Financial Sector

The Ministry of Finance would like to inform the honourable members that the financial sector in Bhutan has shown marked improvement in the recent years. In view of the acceleration of economic activities, the financial sector has also expanded. The total assets of the monetary sector expanded by about 31 percent in the past three years signifying a rapid growth of economic activities.

The quality of assets of the financial institutions have also improved in the recent years as a result of prudential regulations and concerted efforts of the financial institutions to improve their management. Recent estimates show that the recovery ratio now stands at 85 percent and the average non performing

assets ratio has reached a new low of about 15 percent. The target is to bring the ratio to less than 10 percent in the next few years.

In an environment of liberalised interest rates and in order to stimulate lending activities, the Bank of Bhutan, in July 2000, lowered its interest rates on loans and advances ranging from 0.5 percent to 1.0 percent for general trade, personal transport and personal loans.

The financial sector continues to experience excess liquidity signifying a need to continue to improve financial intermediation. The issue of excess liquidity is symptomatic of the limited absorptive capacity of the private sector and the lack of bankable projects. The Royal Monetary Authority has continued to manage the liquidity in the financial system through the use of its monetary instruments (RMA Bills, Reserve Repurchase Agreement, and Cash Reserve Ratio) and foreign exchange to circumvent the immediate macroeconomic threat posed by excess liquidity. The Royal Government on its part is committed to improving the investment climate for private sector development through various policy measures as addressed earlier.

Conclusion

The coming financial year 2001-2002 marks the end of the 8th Five-Year Plan, and the completion of forty years of successful socio-economic development in the country. With the blessings of the guardian deities of Palden Drukpa and the enlightened leaderships of our hereditary monarchs, the Bhutanese people have continued to enjoy peace, prosperity and happiness.

As we gear towards the 9th plan, which commences in July 2002, Bhutan faces a very different domestic and external environment compared to the past. The success of our past development plans and the changes brought about by the process of globalisation places new challenges and opportunities for Bhutan. We have to address emerging issues such as youth employment and rapid urbanisation, as well as prepare to benefit from globalisation and liberalisation of international trade. For that we need to take important decisions to improve the private sector; promote export-oriented industries and create employment by investing in productive sectors.

However, the foremost concern in the minds of the Bhutanese people today is the security threat posed by the presence of ULFA and Bodo militants in our territory. The Royal Government is making every effort through peaceful means to persuade the Assamese militants to leave Bhutanese territory. If these efforts fail to produce concrete results and there is no option left but to resort to military action, as decided by the National Assembly, I would like to inform the honourable members that the Royal Government stands ready to devote all resources necessary to remove this problem.

I am confident that Bhutan will continue to enjoy peace and prosperity with the blessings of our guardian deities, the enlightened leadership of our beloved King and the continued harmonious relationship between the Royal Government and the people.

Tashi Delek

Selected Monetary and Financial Indicators

Items Description	1999/00	2001 March	Percent Change
1 Total Assets of the Financial Sector	22678.18	21934.49	-3.28
a. Royal Monetary Authority	9577.27	9608.64	0.33
b. Four Financial Institutions	13100.91	12325.85	-5.92
2 Money Supply			
a. Quasi Money 1/	5238.88	5738.58	9.54
b. Demand Deposits	2474.76	2879.10	16.34
c. Ngultrum in Circulation	1119.39	1346.36	20.28
3 Domestic Credit	752.12	986.07	31.11
of which Private Sector	1360.04	1912.34	40.61
Millions of USD			
4 Gross International Reserves	292.59	290.00	-0.88
a. Convertible Currencies	221.77	202.05	-8.89
Millions of Rs.			
b. Indian Rupees	3164.96	4100.62	29.56
5 Exchange Rate for USD (Period Average)	44.69	46.62	6.83
6 Consumer Price Index (%)	3.61	4.41	

Note: 1/ quasi money includes foreign currency deposits & time deposits

Selected Monetary and Financial Indicators

In Percent

Items Description	1999/00	March 2001
7. Structure of Interest Rates		
a. Deposits		
i) Savings	5 - 7	5 - 7
ii) Fixed Deposits		
3 months to 1 year	7 - 8	7 - 8
1 year to less than 3 years	9 - 10	9 - 10
More than 3 years	10 - 11	10 - 11
b. Lending Rates		
i) Export Finance	13	13-15.5
ii) Manufacturing, Service, Transport and Agriculture	13	13
iii) Housing	14	14
iv) Working Capital	13 - 15.5	13 - 15.5
v) Personal and General Trade	15 - 16	15 - 16