

BTI 2008 | Bhutan Country Report

Status Index	1-10	3.71	# 110 of 125
Democracy	1-10	3.75	# 99 of 125
Market Economy	1-10	3.68	# 111 of 125
Management Index	1-10	5.14	# 56 of 125

scale: 1 (lowest) to 10 (highest) score rank

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Key Indicators

Population	mn.	0.6	HDI	0.54	GDP p.c.	\$	1,969
Pop. growth ¹	% p.a.	3.4	HDI rank of 177	135	Gini Index		-
Life expectancy	years	64	UN Education Index	0.48	Poverty ³	%	-
Urban population	%	11.1	Gender equality ²	-	Aid per capita	\$	97.6

Sources: UNDP, Human Development Report 2006 | The World Bank, World Development Indicators 2007 | OECD Development Assistance Committee 2006. Footnotes: (1) Average annual growth rate 1990-2005. (2) Gender Empowerment Measure (GEM). (3) Percentage of population living on less than \$2 a day.

Executive Summary

Bhutan is undergoing substantial transformation – politically and economically, internally and externally. Internal political transformation has been driven by the former king's desire to transform his country into a modern democratic constitutional monarchy while balancing these changes by maintaining Bhutan's traditional values. After ruling for over 26 years, Jigme Singye Wangchuck, the fourth king, transferred royal power to an elected cabinet in 1998. In December 2006, he surprised the cabinet and nation by abdicating in favor of Crown Prince Jigme Khesar Namgyal Wangchuck. The major task facing the fifth king is the establishment of a written constitution, the introduction of political parties and the holding of the first democratic elections. The draft constitution was launched in March 2005, and a second revised version was submitted for consideration in August 2005. A final version is currently being prepared. At present, political parties are still banned, and it remains to be seen how free they actually can and will be, especially vis-à-vis the Lhotshampa (Bhutanese of Nepalese descent) part of the population. The first national elections are planned for 2008.

The economy remains dominated by agriculture, and the society is basically rural. The modern urban sector is still of a modest size. Outside of Thimpu and Phuentsholing, small firms easily enjoy local monopolies. This, however, does not apply to the travel industry, where a considerable number of agents and hotels compete for the few international tourists.

International relations are dominated by the desire to maintain as much political freedom as is possible, given the country's unique location in the remote high mountains of the eastern Himalayas, wedged between Asia's two superpowers, China and India. With India holding the Himalayan kingdoms as part of their sphere of influence, Bhutan has to be careful in its dealings with China. There are no diplomatic

relations between Bhutan and China. Bhutan and China signed an Agreement to Maintain Peace and Tranquility on the Bhutan-China Border in 1998, during the twelfth round of bilateral border talks. The bilateral talks are ongoing, although without much visible progress. The fifteenth round of talks in Thimpu is scheduled for November 2007.

The impact of the sensationally improving relations (at least in an economic sense) between China and India on Bhutan is not easy to predict. Bhutan may be sidelined rather than become an important transit area. Separatist movements in northeast India have been using Bhutan as a safe haven and sanctuary. Joint Indian-Bhutanese army operations, meant to drive the insurgents out in 2003, had some success until recently. The insurgency has hampered economic development, especially in eastern Bhutan, where the main road to Assam was closed due to the activities of guerrilla forces. India's economic liberalization policy, and the influx of cheap Chinese products that enter Bhutan mostly via India, hinder the development of Bhutan's miniscule industry.

Since India has opened its markets, China has become the major source of imports to India; Chinese products are available now all over India. There are only a few flights with small airplanes that can bring in luxury goods directly from Thailand or Nepal. The currency union with India, higher wages in Bhutan, and the country's remoteness offer few incentives for manufacturing. The major exception is hydroelectric power that is utilized by India. India's lack of primary energy has prompted India to invest in hydroelectric facilities in Nepal and Bhutan. However, since events in Nepal are hindering projects there, India has become even more dependent on electricity from Bhutan.

History and Characteristics of Transformation

Bhutan, the hermit kingdom, the land of the thunder dragon, has been and still is one of the most reclusive countries in the world. Until a few decades ago, its geography made the country inaccessible. Bhutan built its first access road only when the head of neighboring India came for his first state visit. And it was only in the 1960s that the first road linking the capital with India was built. This road forms the main highway that crosses the center of the country, with a few spurs heading north or south. Many villages remain over a day's walk from the nearest road. There are still only a few roads from India (and none from China, the only other neighboring state). Due to its mountainous terrain, Bhutan does not have a railway or inland water connections. The only international airport, located in western Bhutan, sees very little traffic. Isolation has been, and still is, as much the result of geography and history as of government policy. Bhutan was only recently, in the late 1970s, opened to tourists, although in limited numbers; only a few thousand tourists are permitted to visit the country

annually. It is not easy for foreigners to acquire a residency permit in Bhutan. The sale or transfer of land or any other immovable property to a person who is not a citizen of Bhutan is restricted by Article 7 (9) of the draft constitution. The country has been selective about accepting foreign (“development”) aid, entertains few foreign dignitaries, and has been very effective at restricting the number of foreign tourists with a tourism tax. The standard tariff for groups is \$200 per person per day. Thirty-five percent of the daily tariff goes directly to the Department of Tourism and hence to the national treasury; there are surcharges for small groups of one or two travelers, as well as rebates for the off-season and for longer stays.

Bhutan is a country that prides itself on having never been conquered. It did, however, have a series of encounters with the British empire (i.e., the East India Company and later British India) in the nineteenth century and had to cede the duars, the lands between the various rivers that flow down the eastern Himalayas into the Brahmaputra, after a short and disastrous war against the British. The British, by way of compensation, paid an annual sum to the Bhutanese authorities and this continued after the establishment of the monarchy in 1907. Since then, Bhutan’s boundary is where the foothills start to rise from the plains of north Bengal and Assam. Bhutan’s heartland is behind the first Himalayan range and is thus very much secluded from the Brahmaputra valley.

The British regarded Bhutan more as a kind of protectorate than an independent state, and after they withdrew from the subcontinent, the king of Bhutan was at great pains to prove his independence, especially when China annexed Tibet and India annexed Sikkim (China, however, would insist that Tibet always has been a part of the country, and India has argued that Sikkim was a protectorate that voluntarily acceded to India). Bhutan viewed its accession to the United Nations as a sign of international recognition and a guarantee of its independence. Rumor has it that Bhutan’s census statistics were doctored to give the appearance of a larger population than the country’s actual half a million citizens (estimates hovered around 0.6 million), and international sources still suffer from such inconsistencies (UNDP counts the population at 2.1 million, and the Bhutanese government’s figure is 0.75 million). India was and is satisfied that Bhutan remains in its sphere of influence, especially vis-à-vis China. On 8 February 2007, India and Bhutan signed a revised version of the treaty of 1949, giving the latter more freedom in crucial areas of foreign policy and non-lethal military purchases, as long as such decisions do not damage India’s vital strategic interests. Otherwise, has Bhutan steered clear of major powers and prefers to accept aid from smaller countries like Switzerland, Austria, Denmark and Norway. However, Japan is also a major donor.

Although it is a member of the South Asian Cooperation for Regional Development (SAARC), the South Asian Preferential Trade Area (SAPTA), and the South Asia Free Trade Area (SAFTA), Bhutan differs markedly from other South Asian countries. The national language, Dzongkha, is a Tibeto-Burmese language, written in Tibetan characters. Dzongkha is the language of western Bhutan and was adopted as the official

language in the 1960s; however, it had been the language of government since the seventeenth century. The Lhotshampa, who live primarily in the south and southwest, speak Nepalese, and the other major ethnic group, the Sharchop, are located in the east. With the exception of the mainly Hindu Lhotshampa community, the population is overwhelmingly Buddhist. There is no caste system among the northern Bhutanese, and among the Lhotshampa community, caste is less rigidly adhered to than in Nepal or India. What appears to outsiders as a blissful Shangri-la is not easily assessed; the national language and dress (to be worn when visiting government offices) appear to be enforced, rather than accepted as a matter of tradition, and this applies especially to those Bhutanese with a Nepali background (the Lhotshampa). A policy of forced Bhutanization, which came dangerously close to ethnic cleansing, caused tens of thousands to flee the country. There are around a hundred thousand refugees in camps in Nepal. A joint commission has started to verify claims of Bhutanese nationality on an individual basis, but, following violence at one of the camps in December 2003, little progress has been made.

From the seventeenth to the early twentieth century, Bhutan was a theocracy operating under a system of government introduced by the founder of Bhutan, Zhabdrung Ngawang Namgyal. This system of government had fallen into chaos by the late eighteenth century, and the nineteenth century was dominated by internecine strife. After the abdication of the last Desi in 1904, the establishment of the monarchy in 1907 replaced the Buddhist clergy with the king, who was invested with full authority. The third king began major political, social and economic reforms, which were continued by the fourth and last king. The fourth king appears to have been a rare example of an enlightened, benevolent monarch who ceded responsibility to the parliament, abdicated in favor of his son, insisted on the drafting of a constitution, discussed political affairs inside and outside of the country, proposed the unprecedented formation of political parties, and decided to hold the first free elections in 2008. He even wrote Bhutan's novel contribution to economics, the concept of "Gross National Happiness," into the new constitution. All in all, Bhutan presents itself as a very unusual state in transformation, since the transformation is not the outcome of an internal uprising, a breakdown of the old order, war or international pressure, but rather of the realization that the country has to adapt to the demands of modernity.

Transformation Status

I. Democracy

1 | Stateness

Until 1998, the king exercised direct control over the government, assisted by a national assembly of elected and nominated members. In 1998, he transferred his royal powers to an elected cabinet, which formed the government. However, the king has retained immense influence over both the cabinet and the country. There are, however, three major exceptions to the monopoly on use of force. First, a number of Indian militant groups are fighting for regional autonomy and have turned the thinly populated border areas of southern Bhutan into their sanctuaries. Second, after conflict erupted in 1990 between the Lhotshampa (Bhutanese of Nepalese origin, whose ancestors settled in the southern part of the country) and the royal government, approximately 100,000 Lhotshampa fled the country and are now living in refugee camps in eastern Nepal. Third, “India House,” the Indian Embassy in the capital city of Thimphu, is of considerable size, and all Indian interests in the country are coordinated from the embassy.

Monopoly on the use of force

India has economic interests in Bhutan, mainly tapping the vast potential of hydroelectric power, but India’s main interest is strategic. Despite record volumes of trade between India and China, the memory of India’s defeat in the 1962 border war lives on. India still lays claim to the territory of Arunachal Pradesh, bordering Bhutan in the east, which has been under Chinese occupation since the border war. China was especially mentioned in the Indian prime minister’s letter to the U.S. president after India’s nuclear tests in 1998 (“that other nation”) to defend the tests. India also remains troubled by the fact that a number of terrorist groups have training camps in Bhutan. Bhutan has long attempted to avoid a direct confrontation. In 2003, India engaged in a more proactive manner; Bhutanese forces, together with Indian units (there are joint Indo-Bhutanese military training camps in Bhutan), started to drive out these terrorist groups. India’s leverage is the Lhotshampa refugees. So far, India ensures that the Nepalese refugees do not settle close to the border (like India did in the case of the Tibetan refugees and the Chakma refugees from Bangladesh) and move on to

Nepal. Without India's assistance, it would be difficult for Bhutan to control a Nepalese insurgency. For a while, it seemed that insurgent groups from India had been successfully driven out of Bhutan. However, in early 2007, the South Asia Terrorist Portal claimed that Indian intelligence had identified at least four training camps that are currently run along the India-Bhutan border, where ULFA cadres are receiving training from cadres of the Sri Lankan Liberation Tigers of Tamil Eelam (LTTE). To counter the threat from armed refugees, the government has actively encouraged the resettlement of northern Bhutanese to the south, thereby diluting the Lhotshampa population. There has also been a move to recreate the former pazap system of militia that was developed for the explicit purpose of conducting the military operations of 2003, and also for the implicit purpose of ensuring that, if an insurgency ever arose, that the wider Bhutanese population could be mobilized. Therefore, the state's monopoly on the use of force may not cover the entire territory.

Bhutan has one of the strictest citizenship laws in the world. Article 6 of the draft constitution states that, if both parents are citizens of Bhutan, a person is a natural-born citizen of Bhutan. If a person resided in Bhutan on or before 31 December 1985, and their name is registered in the official record of the government of Bhutan, they can register to be a citizen of Bhutan. To apply for citizenship by naturalization, a person must have lawfully resided in Bhutan for at least fifteen years, must not have any record of imprisonment for criminal offences within or outside of the country, must be able to speak Dzongkha, must have a thorough knowledge of the culture, customs, traditions and history of Bhutan, and have no record of having spoken or acted against the king, the country or the people of Bhutan. How many of Bhutan's population are of Nepalese origin has long been a matter of considerable debate. In order to give the country a more substantial appearance, population figures have been grossly exaggerated for decades, and international agencies still publish extrapolations of population figures based on inflated data. Such estimates have exceeded two million, whereas official Bhutanese sources now number the population at around three quarters of a million. Estimates of people of Nepalese origin amount to up to 40% or, depending on the population numbers employed, to several hundred thousands. If one considers that the Bhutanese migrated from Tibet a few centuries ago, they constitute, according to opposition sources, less than half of the population.

According to the draft constitution, "Buddhism is the spiritual heritage of Bhutan, which promotes among others the principles and values of peace, non-violence, compassion and tolerance" (Article 3 (1)). Religion remains separate from politics (Art. 3). A Bhutanese citizen shall have the right to freedom of religion (Art. 7 (3)) and freedom from discrimination based on religion (Art. 7 (16)). Unlike Nepal or Sri Lanka, Bhutan does not have an official state religion; rather,

State identity

No interference
of religious
dogmas

it acknowledges the importance of Buddhism while promoting religious tolerance.

The structure of administrative institutions emulates the old fortified monasteries (dzong), which were the traditional abodes of the monks and are commonly used as administrative centers. There are 20 dzongkhags (districts). The dzongkhags are divided into gewogs (counties) and chiwogs (sub-units of a gewog).

Basic
administration

2 | Political Participation

Political participation has been minimal until recently, and only now are the formation and registration of political parties permitted. Elections are planned for 2008, and it remains to be seen what kind of parties are allowed to run for office and who will be allowed to vote. So far, elections are on a non-party basis. Article 15 (1) of the revised second draft edition of the constitution (2005) prescribes that “political parties shall ensure that national interests prevail over all other interests and, for this purpose, shall provide choices based on the values and aspirations of the people for responsible and good governance [...] A political party shall be dissolved by declaration of the Supreme Court (a) If the objectives or activities of the party are in contravention of the provisions of the Constitution; [...] (c) On such other grounds as may be prescribed by Parliament or under a law in force; [...]”. Only those two parties that muster the most votes in a primary round of election may stand for election to the parliament to become the “ruling party” or the “opposition party.” Clauses such as “national interest,” “candidates and political parties shall not resort to regionalism, ethnicity and religion to incite voters for general gain,” or “[a party] does not receive money or any assistance from foreign sources, be it governmental, non-governmental, private organizations or from private parties or individuals,” seem to be drafted to prevent citizens of Nepalese origin from obtaining parliamentary representation.

Free and fair
elections

Separation of powers and an independent judiciary are prescribed in the draft constitution: “there shall be separation of the Legislative, Executive and Judiciary and no encroachment of any other’s power is permissible except to the extent provided for in this Constitution.” (Article 1 (13)). In the absence of democratic institutions, there is little that can be said about their stability. It is remarkable that the king’s order that a written constitution be drafted, although met with unease, was not opposed. Bhutan is still a predominately rural society. The capital and “metropolis” of Thimpu is a small city by any standard; the other towns are much smaller, and the majority of the people live in villages and hamlets that are mainly accessible by walking. Traditionally, the dzong (fortress-monasteries) were (and still are) the centers of regional administration. The 20 dzongkhag (districts) have an average population of less than forty thousand each.

Bhutan presents itself as a country with a low average income and a greater degree of income and wealth equality, thus able to avoid the abject poverty of neighboring India. Political and social integration appear to be solid, with the notable exception of the remaining Lhotshampa and those who were either evicted or fled in 1990 and 1991. The official line promoted by the Bhutanese authorities is that very few of the Lhotshampa in refugee camps, as well as others claiming to be refugees from Bhutan, have ever actually lived in Bhutan, and that many of them are claiming to be refugees for simple material gain..

Although there is a National Assembly and most of its members have been elected, it is difficult to say that this body can rule democratically. On the official website of the National Assembly, they boast that, “no decision of the National Assembly embodied in any resolution or statute requires royal assent before coming operative”; however, “All of the decisions in the National Assembly are taken by consensus. However, in the event a vote is required on a particular subject during the Assembly, a two-thirds majority is required to pass the resolution.”

Effective power
to govern

So far parties exist only outside of the country. It was announced that political parties could register with the Election Commission beginning in July 2007.

Association /
assembly rights

Until 2005, there was only one newspaper, written in Dzongkha, Nepali and English. Two new newspapers, the Bhutan Observer and the Bhutan Times, have since been launched. Television and the Internet were introduced only a few years ago. The government does not control access to the Internet, and it has only banned a few satellite television channels, such as MTV, because the authorities viewed such programming as too violent or having a negative effect on the young. Article 7 (2) of the draft constitution reads, “A Bhutanese citizen shall have the right to freedom of speech, opinion and expression.”

Freedom of
expression

3 | Rule of Law

According to the draft constitution, the separation of powers is guaranteed. For the time being, it seems that most powers still rest with the king, at least in practice.

Separation of
powers

The judiciary is independent in principle, an independence that was firmly established by the Judicial Service Act 2007. The High Court has asserted its independence, notably in the acquittal of five southern Bhutanese (of Nepalese origin) suspected of being “anti-nationals.” The separation of powers was reaffirmed in Section 2 of the civil and criminal court procedure code (2001) and re-emphasized at the beginning of the 80th session of the National Assembly in 2002. The Office of Legal Affairs, an autonomous agency, was established in

Independent
judiciary

2000. It is separate from the High Court and, more importantly, from the Ministry of Home Affairs. Among other tasks, it is tackling public corruption.

Contrary to popular belief, corruption seems to be thriving in a regime that still operates with limited transparency and accountability, as the “Business Anti-Corruption Portal” reports. A private sector survey conducted by the International Finance Corporation and the World Bank in 2002 described the bureaucracy in the country as a “clean and well-managed system of governance.” Although opinions differ on the quality of the Bhutanese civil service, it is a fact that only a few corruption cases involving companies have made the national and international headlines during the last decade. This would seem to indicate that corruption is primarily a public sector phenomenon. However, there are several reports of bribery in public fund disbursement and procurement, and many companies complain about requests for facilitation payments when obtaining licenses and permits. The publicly declared war on corruption underlines the government’s intention to promote private sector development.

Prosecution of
office abuse

Civil rights are guaranteed by the draft constitution. Political opponents, especially refugees from Bhutan with a Nepalese background, would argue (rightly) that civil rights are only ensured to some extent and for limited social groups.

Civil rights

4 | Stability of Democratic Institutions

Bhutan is not a democracy.

Whether democracy will be accepted remains to be seen. Elections have been held, but they have been held on a non-party basis thus far. It is a peculiar feature of Bhutan that democratization has been, and continues to be, pursued in a top-down manner.

Performance of
democratic
institutions
Commitment to
democratic
institutions

5 | Political and Social Integration

There are no official political parties at the time of this writing. The new political parties, which will be formed for the first national elections in 2008, must fulfill the conditions set down both in the draft constitution and by the Electoral Commission. The draft constitution provides that only two parties will enter parliament to form the government and opposition (see above).

Party system

The most important and best-organized interest group is the Buddhist clergy. Many people are deeply religious and the monasteries still play an important role in education. The monasteries were the centers of administration. Government offices are still housed in monastery buildings.

Interest groups

Bhutan appears to be a consensus society. In official discussions, at least, it seems culturally privileged to avoid confrontation.

Consent to democratic norms
Associational activities

Bhutanese society appears to be highly egalitarian. Wealth is not openly flaunted, and abject poverty is hidden from view, although the people in general are rather poor. It is estimated that one-third of the population is poor. There has been little urbanization and industrialization, and the vast majority of the population continues to live in their traditional rural environment. Bhutan does not have a caste system, nor are there socially excluded minorities. Buddhist social norms continue to prevail, and social cohesion is maintained..

II. Market Economy

6 | Level of Socioeconomic Development

The level of socioeconomic development is low, even by South Asian standards. The UNDP ranked Bhutan at 135th out of 177 nations in 2004, just ahead of Bangladesh and Nepal. Bhutanese people have a life expectancy of 63.4 years, an adult literacy rate of 47%, and an average ppp-adjusted income of \$1,969. Significant parts of the population are not fundamentally excluded from society by poverty and inequality. There are no indicators available, but it seems that gender gaps, gender education, religion and ethnicity are comparatively better in Bhutan than in neighboring India. As for the Nepalese-speaking Bhutanese, they are mainly concentrated in the southwest of the country, in close proximity to India.

Socioeconomic barriers

Economic indicators		2002	2003	2004	2005
GDP	\$ mn.	546	609	729	844
Growth of GDP	%	8.9	7.1	7.5	6.1
Inflation (CPI)	%	2.5	2.1	4.6	5.3
Unemployment	%	-	-	-	-
Foreign direct investment	% of GDP	0.1	0.2	0.1	0.1

		2002	2003	2004	2005
Export growth	%	1.8	14.3	17.6	-
Import growth	%	5.2	8.5	9.4	-
Current account balance	\$ mn.	-	-	-	-
Public debt	\$ mn.	376.9	481.5	593.3	636.7
External debt	\$ mn.	377.9	485.9	593.3	649.2
External debt service	% of GNI	1.2	1.2	1.7	0.8
Cash surplus or deficit	% of GDP	-3.6	-9.8	1.9	-
Tax Revenue	% of GDP	9.2	9.3	7.4	-
Government consumption	% of GDP	20.0	20.0	19.8	-
Public expnd. on edu.	% of GDP	-	-	-	-
Public expnd. on health	% of GDP	3.3	2.9	3.0	-
R&D expenditure	% of GDP	-	-	-	-
Military expenditure	% of GDP	-	-	-	-

Sources: The World Bank, World Development Indicators 2007 | UNESCO Institute for Statistics | Stockholm International Peace Research Institute (SIPRI), Yearbook: Armaments, Disarmament and International Security

7 | Organization of the Market and Competition

Markets are small; new and better roads guarantee increasing competition. Most nonagricultural products (and some food) have to be imported, primarily from India. Phuentsholing is the main entry point for the majority of imports and goods. It is the second largest urban area in Bhutan, and Bhutanese travel from across the country to buy a range of goods not available elsewhere, including cars and other luxury goods. It was not possible to ascertain how many products enter the country directly from China (Tibet). Very little is brought in via these old trade routes. Anything brought in is illegal contraband, and the area is well known for poaching, with one problem being Tibetans preying on Bhutanese game and livestock. Chinese products, however, have become omnipresent in India over the last few years and enter Bhutan via India.

Market-based competition

The draft constitution deals with the economy primarily under “state policy,” where a number of endeavors are listed (Article 9 (9) sqq.), including economic self-reliance and the promotion of an open and progressive economy. Article 14 deals mainly with state finance.

Anti-monopoly policy

Until the first road was built to connect Bhutan with the outside world, there was little opportunity for foreign trade, and the economy was more or less self-sufficient. Even today, almost all goods enter the country via Phuentsholing on the Indian border and have to be transported by truck across the lower Himalayas. Agriculture is still the largest economic sector, and the economy is basically rural. The modern industrial sector is of a minuscule scale. Most settlements are located along the major road from the border (Phuentsholing) to Thimphu and beyond to the east. India has become a dominant factor in Bhutan's economy; the Indian army maintains a number of (joint) installations, and Indian contractors dominate construction (especially in the energy sector) and have brought highly skilled labor into the country. Indian tourists are permitted to visit without restriction, and they have come in increasing numbers, especially since Nepal became difficult to reach.

Liberalization of
foreign trade

Bhutan's banking system is still in its infancy. Given the de facto currency union with India, the role of the central bank, the Royal Monetary Authority, is limited. The State Bank of India partly owns the largest commercial bank, the Bank of Bhutan. Bhutan National Bank has been partially privatized. There is a small stock exchange (Royal Securities Exchange of Bhutan Ltd.), and an insurance company (Royal Insurance Corporation of Bhutan).

Banking system

8 | Currency and Price Stability

Bhutan has a currency union with India. The ngultrum, the national currency, is on par with the Indian rupee, which is also legal tender in Bhutan. Indians (and Bangladeshi) are also not subject to the strict visa regulations for foreigners; Phuentsholing is practically a "free trade" zone, meaning that there is no effective control of goods and people crossing the border here. The major checkpoints are beyond the entry point on the way to Thimphu. At a GDP of \$740 per capita (the GNP is higher at \$835) and an official population of 752,700, total GDP is just \$557 million. Manufacturing constitutes just 7.2% of GDP, and amounts to only \$40 million, no more than the sales of any medium-sized firm by international standards. Only 30% of the labor force works outside agriculture, numbering less than 100,000 people.

Anti-inflation /
forex policy

Energy, that is the hydroelectric power plants built by India to produce electric power for export to India, is the only major export industry. In Bhutan itself, 45,000 consumers in 40 towns and 819 villages are supplied with electric power. The power sector constitutes 10.8% of GDP, which is more than the manufacturing sector. Bhutan has only recently opened itself to foreign entrepreneurs wanting to start a business there and it is unclear how well this policy will work. Hydroelectric power and timber are Bhutan's primary domestic resources. The southern slopes of the Himalayas receive abundant rainfall and

provide an immense, and so far barely tapped, potential to generate electric power. The narrow valleys are ideally suited for the construction of dams and reservoirs; the area is sparsely populated, and the problem of displacing local people is not as troubling as it is in the central and western Himalayas. Bhutan, however, is one of the ecological “hot spots” of the world. Hydroelectric construction might collide with ecological concerns. The government is very sensitive to the dangers of harvesting Himalayan forests and has limited the felling of trees, despite of the high percentage of land covered by forest. The government is even encouraging reforestation and increasing the size of the wooded area. Consensus is obviously a major goal of Bhutanese society, although loyalty may be restricted to those they consider to be Bhutanese. The treatment of the Nepali and the restrictions to those married to non-Bhutanese, not to speak of foreigners who intend to reside and/or work in the country, clearly show the constraints under which consensus is being strived at.

The country stands out in international comparison in many ways: It is small, less-developed, land-locked, difficult to reach, reclusive, overshadowed by a mighty neighbor, and very much concerned with maintaining its independence, sovereignty and identity. With its currency parity with India, Bhutan is in a position to pursue its own currency policy, although probably not even its own foreign economic policy. It is hard to imagine that Bhutan could develop into any kind of an offshore financial center like Dubai, Singapore or Mauritius. If at all, Mauritius would be the most likely example to follow. Bhutan would lack, however, Mauritius’ accessibility and international outlook. It is also doubtful that India (and/or the government of West Bengal) would tolerate a tax haven in the Himalayas.

The latest reports (as of February 2007) indicate an extraordinary growth rate of 12%, even higher than in neighboring India and China. Given currency parity with India, the Bhutanese government depends heavily on India’s macroeconomic policies to check inflation. The inflation rate in India has been increasing, which should have spillover effects in Bhutan. Indian policies meant to arrest inflation will thus be welcome in Bhutan.

Macrostability

9 | Private Property

Since Bhutan’s economy is based on agriculture, agricultural land is the most important property, and property rights rest with the (private) farmers. Outside agriculture, there are a number of state enterprises. The government ensures that there is no encroachment on forestland. Under the Land Act of 1979, landholdings are restricted to 25 acres. A new cadastral survey was completed in 2003, and people had to pay for any land holdings above those shown on their original land deeds.

Property rights

Bhutan has a modern Companies Act of 2000. Enterprises have to be registered. As of 31 December 2004, there were 15,554 licensed industries, almost half of them (6,295) registered in the capital of Thimpu, and another tenth (1,503) in the southern dzongkhag of Chukha, which borders West Bengal. Less than 6% (874) of all industries are in production and manufacturing, half of them (368) are forest-based, a smaller proportion is agro-based (162), and the rest are classified as “other.” One-third of all licenses are granted to the services sector (5,468), and almost two-third are “contract licenses” (9,212). Most of the licensed industries are cottage industries (5,624 of all the 6,342 production, manufacturing and services industries), and only 47 are classified as large, 43 as medium, and 628 as small. There were 20,688 trade licenses on 31 December 2004, almost all of them in retail (20,102); 243 were dealership licenses, and 345 licenses were held by expatriates. Half of the licenses (10,448) were held in the Thimpu Region, mostly in the Thimpur dzongkhag (7,761), and the others were held primarily in the border areas of the Sandrup-Jongkhar and Phuentsholing regions.

Private
enterprise

10 | Welfare Regime

Bhutanese society still relies primarily on the social safety net provided by the (extended) family. Traditionally, the monasteries have played an important role in the mitigation of individual and collective disasters. The state is also active; according to a World Bank study of 2003, 0.6% of GDP is spent on social security and welfare (very low by international standards), 0.7% on transfers to organizations and households (also very low), but 4.0% on education. Thirty-six percent of total government expenditure is spent on safety nets, a very high percentage by international comparison.

Social safety nets

UNESCO reports that women in Bhutan enjoy considerable freedom and equal opportunity, both in government and in society in general. This may be attributed to the strong influence of Buddhism in every aspect of Bhutanese society. In Mahayana Buddhism, women and men are considered equal, though in reality this was more an ideal than an implemented practice. In legal terms, women are viewed as equal to men. Traditionally, the society was largely matriarchal; women were expected to hold the house and land property while sons left home to settle in their wives' houses.

Equal opportunity

11 | Economic Performance

The economy performs perfectly well if measured by annual growth rates that, according to the expectations of the World Bank, have reached 12%.

Output strength

12 | Sustainability

Bhutan is one of the most important environmental hot spots in the world. The government has actively pursued environmental policies and is aware of the fragility of Bhutan's environment. Although the country is forested (depending on the definition of this term), the government has made it a policy to increase the land under forest cover.

Environmental
policy

Until the 1960s, education was dominated by the monasteries, with only a few Bhutanese attending boarding schools in India. Under the third king, a modern education system emerged with English as the language of instruction. There are 19 private, 202 community, 90 primary, 77 lower secondary, 29 middle and 16 higher secondary schools, plus 14 educational institutions. The government of Bhutan rates their adult literacy rate for 2004 at 54%, and the UNDP, in their Human Development Report 2006, at 47%. Separate figures for men and women are only available from an older source, but this demonstrates a marked gender gap: the adult literacy rate was estimated by UNESCO to be 56.2% for males and 28.2% for females.

Education policy
/ R&D

Transformation Management

I. Level of Difficulty

The leadership tends to act in accordance with the interests of the royal family and the Buddhist clergy. This does not necessarily apply to opposition parties agitating outside the country. The clergy reportedly does not interfere in politics and will have no official right to representation in the new institutions, once the constitution is enacted.

Structural constraints

If we consider Buddhist monasteries and the clergy as part of the civil society, it has to be rated very high in its influence and effectiveness. In terms of a more conventional understanding of the concept of civil society, Bhutan's civil society must be evaluated as weak, and, with the exception of NGOs funded by international donors, as almost nonexistent.

Civil society traditions

The major conflict is ethnic, although it might have also religious and social undertones. As is so often the case in Bhutan, economic and social change are accompanied by exaggerated aspirations and expectations among the up-and-coming "educated" class. They see government as their (only) prospective employer and government jobs as their natural right. In this context, language becomes an important economic commodity; insisting on the command of the national language (Dzongkha), can exclude large segments of the population, such as the Nepali speakers in Bhutan.

Conflict intensity

II. Management Performance

14 | Steering Capability

The king, rather than political leaders, sets strategic priorities, from the concept of "Gross National Happiness" to the drafting of the constitution.

Prioritization

The king has been effective in implementing reform policy, a move designed to pre-empt the political radicalization that has occurred in northeast India and Nepal. The next step will be the founding of political parties, which will also have far-reaching consequences for the economy.

Implementation

The Bhutanese leadership has been carefully watching developments elsewhere and trying to prevent avoidable mistakes. This can be seen in their cautious approach to tourism and environmental issues. Such learning from the past or from other countries, however, does not extend to citizenship policies or the emergence of a particular vision of national identity.

Policy learning

15 | Resource Efficiency

Bhutan's major economic resources (besides agricultural land that is scarce) are forests and hydroelectric power. Both have been used prudently. The government has been careful not to commit the same mistakes in forestry as made in so many other countries; tree-felling is restricted, and the government is actively reforesting deforested areas. Hydroelectric power plants are built only in sparsely populated areas. However, Bhutan still has no full-fledged university; the government has been providing generous stipends to send gifted students to study abroad (especially in India). The Jigme Dorji Wangchuck University was set up in 2001, bringing together a range of educational institutions; it is still has to be properly launched, but it does exist. Sherubtse College in Kanglung provides pre-university teaching. The number of graduates in the country is still small.

Efficient use of assets

The government appears to be fairly successful in coordinating conflicting objectives into a coherent policy, as long we exclude the Nepalese opposition (outside the country).

Policy coordination

Bhutan has become known as one of the least corrupt societies in the region. There are, however, also voices of dissent. As long as there is no free press and no political parties, there is also no forum to publicize cases of corruption.

Anti-corruption policy

16 | Consensus-Building

Market economy and democracy are the declared goals of the government; the draft constitution shows, however, that the government has their own interpretation of democracy. It remains to be seen how much a market economy will be tolerated.

Consensus on goals

The government approach seems to encompass and co-opt potential veto players. Policies restricting citizenship and voting rights keep potential veto players out of the game.

Anti-democratic veto actors

It is open to discussion whether Bhutan really is the blissful Shangri-la that it is so often described to be, or whether there are substantial cleavages that the government has managed to keep from escalating into irreconcilable conflicts. The fact that the country has long enjoyed foreign exchange reserves in excess of foreign debt not only points to a conservative approach to maintain international economic maneuverability, but it also points to the willingness to take on enough (foreign-funded) projects to appease the elite.

Cleavage / conflict
management

The elite appear to have been taken care of efficiently by a paternalistic kind of government. The professional class is still small, and it will slowly develop its own organizations in order to voice its interests and demands. Civil society is gradually emerging, and it has to be considered against a broader ability to participate in political debate. RENEW, a local NGO established in 2004 that deals with violence against women, is a good example of a new organization seeking to address gender issues.

Civil society
participation

If we consider the eviction of tens of thousands of Nepalese speaking Bhutanese as a major past injustice, bringing reconciliation between the victims and perpetrators should be a priority. The Nepalese view the government as the perpetrator.

Reconciliation

17 | International Cooperation

Bhutan has made very prudent use of international support. It has been selective in choosing development partners, turning to smaller donor countries, with the exceptions of India and Japan. It has also abstained from oversized showpieces of modernity. Foreign exchange reserves exceeded foreign debt long before the present dollar glut. Long-term debt of \$593 million (2004) almost reached the GDP of \$729 million. Surprisingly, according to World Bank calculations, the present value of debt equals that of the gross national income (GNI, \$694 million), which points to the arrival of either a smaller-than-expected grant element or considerable short-term debt.

Effective use of
support

Bhutan enjoys high credibility as far as aid is concerned. Most foreign investment comes from India and is in hydroelectric energy. Bhutan has little experience in private international cooperation (see 17.1, Using support).

Credibility

International cooperation is strictly with one neighbor, India, and in a very limited way with others, such as China. Like Nepal, Bhutan hopes for more trade through Bangladesh, which is only a few hours from Phuentsholing. However, India has not been very supportive in assisting with the development of better relations. Relations with Nepal are strained because of the ongoing refugee crisis.

Regional cooperation

Strategic Outlook

Bhutan provides an interesting example of a top-down approach of an enlightened monarch. The king is selective, however, in his care for the country's people. The government determines who qualifies as a Bhutanese citizen on the ground of ancestry, and the policy is clearly aimed at excluding those without a "native" background. Nepalese refugees argue that the numbers of Nepalese and "natives" are underestimated, and that the Drukpa are actually in the minority. Religion was never the basis for the conflict in the south, despite the claims of some refugees. This singles out those with a Nepali background, meaning those whose ancestors emigrated from Nepal directly or indirectly, who speak Nepali, and who may be (although not necessarily) Hindus. There is a need to recognize that many refugees may also have been living not in Bhutan, but in the northeastern states of India, where local nationalists forced them out. Therefore, one should be careful about unqualified acceptance of refugees' claims. Bhutan's overpowering neighbor, India, claims to have "special interests" in the country, especially vis-à-vis China. The Friendship Treaty of 8 February 2007 updated the 1949 Treaty and gives Bhutan equal rights, calling for their close cooperation. The clause stating "Neither government shall allow the use of its territory for activities harmful to the national security and interest of the other," is, of course, more binding for Bhutan than India. India, however, supports the present regime and seems to decide the fortunes of the country in many ways. India's internal problems, including a number of regional dissent movements in the northeast, have started to spill over into Bhutan, and Bhutan cannot easily resist being drawn into India's domestic politics. As of the beginning of 2007, no immediate changes seem to be in the air. The transition of power to the crown prince, the country's first constitution, and a democratically elected parliament, will all bring changes. One should not forget that the monarchy celebrates its centenary in 2007; festivities have been postponed for astrological reasons until 2008.