

PRIVATE SECTOR DEVELOPMENT

The Way Forward

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Executive Summary

After five decades of planned development, Bhutan stands at the crossroads of history. The transition to multi-party democracy, after a century of enlightened monarchy, and the relentless forces of globalization bring challenges as well as opportunities for the continued growth and prosperity of the country. The choices Bhutan makes now will influence the future trajectory and quality of its socioeconomic growth.

Recognizing the importance of the private sector for creation of wealth and overall economic growth, coupled with the urgent need to define its role in a rapidly changing socioeconomic scenario, this paper presents a brief review of private sector development. The report includes an analysis of the current situation, constraints to unlocking the potential of the private sector, and elements of a private sector development strategy.

The potential of Bhutanese firms to compete, innovate and move up the value chain has been constrained by a number of inherent factors such as location, size, and the short history of private sector development with the attendant lack of adequate access to business infrastructure and business culture. Constraints at the firm level include the access to labor, capital, skills, technology, and the limited participation of the private sector in policy formulation.

The government has made considerable progress in creating an enabling environment for private sector development. However, its efforts are hampered by the lack of an industrial roadmap, the uncoordinated and inconsistent nature of government rules and regulations, and cumbersome legal and administrative requirements. This has fostered an uncertain and insecure environment that deters investment and entrepreneurship, while encouraging rent-seeking and short term profit-taking over more beneficial long term investment.

With the inevitable move to market-led growth, the private sector needs to lead the formulation of policies and plans for private sector development. Towards this end, the paper chalks out the way forward by highlighting the main elements of a strategy that will create market-based regulatory regimes and institutions to support investment, innovation, and competition. This involves actions by the government to strengthen the rule of law, create a level playing field, simplify regulations, modernize financial services, develop specialized factors of production, and promote outsourcing and public-private partnerships. The paper recommends that, in-step with the proposed government initiatives, the private sector also vigorously pursue innovation, adopt higher levels of technology and skills, and strengthen its lobbying power.

The paper concludes with the identification of four potential or green areas that should be in the forefront of private sector development plans. These include tourism, power-intensive industries, organic products, and educational centers.

1. Background

Five decades of socioeconomic development have spurred the growth of the Bhutanese private sector, especially small-scale enterprises. While private sector development reinforces overall economic growth, generates employment and reduces poverty, its potential is still constrained by several factors.

The following sections briefly review the current situation, potential of the private sector and the constraints to private sector development.

1.1 Current Situation

Since planned development started in the early 1960s, economic activity in Bhutan has progressed from an almost totally subsistence economy towards commercialization. The formal private sector is growing and picking up momentum, with the number of licensed enterprises doubling from 9,016 in 2000 to 17,257 in 2005 (see Table 1).

Table 1 Composition of the Private Sector

	2000	2001	2002	2003	2004	2005
Sector						
Private	8,959	12,807	13,833	14,627	15,489	17,181
Joint	23	24	24	15	15	15
Public	34	47	51	50	50	61
Size						
Large	39	41	44	43	47	57
Medium	43	44	50	36	43	62
Small	409	473	467	588	628	678
Cottage & Mini	7,647	3,784	4,277	4,945	5,624	6,941
Construction	5,212	8,536	9,050	9,080	9,212	9,519
Type						
Production & Manufacturing	523	569	586	800	874	985
Agro based	109	116	121	155	162	181
Forest based	288	317	324	341	368	414
Mineral based	42	46	46	55	66	80
Others	84	90	95	249	278	310
Construction	5,212	8,536	9,050	9,080	9,212	9,519
Services	3,281	3,773	4,272	4,812	5,468	6,753
Total	9,016	12,878	13,908	14,692	15,554	17,257

Source: *Statistical Yearbook of Bhutan 2005 and 2006, National Statistical Bureau*

Molded by its small economy and relatively recent business culture, the Bhutanese private sector is characterized by:

- predominantly small-scale enterprises, employing less than 10 people, in trade, industry and services;
- dominance of private sector activities by few large-scale companies, both private and public;
- dependence of production and manufacturing on natural resources, employing low technology with very little value addition;
- general lack of specialization;
- importance of project-tied hydropower and infrastructure development for the economy, especially the construction sector;
- reliance of export-oriented power-intensive industries on the availability of relatively cheaper electricity;
- low employment elasticity of large industries with minimal linkages in the domestic economy;

- dependence on India for cheaper unskilled labor as well as skills and technology;
- significant informal business activities, including fronting; and
- regionally unbalanced growth.

1.2 Potential

The importance of private sector development for the economy is undeniable with the average annual GDP growth rate of 6-7% in the last decade being driven primarily by hydropower, construction, services and power-intensive manufacturing sectors. This is brought out by the following table, which also reflects the gradual transformation of the economy as measured by the contribution of each sector to GDP.

Table 2 Share of Gross Domestic Production in Constant Prices

	Sectors	% of GDP			GDP Growth*
		1996	2000	2005	2005
1	Agriculture	37.5	27.7	21.8	0.4
2	Mining and Quarrying	1.5	1.5	1.5	13.4
3	Manufacturing	9.2	8.3	6.7	4.4
4	Electricity	10.8	11.2	11.4	10.2
5	Construction	7.6	13.3	16.2	-2.9
6	Wholesale and Retail trade, hotels & restaurants	6.4	5.2	7.1	15.0
7	Transport and Communications	8.5	9.4	9.1	7.3
8	Finance, insurance and real estate	8.0	6.8	8.0	18.6
9	Community and social services (Govt.)	10.5	14.1	12.9	13.2
10	Private, social & recreational services		0.5	0.5	18.7
11	Plus: Indirect taxes less subsidies		2.5	4.8	13.8
	GDP	100	100	100	6.5

*Over the preceding year

Source: *Statistical Yearbook of Bhutan, various year, National Statistical Bureau*

Private sector activity is the main source for earning the much-needed foreign exchange through the export of high-value low-volume niche products. Apart from its contribution to GDP, the potential of private sector development also lies in its ability to generate gainful employment and reduce poverty, especially through cottage and small-scale enterprises. Private sector development will also reduce the country's overwhelming dependence on donors for development needs.

Given the stable macroeconomic and political environment, the abundant natural resources, and the increasing number of educated youth joining the labor market, the conditions are right for fast-tracking private sector development so as to fulfill its potential to contribute to Gross National Happiness through the creation of more opportunities and a higher standard of living.

1.3 Constraints

The wealth of the country as measured by GDP has increased over the years with respectable growth rates. However, the potential of the private sector to enhance the domestic revenue base, boost exports, generate employment and reduce poverty has been held back by a combination of factors. These well-known constraints can be grouped into external and internal factors.

i. External constraints

External factors include inherent constraints such as the landlocked, small and scattered domestic market resulting in higher transportation costs and low economies of scale; and

the lack of adequate infrastructure and required skills and knowledge largely due to the relatively recent history of modern Bhutanese economy.

The key cross-cutting issues that impact, and even inhibit, private sector development include policy and coordination, legal and administrative, infrastructure, financial services, and taxation issues. They are briefly discussed below:

Policy and coordination issues

Policy documents have declared the private sector as ‘the engine of growth’ of the Bhutanese economy and, while it is a major driver of economic development, the government is yet to develop and adopt a consolidated policy and strategy for private sector development. This has resulted in an uncertain policy atmosphere, albeit in a stable political and macroeconomic environment, leading to uncoordinated development and lack of focus, inconsistent application of rules, and overregulation.

The lack policy coordination between ministries has resulted in separate ministerial policies that are often contradictory, such as the restrictions placed on tourism infrastructure development by the rules and regulations of the Ministry of Home Affairs and the impact of the Forest Nature Conservation Act on private sector activities. Coordination gaps with donor agencies also often result in situations where an activity is approved and the implementation is halted for the lack of funds.

In addition to the ambiguous policy environment and the lack of coordination within the government, private sector development is also constrained by the absence of a central coordinating agency for such activities.

The unclear and inconsistent policy environment coupled with overregulation has fostered rent-seeking, corruption, and inefficiency. This, in turn, has diluted the potential of the private sector by dampening innovation, discouraging competition and decreasing the ease of doing business in Bhutan.

Government dominance in the economy and the private sector through the large public enterprises has been a breeding ground for inefficiency and, at times, the government is in direct competition with the private sector. As a result, government attitude towards the private sector sometimes ranges from paternalism to mistrust and confrontation.

The current situation wherein certain government agencies, such as the BDFC, are charged with mandates that include both profit maximization as well as social obligations, have often resulted in the dilution of both responsibilities.

Legal and administrative issues

The ease of doing business in Bhutan is constrained by the cumbersome, bureaucratic and lengthy procedures and the World Bank ranks the country’s business environment at 138 out of 175 countries. These barriers foster rent-seeking and inefficiency, thereby increasing costs and stifling entrepreneurship. The main legal and administrative issues include:

- Inconsistent rules and regulations that are open to interpretation and case-by-case application;
- cumbersome and lengthy procedures for starting a business, licensing and permit requirements;
- weak judicial capacity in commercial law and enforcement of contracts;

- lack of coordination between various acts, rules and regulations, which are sometimes at cross-purposes e.g. the land requirement for private educational institutes and the legal land ceiling;
- lack of consultation with private sector stakeholders resulting in rules and regulations that impede private sector development;
- inconsistent and ‘open to interpretation’ schedules that administer the implementation of laws, rules and regulations;
- low levels of transparency and accountability in the government resulting in nepotism, cronyism, corruption, inefficiency and a general lack of professionalism in service-oriented government agencies;
- irrational bidding procedures which are based on outdated manuals;
- prohibitive labor regulations with stringent restrictions for recruiting foreign workers, high dismissal costs and restrictions on term contracts;
- outdated and lengthy legal and administrative requirements for registering property; and
- weak investor and consumer protection.

Financial issues

Limited access to credit and the high cost of borrowing are recognized as major barriers to starting a business venture in Bhutan. The financial sector’s potential to stimulate private sector development is constrained by:

- undeveloped financial markets with only two banks and two non-banking financial institutions (FIs) with very limited private and international participation;
- lengthy and time-consuming formalities for processing loans;
- interest rates are considerably higher than regional averages;
- prohibitive security and collateral requirements at a minimum of 1:1.5 ratio of the loan,
- inconsistent mechanism for property valuation and criteria for security among FIs, such as the differentiation for urban and rural land;
- low capitalization structure of FIs;
- low ceiling for loans that can be sanctioned by the FI managing directors;
- weak legal rights for borrowers and lenders;
- lack of new products and alternative financing mechanisms such as bonds, venture capital, hire purchase, debit and credit cards, travel insurance, etc;
- high rate of guarantee charges for bidding in government tenders, contracts and orders as well as bank and transfer charges;
- relatively high insurance premium for securities mortgaged to FIs and the lack of competition in the provision of insurance services;
- relatively high insurance premium for securities mortgaged to FIs;
- absence of a common and transparent credit rating system between the FIs;
- lack of incentives such as preferential interest rates and banking charges for good clients;
- thin loan markets with substantial assets being held abroad;
- stringent requirements for FDI;
- lack of monitoring of FIs by Royal Monetary Authority (RMA) according to its Prudential Guidelines;
- lack of professionalism of FI Boards;
- limited capacity of FIs in project evaluation, appraisal and monitoring;
- conservative management of FIs with poor customer service; and
- lack of private sector participation in the RMA Board and the conflict of interest of the Finance Minister serving as the Chairman.

Infrastructural issues

A debilitating impediment for private sector growth is the low quality and reach of required business infrastructure. While many infrastructural shortcomings are tied to the landlocked nature and rugged topography of the country, the main constraints include:

- slow development of industrial estates and the lack of dry ports;
- limited access to land and the lack of a competitive land market with secure property rights and at transparent prices;
- complicated transactions for transfer of property, making the negotiating process long, cumbersome and frequently corrupt;
- archaic land laws;
- dominance of the government in land holdings and inconsistent cumbersome procedures for leasing government land;
- limited reach of essential infrastructure like power, water, communications and transport which negatively impact supply chain management and increase costs of production;
- limited tourism infrastructure;
- limited exploitation of natural resources, especially power and forests;
- imperfect markets for local raw materials, especially sand, stone and timber coupled with lengthy procurement procedures; and
- the freeze on licenses for new business activities in the south for security reasons.

Taxation issues

According to the World Bank, businesses in Bhutan spend 274 hours complying with tax rules to pay 43% of their profits in tax. Constraints related to taxation include:

- narrow tax base;
- complexity of the tax system leading to non-compliance and evasion;
- ad hoc duty structures with unilateral and sudden changes in rates;
- incidences of double taxation;
- short term and irrational nature of tax holidays, which are due to end across the board by 2008;
- although a legal requirement, limited practice of maintaining proper accounts with negative impact on investment, competition and efficiency as a result of the accompanying lack of transparency and poor accounting standards;
- lack of internal auditing and cost accounting systems in the private sector; and
- the need for revision of tax deductible expenses for sales promotion, advertisement, HRD, entertainment and salaries to reflect the actual need for these activities and to ensure efficiency and transparency by formalizing these expenses.

ii. Internal constraints

Apart from the external constraints discussed above, private sector development is also hampered by internal weaknesses related to labor and technology. These impediments inhibit the ability of Bhutanese firms to compete in terms of price, quality, delivery and marketing. Due to its weak institutional lobbying power, the private sector is also largely excluded from policy formulation.

Labor issues

While the Bhutanese private sector has the advantages of a stable and flexible labor force, private sector development is severely constrained by the following labor related issues:

- lack of skilled and unskilled labor;

- mismatch of supply of workers available in the market and labor needs of private firms;
- lack of incentives for employing domestic labor, especially in construction;
- inconsistent and limited access to cheaper Indian labor;
- lengthy procedure for recruitment of non-nationals;
- implementation of the Labour and Employment Act; and
- cumbersome requirements for visiting business professionals.

Technology issues

Private sector development is limited by the generally low levels of production technology and investment for productivity improvements. Although technology is firm specific, the Bhutanese private sector is constrained by the following:

- weak management with limited managerial skills and external experience;
- limited market knowledge and marketing skills;
- lack of innovation and limited value addition;
- low levels of production technology, which is mostly imported from India;
- lack of quality standards and product consistency; and
- limited technology transfers due to capacity and cost constraints as well as the lack of learning mechanisms.

Institutional issues

The overdependence of the private sector on government tenders and government operations, the insufficient role of lobby groups for private sector interests, and the lack of a central agency for private sector activities are the main institutional constraints for private sector development. Areas that require special attention include:

- limited capacity of the Bhutan Chamber of Commerce and Industry (BCCI) to lobby for private sector interests;
- limited reach of BCCI to the districts;
- low levels of interaction and networking with other regional chambers and donor agencies;
- lack of broad-based membership and adequate representation of the private sector in the reconstituted Private Sector Development Committee of the Ministry of Trade and Industry; and
- limited capacity of business associations, which are still growing, in voicing needs of small enterprises and stimulating inter-firm exchange of information and technology transfers.

2. The Way Forward

Bhutan stands at a crucial threshold in its history. With increasing integration of the global economy and the imminent introduction of multi-party democracy, the choices made now will determine the course of its socioeconomic growth.

Strategies to meet these challenges, and capitalize on the opportunities that they bring, must include private sector development. A robust private sector propels sustainable economic growth, generates government revenue, and creates gainful employment, which are indispensable factors for achieving the country's shared vision of peace, prosperity and happiness.

While the present growth of private sector has largely been spurred by overall socioeconomic development, given the gathering forces of change, a review of private

sector development is warranted. The need of the hour is for an ambitious vision for the private sector as the driver of economic growth; one that maximizes its potential while being grounded in reality.

In order to achieve this vision, a coherent private sector development strategy needs to be developed. Although aspects of such a strategy have been mooted in many studies and reports, implementation has been sketchy, uncoordinated and weak.

In keeping with the above review of external and internal constraints, the elements of a strategy to unleash the full potential of private sector development can be grouped according to actions required by the government and the private sector. The following recommendations, based on stakeholder discussions and a desk review of various studies, are not exhaustive and, priorities for the short and long term will need to be calibrated through further research and in-depth discussions with a broad spectrum of stakeholders.

2.1 What the government needs to do

The government recognizes the importance of private sector development and is engaged in creating and maintaining an enabling environment. However, it needs to move away from overregulation and strengthen its ability to catalyze, encourage, challenge, or even push business enterprises to raise their aspirations and move to higher levels of competitive performance.

While capitalizing on its comparative advantages of political and economic stability, natural resources, and strategic location, Bhutan needs to improve the competitive advantage of its firms if it is to ensure higher levels of quality and growth. This can be achieved by stimulating the private sector's potential to become more competitive through innovation, both technical improvements to product or to the production process.

The tools available to the government in carrying out this vital task include subsidies to firms, either directly or indirectly through infrastructure development, specialized factor creation, fiscal and tax policies, and by enforcing stringent standards to establish high technical and product benchmarks, including environmental regulations.

The following issues need to be addressed by the government in order to promote the development of a dynamic and competitive private sector:

i. Strengthen the rule of law

Private sector development requires a coherent, consistent and transparent policy environment for improving the ease of doing business. Strengthening the rule of law is also essential given the impending adoption of the Constitution. Issues requiring government attention include the following:

- the need for revising policies, rules and regulations that impact private sector development so as to ensure greater accountability, transparency and coordination among the different government agencies;
- the need for clear trade and industrial strategies and policies, including an industrial development roadmap;
- the need for strengthening contractual assurance to ensure effective enforcement of laws, rules, and regulations;
- the need to ensure and protect property rights through review and implementation of relevant legislation;

- the need for more efficient commercial jurisprudence and out-of-court arbitration mechanisms;
- the need for establishing an enforcement mechanism that is fair, effective and trustworthy while avoiding overregulation;
- the need for complaint cells in government agencies and a mechanism for feeding genuine complaints into the performance evaluation of civil servants;
- the need for a single-window policy for dealings with the private sector so as to remove bureaucratic hurdles and discourage rent-seeking while promoting efficiency and ensuring consistent, transparent and uniform application of rules and regulations; and
- the need for, and the right to, easy access to clear and concise information on government policy in all areas.

ii. Engage private sector in policy formulation

Initiatives for private sector development have more scope for success when the private sector is itself involved in all aspects of policy formulation. While participation of the private sector in decision-making has been increasing over the years, the private sector must play an equal, if not the leading role, in formulating policies, plans and strategies for private sector development. However, representation in such exercises should be broad-based and transparent.

iii. Create a level playing field

The Bhutanese business environment, shaped by its short history, small economy and close-knit society, is an uneven playing field that encourages ad hoc decisions, rent-seeking and inefficiency.

The creation of a level playing field for firms to compete fairly and move up the value chain requires strengthening the rule of law, broad-based participation of the private sector in policy formulation, and simplification of regulations to ensure the policy environment is fair and transparent, with adequate accountability mechanisms.

Ensuring fair competition will also involve providing incentives for balanced regional development through subsidies such as tax breaks, infrastructure development and business development services.

Anti-trust legislation to check the growth of monopolies and cartels needs to be strengthened along with a review of public sector activities, such as the Construction Development Corporation, that are in direct competition with the private sector. State protection and unfair advantages accorded public corporations, such as the STCB, PCA, Bhutan Telecom, etc, and the conflict of interests in government ministers heading the board of public sector corporations also need be reviewed.

iv. Simplify regulations

Regulatory risks and costs are among the most significant obstacles for doing business and attracting foreign direct investment. Flawed regulation translates into major constraints on growth, productivity and the formal economy. On the other hand, experts estimate that countries can increase GDP growth rates by up to 2% by improving regulatory practices¹.

¹Center on Regulation and Competition Policy Brief: *Why Regulatory Governance Matters*. University of Manchester, 2004

The private sector is overregulated and doing business in Bhutan is constrained by cumbersome bureaucratic procedures. While sustainable regulatory reform initiatives must strike an appropriate balance between quick-wins and long term institution-building, measures to simplify regulations to make them more meaningful should include:

- establishing single-window or one-stop shops, both physical and electronic, for government dealings with the private sector;
- providing easy access to clear and concise information on government policy in all areas through tools such as a centralized online register of formalities;
- introducing checklists for permits, licenses, registration, procurement of inputs, and other bureaucratic requirements;
- allowing immediate establishment of business enterprise, apart from activities that are very large-scale, or with significant environmental, cultural or security implications, after signing an undertaking that all requirements of the checklist for such activity have been met;
- developing adequate monitoring capacity to ensure business activities are in-line with statutory and other requirements, together with transparent punitive mechanisms for defaulters;
- de-licensing cottage and small-scale enterprises based on investment and not turnover as is the current practice;
- instituting time limits for government decision-making and the ‘silence is consent’ principle;
- providing regulatory compliance assistance for cottage and small enterprises;
- adopting a risk-based approach, wherein rogue traders and firms are subject to consistent checks while compliant businesses are subject to ‘light touch’ regulation;
- implementing impact assessments of legislative and policy initiatives to ensure coordination, consistency and relevance;
- undertaking an independent review of red tape;
- building capacity in regulatory impact assessment skills through improved data collection methods and public consultation practices;
- streamlining import and export regulations in consultation with trading partners;
- developing a policy and regulatory framework to support re-exports;
- limiting regulation to domestic needs and avoiding regulation on behalf of other countries;
- ensuring standards are reflect domestic needs and not based on conditions in more advanced countries; and
- increasing use of IT-based solutions to increase efficiency and provide fair, consistent and impersonal regulation.

v. Improve access to finances

Although some liberalization initiatives have been implemented, the limited competition in the financial sector continues to constrain access to finances by way of high intermediation costs, heavy collateral requirements, and limited product development. Recommendations to improve access to finances include:

- increase the capital base of banks to facilitate international trade;
- fast-track the process for the establishment of more private banks;
- reduce financial charges for banking transactions, both domestic and external;
- review the current interest rate calculation system so as to adopt competitive interest rates based on market mechanisms and internationally accepted financial norms;

- reduce collateral security for business loans by strengthening monitoring mechanisms, base asset valuation on market rate and basing collateral requirement on feasibility of the business;
- allow and facilitate external borrowings for large-scale activities that are beyond the capacity of the FIs;
- adopt a cash-flow based system of financing instead of the current security-based method;
- institute credit rating system for customers to reduce nonperforming loans;
- introduce innovative financing schemes to improve access, especially of small and microenterprises, such as developing feasible projects for potential entrepreneurs ;
- introduce alternative forms of financing like bonds, venture capital, hire purchase, etc;
- develop private debt markets through inter-company borrowings;
- encourage long term domestic savings;
- provide foreign exchange for raw materials that have potential for value addition through processing;
- review the FDI policy to improve consistency and transparency and liberalize the foreign investment regime;
- strengthen the Bhutanese stock market to increase investor confidence;
- stop investment in fixed deposits outside the country;
- introduce competition in the provision of insurance services by allowing private insurance firms; and
- reconstitute the Boards of the RMA and FIs to ensure professionalism and transparency.

vi. Review taxation policies

In order to create an enabling environment for private sector development, the following issues require attention for ensuring an efficient and fair tax system:

- rationalize and simplify the tax system to remove minor hassles and ensure better compliance and collection;
- provide training on and encourage maintenance of proper accounts;
- provide incentives for model taxpayers;
- promote the development of internal auditing and cost accounting systems in the private sector;
- provide long term tax holidays to stimulate investment and innovation;
- develop and implement a more rational system for tax deductible expenses;
- consider declaring southern border towns as tax-free zones to promote competition with their Indian border towns;
- refund 100% of the excise duty for raw materials and semi-finished products for further value-addition, if supported by proper documents, so as to smoothen excise refunds from India, stimulate competition in border towns, and promote record-keeping; and
- implement formula-based resource allocation to local governments as recommended by the GG Plus Report, thereby promoting ownership, competition, decentralization, accountability and private sector development.

vii. Develop specialized factors of production

A nation's competitive advantage is based on key or specialized factors of production which are created as opposed to general use factors, such as unskilled labor and raw materials that are more readily obtainable. Specialized factors of production include skilled

labor, capital and infrastructure. As their development involves heavy and sustained investment, such assets provide competitive advantage as they are more difficult to duplicate. Towards this end, it is recommended that government:

- align the future skill and knowledge needs of the private sector with the curriculum of schools and other educational institutes;
- expand the reach and improve the quality of vocational training programs and business development services;
- improve and expand business and socioeconomic infrastructure;
- accelerate the development of industrial estates and dry ports and communication infrastructure, such as the proposed international airport and railway links to India;
- consider the establishment of Special Economic Zones;
- accelerate the reclamation land from near the Toorsa river to expand access to land in Phuntsholing through alternative financial instruments, such as bonds, if donor support is not forthcoming;
- improve managerial and marketing skills of Bhutanese firms;
- professionalize corporate governance;
- provide incentives for higher levels of production technology;
- develop and enforce high quality standards and product consistency;
- facilitate adherence to environmental standards through government and donor support; and
- promote technology transfers through learning mechanisms such as foreign investment, matching grant schemes, exporting, foreign consultants, worker training and external support services.

Information and Communication Technology (ICT) can help Bhutan to overcome the constraints of geography and a dispersed population; create a knowledge-based society; promote private sector development; tap international markets; support good governance; and promote culture. Development of ICT has potential as an enabling factor for developing specialized factors of production, private sector development and as well as a viable business opportunity in itself. Initiatives to harness ICT for private sector development include:

- Introducing a modern legal and regulatory framework for the sector;
- Strengthening relevant policy and regulatory bodies;
- Reducing costs of ICT services;
- Developing nation-wide affordable, fast, secure, sustainable and appropriate ICT infrastructure;
- Investing in laying a Dark Fiber conduit to an international gateway to boost ICT efficiency and potential for business, as the capacity of satellite connectivity limits the development of BPOs;
- Developing skills and technology through improving the quality and coverage of training institutions and establishing a center of excellence to accredit national training institutes;
- Improving content and applications;
- Outsourcing government ICT work;
- Exporting ICT services;
- Encouraging application of ICT in non-ICT businesses; and
- Conducting awareness campaigns.

viii. Promote public-private partnerships

In order to enable greater private sector participation in economic development and facilitate private sector development, the government needs to increase outsourcing of works and develop public-private partnerships (PPPs) as recommended by policy documents such as the Good Governance Reports.

PPPs involve the transfer of investment projects that have been traditionally executed or financed by the government, such as public infrastructure and community facilities, to the private sector along with an emphasis on service provision and investment by the private sector. Such partnerships entail sharing of investment, risk, and responsibility between the partners through an enforceable contract.

In this regard, the government needs to develop an appropriate legislative and fiscal framework for PPPs as well as its own capacity to negotiate, design, monitor and evaluate PPPs so as to ensure high safety, environmental and quality standards. Private companies will also need support and incentives such as access to adequate finances, non-national skilled and non-skilled labor, tax relief for technology imports, etc.

2.2 What the private sector needs to do

In tandem with the above recommendations for the government, the private sector also needs to move forward and undertake activities that promote quality and efficiency. This involves promoting innovation, mainstreaming of corporate social responsibility, and strengthening the Bhutan Chamber of Commerce and Industry.

i. Promote innovation

Empirical evidence shows that a nation attains competitive advantage if its firms are competitive which, in turn, is achieved through innovation. While a conducive environment for technical improvements to the product or to the production process is influenced greatly by the role of the government and its policies, the management, functioning and work environment within firms are also crucial for innovation.

In this regard, Bhutanese firms need to adopt modern methods of business management and marketing, invest in new technologies and human resource development, and adopt learning mechanisms for technology transfer.

ii. Mainstream corporate social responsibility

In keeping with the overarching development philosophy of Gross National Happiness, private sector enterprises have an obligation to mainstream corporate social responsibility (CSR) standards by considering the interests of customers, employees, shareholders, communities, and the natural environment in all aspects of their operations.

CSR is in tune with the country's cultural ethos of interdependence and karma, and closely linked to sustainable development principles that guide Bhutan's socioeconomic development. Mainstreaming CSR requires enterprises base decision-making not only on financial factors such as profits or dividends, but also on the immediate and long term social and environmental consequences of their activities.

While codes of conduct are the main tool for mainstreaming CSR, research suggests that once adopted and implemented, they become tools for managing corporate governance and employee compliance as well. However, CSR should extend beyond statutory obligation to comply with legislation or cosmetic corporate social responsibility. On the other hand, the private sector's ability to answer frequent pleas for social, religious and other causes is

constrained by government rules that limit the size and direction of donations. As an incentive, donations up to 5% of the net profit should be tax deductible, if supported by authentic receipts.

CSR should not be restricted to large companies and corporate governance but also include smaller enterprises and individual proprietors. The Bhutan Chamber of Commerce and Industry, as the apex private sector institution, must lead the effort to mainstream CSR and promote its values throughout the private sector.

In the long term, mainstreaming corporate social responsibilities depends on the quality of the education and the values that shape our entrepreneurs. While successful CEOs of multinational companies use techniques like meditation to improve their lives and companies, such enlightened leadership is largely absent in the Bhutanese private sector.

iii. Strengthen BCCI

The Bhutan Chamber of Commerce and Industry (BCCI) is the main link between the government and private sector and its participation in programs for private sector development is essential. However, the Chamber urgently requires institutional capacity building for it to facilitate private sector development.

In order for BCCI to effectively lobby for private sector interests, it requires the necessary skills and stature. Towards this end, it is recommended that BCCI upgrade its skills and knowledge through an HRD plan that strengthens its capacity in key areas, expand its reach to the districts, and increase its interaction with other regional and international chambers and development agencies.

A crucial milestone in empowering the BCCI will be the ratification of the Bhutan National Chamber of Commerce and Industry Bill by the coming session of the National Assembly. Once passed, the Act will facilitate the establishment of a federation of branches in the districts; define the functioning of these bodies; and accord statutory powers to the organization.

In the spirit of democracy and for more inclusive decision-making, membership in the reconstituted Private Sector Development Committee of the Ministry of Trade and Industry should be expanded to ensure the greater participation of the private sector, including representation from small-scale enterprises.

The growth of business associations should be promoted by BCCI as such bodies are essential for the development of the industries they represent by encouraging self-regulation and stimulating inter-firm exchange of information and technology transfers.

The Chamber, along with relevant government agencies, also needs to conduct more awareness campaigns to inform and sensitize the private sector on government policies and regulations.

An important, but largely overlooked, role of the BCCI is to create a positive image of the private sector by promoting corporate social responsibility. The Chamber should promote activities such as instituting excellence awards based on peer and consumer reviews, encouraging private sector participation in social service, patronizing local artistes, etc.

3. Green Areas for Private Sector Development

The above sections have reviewed ways to facilitate private sector development by unlocking the potential of private enterprise and overcoming the external and internal constraints through coordinated action by the government and the private sector. While these recommendations will stimulate an enabling environment that is conducive for competition, value addition and innovation in general, a long term vision for private sector development is required.

The Vision 2020 document advocates economic growth that is based on strategic and comparative advantages in the production of hydropower, tourism, natural resource-based processing industries, horticulture, rural enterprise development through SMEs, and niche market products. While the potential of these sectors still holds true, it is necessary to review this vision through the lens of competitive advantage and in the light of the internal and external changes. It is also time to think more ambitiously.

Towards this end, four priority sectors or green areas that should spearhead private sector development in the long term have been identified. The selection of these sectors is based on their potential for growth, income generation and creation of gainful employment, and comparative advantages of the country. The green areas are tourism, power-intensive industries, organic products and education centres.

A pressing and vital issue is how to mainstream the promotion and development of these four sectors into public policy, governance, administration, and even the mandate of Bhutanese embassies and missions. At the same time, a clear and cohesive strategy to achieve their full potential needs to be developed with adequate participation from all stakeholders and implemented according to a realistic time schedule.

While the decision to aggressively promote the recommended four priority areas will require an in-depth study and approval of the government, the following sections briefly suggest strategies would stimulate the potential of these sectors to propel Bhutan towards prosperity.

1. Tourism

The tourism sector is crucial for Bhutan's economy and private sector development. It is the largest commercial source of convertible currency and among the highest revenue earners for government. It also has an important role to play in the country's economic development through the industry's significant linkages in the domestic economy and its potential for employment generation and poverty alleviation.

Last year, around 17, 300 tourists visited Bhutan through 166 tour companies of the total 250 registered. The sector earned about US\$ 24 million and the royalty paid to the government increased to US\$ 8.3 million from US\$ 6.5 million in 2005. If the current growth rate is sustained, it is estimated that tourism can generate foreign exchange revenue of over US 50 million annually within the next ten years and create direct and indirect employment for over 20,000 employees.

The potential of the tourism sector is constrained by government policy, seasonality, lack of product development, low quality of services, and regionally imbalanced growth. However, these impediments are not insurmountable and the tourism industry can be further developed to increase its contribution to private sector development and overall economic growth. Promotion of tourism as a priority sector should include the following issues:

- Formulate a clear and transparent tourism policy that stimulates an enabling environment;
- Mainstream the importance of tourism into the policies and plans of all relevant government agencies;
- Increase coordination among stakeholders, both within the government and with the private sector;
- Establish a Tourism Development Board composed of stakeholders from the government and private sector to spearhead tourism development activities such as marketing and infrastructure development;
- Revise the tariff structure to promote competition, innovation and quality by regulating the royalty component while allowing operators to calculate their package prices and margins freely (this change in policy should be undertaken after broad consultations and implemented after adequate time has been given to operators to realign their strategies);
- Improve quality of accommodation, food and other tourism services through skills development, enforcement of standards, allowing recruitment of non-national skilled personnel, and tax exemptions on import of tourism-related items;
- Increase access by allowing exit and entry through any part of the country, streamlining visa and permit requirements by instituting a one-stop-shop for required clearances;
- Open up potential areas such as Manas and Merak Saktien;
- Develop tourism infrastructure in the east and south;
- Develop policies for allocating and leasing land for construction of hotels and other tourism-related infrastructure;
- Expand community-based tourism by promoting homestays and rural enterprise development;
- Improve transport infrastructure and augment road network by domestic air links for small fixed-wing aircraft and helicopters;
- Improve efficiency and maximize yield of Druk Air operations by subscribing to a Global Distribution System and promoting use of ICT;
- Expand Druk Air's fleet and its operations to more destinations such as Singapore, Hong Kong and the Middle East to increase economies of scale;
- Accelerate development of an all-weather airport and railway links;
- Intensify marketing efforts by inviting reputed travel writers and documentary producers;
- Provide fiscal incentives for tourism development such as soft loans, longer tax breaks, duty exemption on import of vehicles and equipment, access to foreign exchange for imports, and the reduction of annual licence renewal fees to eliminate entry barriers;
- Treat Tax Deducted at Source as an all-inclusive tax (apart from PIT), after revising the rate through broad consultations; and
- Promote development of new and potential products such as MICE (meetings, incentives, conventions and exhibitions) tourism, rejuvenation centers, entertainment industries such as casinos in southern towns (for tapping external spending only) etc.

II. Power-Intensive Industries

With an estimated hydropower potential of 23,500 MW and an almost insatiable market in India, energy is a key element in Bhutan's economic development. It is the highest contributor to GDP and a catalyst for the development of industry. However, only four

major hydropower projects have been developed amounting to 1,488 MW or around 6% of the estimated potential.

Although the hydropower development is constrained by market imperfections, high investments, and technical difficulties, the following measures need to be undertaken to tap Bhutan's hydropower potential:

- Accelerate hydropower development so that at least 20,000 MW are harnessed by 2020;
- Develop suitable legal and regulatory arrangements to attract private sector in all aspects of hydropower development;
- Expand financing options, such as independent power producers and PPPs backed by international financial institutes;
- Accelerate the consolidation of hydropower projects into a single corporation so as to reap economies of scale, increase efficiency and improve bargaining power;
- Rationalize the method of setting export power tariffs;
- Introduce alternative pricing mechanisms, such as time-of-day charges;
- Accelerate the proposed connection to the SAARC power grid;
- Develop skills and knowledge required in the power sector; and

The industrial sector is vital for economic growth and overall socioeconomic development of the country. Recognizing the comparative advantage that the acceleration of hydropower development will bring through the abundant availability of relatively cheaper power, it is recommended that power-intensive industries be promoted as a key component of private sector development. Realizing the potential of this sector will involve capitalizing on comparative advantages, while developing competitive edge through an enabling environment that stimulates increased competition and innovation by nurturing a sophisticated market for high quality products and promoting a set of strong related and supporting industries.

In addition to the need for an overall enabling environment and the accelerated development of the country's hydropower potential as discussed above, the recommendations for development of power-intensive industries include:

- Develop a comprehensive strategy for power-intensive industries;
- Accelerate industrial infrastructure development, including fully-serviced industrial sites and dry ports;
- Develop and improve transportation and communication infrastructure;
- Increase access to finances through alternative financial instruments and liberalization of FDI;
- Increase access to both skilled and non-skilled non-national labor;
- Align the future skill and knowledge needs of power-intensive industries with the curriculum of schools and other educational institutes;
- Increase worker productivity through worker and management trainings, adoption of new and appropriate technology, and R&D;
- Provide incentives for hiring domestic labor;
- Streamline and simplify import and export formalities in coordination with major trading partners;
- Unfreeze issue of licenses in the south;
- Support industrial development through export incentives such as duty draw-back schemes, and pre-and post-shipment financing; and
- Encourage higher value addition through direct and indirect support;

- Explore niche markets and promote niche products, such as components; and
- As an environmental champion, utilize electricity to power transportation and freight (such as ropeways), while promoting the use of alternative sources of energy such as CNG, bio-diesel, solar energy, etc.

III. Organic Products

Although much progress had been achieved in economic development over the last five decades, Bhutan still faces the challenges of poverty alleviation, rising income inequalities and unemployment. These challenges take on a more urgent note given the advent of democratization and globalization.

Developing cottage and other small-scale enterprises provides viable avenues for the poor to unleash their latent potential and participate effectively in the market economy and improve their livelihoods. Rural enterprise development augments direct agricultural interventions and provides smallholder farmers with an opportunity to access alternative sources of income as safety net.

The promotion of such people-centric enterprises requires a clearer focus of private sector development policies and appropriate interventions to bring vulnerable people into the socioeconomic mainstream. The promotion and development of organic niche products is recommended as a priority sector based on Bhutan's inherent constraints of size, location and topography as well as its comparative advantages of varied agro-ecological zones, clean environment and the growing market for such products. Some pertinent issues that are vital for creating an overall enabling environment for the development of cottage and small-scale enterprises engaged in the production of organic products are listed below:

- Formulate a comprehensive strategy for the promotion of such enterprises;
- Address regulatory and administrative impediments to doing business as discussed in the earlier sections;
- Develop efficient transport, communication and business infrastructure across the country, with a focus on increasing access of rural communities;
- Develop niche strategies, identify niche markets for organic products, and provide information on markets, regulations, standards and packaging requirements of importing countries;
- Strengthen marketing of niche organic products through the development of a Bhutan brand or label that reflects desirable attributes such as organic production, and environmental and ethical standards;
- Promote production of organic products by implementing community-based pilot projects for their demonstration effect;
- Promote business education modules in schools, technical and vocational institutes and private centers to stimulate interest in organic products and to provide R&D for such products;
- Expand HRD in the private sector by increasing access to skills development in the districts;
- Improve access to finances through alternative financing mechanisms that are tailored for small enterprises such as micro finance and micro credit;
- Provide tax relief for producers of organic products;
- Provide adequate technical support for producers of organic products through the relevant agencies of the Ministry of Agriculture;
- Enhance access of potential rural entrepreneurs to business development services;

- Support the establishment of business associations and cooperatives, especially community-based Tshogpas, and involve such associations in formulation of private sector related plans and policies;

IV. Education Centers

Another potential area for private sector development lies in the development of education centers or learning institutes that cater to regional and global needs. Viable institutions include educational, management, medical, environmental, and hospitality training centres. Along with the creation of an overall enabling environment, the following issues will need to be addressed to promote such knowledge centers:

- Development of appropriately qualified human resources and technology within the country;
- Development of a legal and regulatory framework for knowledge centers, one that allows such centers to adopt any curriculum/examination board through affiliations with regional and international institutes;
- Easy access to skills, knowledge and technology from outside the country;
- Development and enforcement of high standards;
- Access to adequate finance;
- Access to adequate land, which will entail revision of the outdated Land Act;
- Development of supporting industries and infrastructure;
- Long term tax breaks;
- Review of rules and regulations that impact development of these institutions, such as visa and permit requirements; and
- Development of effective marketing strategies.

4. Conclusion

This paper briefly reviewed the current situation, potential of the private sector and the constraints to private sector development. While it is constrained by an array of external and internal impediments, the Bhutanese private sector has the potential to propel the country to higher levels of growth and prosperity.

The way forward is by creating an overall enabling environment for innovation, investment and competition by overcoming the current external and internal constraints through coordinated government and private sector initiatives.

While the ease of doing business will exponentially improve if the above recommendations are implemented, a comprehensive private sector development strategy is required. The paper presents the elements of such a strategy. Four priority areas: tourism, power-intensive industries, organic products and education centers, have been identified as priority sectors based on their potential for capitalizing on the comparative advantages of the country and their capacity for growth and value addition.

Annex I: Working Group Members

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2. Dasho Ugen Tsechup Dorji, President, Construction Association of Bhutan
3. Mr. Yeshey Norbu, President, Association of Bhutanese Tour Operators
4. Aum Damchae Dem, Managing Director, Bhutan Steel Enterprises
5. Mr. Karma Dorji, Managing Director, Karma Group
6. Mr. Tshenchok Thinley, Tashi Tours and Travels
7. Dasho Bap Kinga, Vice-President, BCCI
8. Mr. Phub Tshering, Secretary General, BCCI and Working Group Secretary

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