Bhutan
Development Update

Special Topic: Ramping up e-trade in Bhutan

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Preface and Acknowledgments

The Bhutan Development Update (BDU) is published annually. It assesses recent economic and social developments, prospects, and policies in Bhutan. The BDU also provides an in-depth analysis of selected economic and policy issues. In this edition, the special section focuses on e-trade, outlining opportunities and challenges in harnessing digital trade in Bhutan. The report is intended for a wide audience, including policy makers, business leaders, researchers and academics, the community of analysts monitoring Bhutan’s economy, and the general public.

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The report was prepared based on published data available on or before March 25, 2021. The BDU draws on data reported by the government, as well as information collected through the World Bank Group’s regular economic monitoring and policy dialogue. Data sources include the World Bank, International Monetary Fund, Royal Monetary Authority, Ministry of Finance, National Statistics Bureau, and press reports.

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Recent Economic Developments

Bhutan has been successful in preventing the COVID-19 virus from spreading domestically. Cases have remained low, due to stringent containment measures. As of March 25, 870 cases have been confirmed, and only one death. The government has successfully contained two domestic outbreaks in August and December 2020 with strict nationwide lockdowns. Borders have remained closed since March 2020.

Bhutan’s economy contracted by 0.8 percent in FY2019/20 after growing by 4.3 percent in FY2018/19. Tourism and related services were severely affected in the second half of FY2019/20 (January to June 2020) when borders were closed. Industrial output fell in FY2019/20. While the hydropower sector performed well thanks to the on-streaming of the Mangdechhu hydropower plant, other industrial activities were significantly affected by supply-chain disruptions (limiting access to essential inputs, including foreign labor), and depressed external demand (especially from India).

Inflationary pressures have increased. Average inflation increased from 3 percent in FY2019/20 to 7.7 percent in the first half of FY2020/21, driven by an increase in domestic and imported food prices. Food inflation averaged 15.6 percent in the first half of FY2020/21.

Poverty is expected to have increased slightly in 2020, mainly due to high food inflation. Elevated food prices, along with disruptions in agricultural activities, likely eroded the real incomes of many rural poor. As a result, the $3.20 poverty rate (in 2011 purchasing power parity terms) is expected to have increased slightly, from 10.7 percent in 2019 to 11.2 percent in 2020. The labor market shock from COVID-19 mainly affected service sector workers in urban areas, including many that directly or indirectly depend on tourism. However, the Druk Gyalpo Relief Kidu (DGRK) program, which provides immediate income support to vulnerable households, has helped reduce adverse welfare impacts.

Vulnerabilities have increased in the financial sector. The Royal Monetary Authority (RMA) extended relief measures, including a partial interest waiver on loans (until March 2021) and the deferment of monthly loan installment repayments (until June 2021). The non-performing loan (NPL) ratio stood at 15.5 percent, as of September 2020. However, asset quality is expected to deteriorate once the interest moratorium and forbearance measures are phased out.

Trade has slowed as a result of COVID-19, but hydropower exports have been resilient. Although there have been limited formal restrictions on the movement of goods, some trade disruptions have been reported, due to high transport and logistics costs and labor shortages. Exports of non-hydro goods and services have been severely impacted by the border closure and lower
external demand. Hydropower exports doubled, as a share of GDP, from FY2018/19 to FY2019/20, offsetting the decline in non-hydropower exports. Meanwhile, goods imports were subdued as the pandemic curbed public investment projects and hydropower projects. As a result, the current account deficit narrowed to 12.2 percent of GDP in FY2019/20, down from 21.1 percent in FY2018/19.

The fiscal deficit widened to 3.2 percent of GDP in FY2019/20, with spending growing faster than revenues. While revenues were boosted by one-off profits from hydropower, non-hydropower revenues fell due to the discontinuation of excise duty refunds from India and a drop in tourism receipts. Spending growth was primarily driven by an increase in salaries and wages (40 percent, year-on-year [y-o-y]) and an increase in capital expenditures. As a result, public debt rose to 121 percent of GDP as of December 2020. However, debt sustainability risks are moderate as the bulk of the debt is linked to hydropower project loans from India (to be paid off from future hydropower revenues), for which there are minimal re-financing or exchange rate risks.

Outlook and risks
The economy is projected to contract further, by 1.8 percent, in FY2020/21. Services sector output is expected to fall by 3.7 percent, as tourism activity is not expected to resume until mid-2021. Labor shortages, high input prices, and trade disruptions will continue to affect construction, manufacturing and non-hydropower exporting industries. Output is expected to return to pre-pandemic levels (in real terms) in FY2021/22, when tourist inflows gradually resume and non-hydropower activities resume at scale. Growth is expected to pick up in FY2022/23, as tourism recovers and the Punatsangchhu (Puna) II hydropower project begins operations. The current account deficit is expected to remain lower than pre-COVID, given subdued imports for public investments. However, the fiscal deficit is projected to increase sharply in FY2021/22. Revenues will be impacted by the discontinuation of the profit transfer from Mangdechhu and weak expected non-hydropower revenue performance, and expenditures will rise to accommodate recent salary increases and the COVID-19 recovery package. Poverty is expected to increase further in 2021. The $3.20 poverty rate is projected to increase from 11.2 percent in 2020 to 12.5 percent in 2021, given continued inflationary pressures and the growth decline.

Risks to the outlook are high given continued pandemic-related uncertainties. The pace of economic recovery will depend on how fast COVID-19 vaccines can be deployed globally, and specifically in India (given significant tourism and trade linkages between the two countries). Domestic risks include possible delays in hydropower project completion and lower hydropower production (triggered by inclement weather or maintenance work), and the materialization of financial sector contingent liabilities. The implementation of revenue measures, particularly the GST, is critical to expanding domestic resource mobilization beyond hydropower revenues and ensuring fiscal sustainability.

The digital economy - including the sale of goods and services online - is likely to emerge as a major growth pillar in the aftermath of the COVID-19 crisis. For a small landlocked country such as Bhutan, e-trade in both goods and services is a key growth opportunity in that it can reduce the cost of distance and remoteness. For instance, digital platforms could reduce the costs of connecting Bhutanese buyers and suppliers with external markets. E-trade and online business activity also generate consumer gains, while supporting entrepreneurship, job growth, and productivity and opening-up international trade to micro, small, and medium enterprises.
Special topic: Ramping Up E-trade in Bhutan

Although Bhutan has made progress in recent years, notably by initiating the development of a domestic e-commerce ecosystem, gaps still remain. The Royal Government of Bhutan (RGoB) has prioritized information and communications technology (ICT) development to promote the vision of “an ICT-enabled, knowledge society as a foundation for Gross National Happiness.” Initiatives, such as the Digital Drukyul flagship program, the guidelines on e-commerce and the e-commerce Policy Framework, aim to increase Bhutan’s digitalization and participation in e-commerce. Yet, constraints in the e-trade environment—such as limited Internet connectivity, high costs of payment transactions, an incomplete regulatory infrastructure, and high trade facilitation and logistics costs—still hold Bhutan back, resulting in low levels of e-trade participation at present.

The special focus section assesses the main regulatory and trade facilitation priorities for digital trade in Bhutan and makes concrete proposals to develop the country’s e-trade framework. The development of Bhutan’s digital economy and e-trade is contingent on a number of complementary factors including reliable Internet connectivity, mobile and computer penetration, digital literacy, availability of efficient logistical and payment systems, and relevant infrastructure to facilitate those factors. E-trade in goods and services also requires supporting policies in areas such as data protection, cyber security, consumer protection, competition law and the recognition of e-signatures and electronic transactions, which are the basic building blocks of all business online.
1. Recent Economic Developments
1.1. Context

Bhutan’s COVID-19 strategy has been highly successful as only a few cases and one death have been reported. As of March 25, 2021 Bhutan had recorded 870 cases with only one death (Figure 1). Between March 20, 2020, when the first known case was discovered, and August 20, approximately 100 cases were identified, all of which imported -i.e. not a result of local transmission- and detected under mandatory quarantine. On August 20, the first locally transmitted case was confirmed, and a stringent nationwide lockdown followed. The outbreak was contained from September onward until another domestic outbreak started (from the international airport in Paro) on December 20. A second nationwide lockdown was announced shortly thereafter, on December 23. During the second lockdown, the number of confirmed cases increased sharply. Since it was lifted on February 1, 2021 all known new cases have been imported.

Figure 1. Number of confirmed and recovered cases, daily reported cases

Source: Ministry of Health (as of March 25, 2021), WB staff estimates

Bhutan’s success in fighting the epidemic came at the cost of stringent containment measures. The government’s efforts to contain the pandemic have focused on mandatory quarantine, mass testing, and contact tracing. Borders have remained closed since March 2020. Incoming travelers are obligated to undertake a 21-day quarantine in a government assigned facility. The government has categorized areas and districts into low and high-risk areas and introduced movement restrictions for individuals traveling between high risk areas (e.g., southern districts and border towns with India) and low risk areas, including a 7-day mandatory quarantine. The government used mass-testing to inform the phase-wise relaxation of the second nationwide lockdown.

1.2. Real Sector

Growth

The economy contracted in FY2019/20 due to COVID-19-related disruptions, with output falling in tourism-related services, construction, and manufacturing. Overall, growth is estimated to have been negative at -0.8 percent\(^1\) in FY2019/20, down from 4.3 percent in FY2018/19, and 6.3 percentage points lower than the pre-COVID-19 forecast (5.5 percent) (Figure 2).\(^2\) Low tourist arriv-
als in the second half of FY2019/20 dampened services sector growth. While the hydropower sector performed well, thanks to the on-streaming of the Mangdechhu hydroelectric power plant, other industrial activities have been significantly affected by supply-chain disruptions (for critical inputs, including foreign labor), and weak external demand (especially from India).

**Figure 2. Contribution to GDP growth, supply side (percentage points)**

Services sector growth slowed to 1.6 percent in FY2019/20, down from 10.8 percent in FY2018/19. While services performance was good during the first half of the year, it deteriorated markedly thereafter. Tourism – a key driver of services growth before the pandemic - came to a standstill after the government closed the country to visitors on March 6, 2020. As a result, tourism-related activities, including hospitality, accommodation and transport services, contracted by 8 percent in FY2019/20 (Figure 3). In addition, finance, insurance and real estate services have also contracted, reflecting the poor performance of the financial sector.

**Hydropower production and exports to India increased in FY2019/20.** Hydropower production increased by 23.3 percent in FY2019/20 due to the commissioning of the Mangdechhu hydropower project (720MW) in August 2019 (Figure 4). Production also increased in the Tala project - the country’s largest hydropower project - (1,020MW), for which maintenance work was completed after two years. As a result, the electricity (and water) sector grew by 14.2 percent in FY2019/20.

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3 Footnote 3: from 8,182 GWh in FY2018/19 to 10,088 GWh.
Despite this boost from the hydropower sector, industrial output, as a whole, contracted by 1.5 percent. The pandemic and related restrictions on cross-border movement of people created severe labor shortages, which affected construction and large manufacturing industries, including cement and wood industries. Shortages of foreign labor (mainly from India) impaired the construction of hydropower as only one third of the usual labor force on site could be mobilized. Non-hydropower exporting industries, mainly base metals and minerals, were affected by trade-related disruptions and low external demand. Regional exports of boulders (to India and Bangladesh) were temporarily halted from March to September 2020.

In contrast, agricultural production has been broadly resilient to the pandemic. Agriculture output grew by 1.9 percent in FY2019/20, driven by crop and livestock production—which together account for about 80 percent of agriculture value-added. However, the forestry and logging sector has been contracting for five consecutive (fiscal) years, given low domestic demand for timber. While subsistence producers appear to have been relatively shielded from the pandemic, agribusiness has been affected by trade disruptions and reduced external demand from India and Bangladesh.

These supply-side developments were reflected, on the demand side, in a slowdown in consumption growth and a sharp contraction in investment. The deceleration in private consumption growth and the sharp contraction in investment in FY2019/20 (y-o-y) reflected the adverse impact of domestic containment measures, in the second half of the fiscal year, on day-to-day economic activities as well as public infrastructure and hydropower projects. Net exports contributed positively to growth, as hydropower exports grew (from the Mangdechhu hydropower plant) enough to offset a decline in non-hydropower exports, and imports for public infrastructure and hydropower projects were subdued (Figure 5).
Inflation increased to a six-year high, driven by food inflation. Since 85 percent of Bhutan’s imports come from India and the Bhutanese Ngultrum is pegged to the Indian Rupee (INR), Bhutan’s inflation rate co-moves with that of India with a time lag.\footnote{WB (November 2018). Bhutan Development Update. The time-lagged correlation coefficient between India’s Wholesale Price Index (WPI) and Bhutan’s CPI is statistically significant and suggests that Bhutan’s CPI lags India’s WPI by six months.} Average inflation was low—at 3 percent—in FY2019/20, thanks to a decrease in food prices. Inflationary pressures materialized with the onset of the crisis in March 2020, and average inflation increased to 7.7 percent in the first half of FY2020/21 (Figure 6). While non-food inflation remained modest, averaging 1.7 percent in the first half of FY2020/21, food inflation rose to an average of 15.3 percent. The composite food price index, which carries a 46 percent weight in the CPI basket, soared to 16.4 percent (y-o-y) in October 2020, mainly due to increases in prices of perishable products such as meat and fish, vegetables, fruits, dairy and egg products. Food prices remained elevated at 14.8 percent in December (Figure 7, Figure 8).

Figure 6. Inflation, Bhutan and India (percent)
Limited market access by domestic farmers and import restrictions may have contributed to food inflation. Anecdotal evidence suggests that domestic production was affected by erratic weather and disruptions to transport and sales, especially during the nationwide lockdowns in the second half of FY2020/21. These constraints were compounded by import restrictions on meat products since the onset of the crisis, which led to shortages in select food items, including chili and meat. As part of the Economic Contingency Plan (ECP), which aims to support economic recovery and growth with a focus on agriculture and farm roads, tourism and construction, the Ministry of Agriculture and Forestry (MoAF) is supporting the production of commercial winter vegetables and livestock production, to strengthen food security and increase food self-sufficiency. Digital platforms and e-trade could increase competitiveness and productivity in the agriculture sector, by reducing inefficiencies in the distribution of farm produce and increasing farmer’s access to external markets (see special section on e-trade).

Figure 7. Food inflation, imported and local (percent)

![Figure 7. Food inflation, imported and local (percent)](image)

Source: NSB

Figure 8. CPI categories and inflation drivers in the first half of FY2020/21

![Figure 8. CPI categories and inflation drivers in the first half of FY2020/21](image)

Source: NSB

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10 https://kuenselonline.com/erratic-weather-affects-winter-vegetable-production/
11 The MoAF has lifted the ban on import of processed and packaged meat, fish and dry fish except pork with effect from June 22, 2020. The import of raw meat remains.
13 https://thebhutanese.bt/focus-on-southern-dzongkhags-for-winter-vegetables/
**Poverty**

The COVID-19 pandemic has resulted in widespread losses of job and earnings, mainly in services and industry. In preliminary results from a Rapid Phone Survey (Box 1), nearly a third of the respondents who were employed pre-COVID reported a deterioration in labor market outcomes: about half in the form of lower earnings and the other half in job losses. Lost livelihoods and an influx of return migrants14 (that started with the onset of the pandemic) have led to increased labor market pressure, especially in urban areas. Before COVID-19, the overall unemployment rate decreased from 3.4 percent in 2018 – the highest rate since 2011 – to 2.7 percent in 2019, which is equivalent to about 9,000 unemployed people.15 Preliminary estimates from the Ministry of Labor and Human Resources (MoLHR) suggest that the unemployment rate has increased significantly during the pandemic, to between 9.6 and 14.3 percent in 2020.16

The government has provided relief via income support and employment programs. The DGRK program (launched in April 2020) has been providing immediate income support to those whose livelihoods have been impacted, reaching over 34,000 individuals to date.17 The ECP includes a training and re-skilling program in the tourism sector, which aims to create jobs and skills opportunities for over 1,000 workers in tourism infrastructure and professional development activities. The ECP also includes the Build Bhutan Project (BBP), which aims to engage Bhutanese job seekers in the construction sector. As of December 2020, the BBP has engaged about 500 individuals in the direct employment scheme and another 500 in re-skilling programs.18

14 The MoLHR estimates that COVID-19 caused the return of about 3,500 of migrant laborers to Bhutan.
15 LFS 2019. Reasons for the decline include a decrease in the youth population as per population projection, leading to a decline in youth labor force entering the labor market; and youth staying in the school system, thus reducing the number of unemployed youths who are seeking jobs.
Poverty is estimated to have increased slightly in 2020, mainly due to high food price inflation and some disruptions in agricultural activities. As most of the rural poor tend to be net buyers of food, high food inflation eroded their purchasing power. Among respondents to the Rapid Phone Survey 45 percent of households reported having worried about running out of food in the 7 days prior to the survey; nearly 80 percent reported that they reduced the purchase of preferred food due to budget constraints; and 15 percent reported having run out of food and lacked the money to buy more. Over 90 percent of the poor live in rural areas, many of which subsistence farmers, and are believed to have been largely shielded from the labor market impacts of the crisis. However, disruptions in the production, transport, and sales of agricultural products may have impacted the income of some farmers and others suffered from the effect of higher prices. As a result, the $3.20 poverty rate is estimated to have increased slightly to 11.2 percent in 2020, up from 10.7 percent in 2019.

Box 1. The World Bank COVID-19 South Asia Rapid Phone Survey

The World Bank conducted a rapid phone survey across eight South Asian countries. In Bhutan, the survey was implemented in September and October 2020, and primarily aimed to understand changes in the labor market among different groups. Additional questions were included on ability to meet basic needs, safety nets and coping mechanisms. Full survey results with more detailed analysis will be published in the coming months.

With a sample size of over 1,500, the survey intends to achieve national coverage, but there are important caveats to interpreting the results. First, since the survey was conducted based on random-digit dialing, the sample is likely to have been biased toward mobile phone owners who are likely to be relatively more urban, younger and more educated. Second, the labor market results are not to be compared with standard labor market indicators that are produced from sources such as the Labor Force Survey conducted by the National Statistics Bureau of Bhutan but rather reflective of pre- and post-pandemic changes in the labor market.

1.3. Monetary Policy and Financial Sector

Monetary Policy

Monetary policy is anchored by the currency peg to the INR. The RMA does not have an explicit inflation target. It uses the cash reserve ratio (CRR) and the statutory liquidity ratio (SLR) to manage credit growth and interventions in the foreign exchange markets to maintain the exchange rate peg. The RMA manages its foreign exchange reserve position by investing in short-term Indian T-Bills and using a credit line facility at the Reserve Bank of India. Overall money supply growth accelerated in the first half of FY2020/21 (y-o-y), driven by an increase in net foreign assets due to higher capital and financial inflows including grants. Over FY2020/21, however, the growth in net domestic assets slowed, reflecting a deceleration in credit to the private sector (Figure 9).

The RMA adjusted liquidity management in response to the crisis and sought to improve policy transmission. The RMA reduced the CRR by 200 basis point to 7 percent in April 2020. In November 2020, it announced a forward-looking web-based domestic liquidity management frame-
work (DLMF) and guidelines to improve systemwide liquidity management. The new policy framework, while continuing to support the existing pegged exchange rate arrangement, is expected to improve monetary policy transmission and create supportive conditions for the development of an interbank market through the establishment of a reference rate. The RMA has also ensured the continuity of critical financial services through promoting the use of digital banking platforms and the activation of a command call center.

**Figure 9. Money supply (y-o-y growth, percent, 3-month moving average)**

![Money supply graph](image_url)

Source: RMA

**Financial Sector**

The growth of credit to the private sector fell to a six-year low in the first half of FY2020/21. It had already been declining since August 2019, driven by a slowdown in the growth of credit to trade/commerce (Figure 10). But credit growth slowed further in 2020, from 17.6 percent (y-o-y) in January to 7.6 percent (y-o-y) in November. The slowdown was most accentuated in trade/commerce, and construction/housing, reflecting the adverse impact of the pandemic on these sectors. Credit growth to services/tourism also declined, but to a lesser extent.

**Figure 10. Credit growth to select sectors (y-o-y growth)**

![Credit growth graph](image_url)

Source: RMA, WB staff estimates
The RMA took steps to mitigate the impact of the crisis on households and businesses. Monetary relief measures were extended in July 2020 (Phase II), and included a partial interest waiver on loans (until March 2021), deferred monthly loan instalment repayment (until June 2021), loans for the tourism, manufacturing and wholesale trade sectors at concessional terms, and micro loans for cottage and small industries (CSI) (until June 2021). In October 2020, the government also launched the National Credit Guarantee Scheme (NCGS) to support lending to CSIs (Box 2). The government and the RMA are also conducting a comprehensive asset quality review (supported by the Asian Development Bank) and announced an NPL resolution framework in February 2021 to facilitate rehabilitation and/or foreclosures of NPLs.

Since asset quality was already poor before COVID-19, vulnerabilities have increased in the financial sector, particularly among non-banking financial institutions (NBFIs). The NPL ratio stood at 15.5 percent, as of September 2020 (Figure 11). However, asset quality is expected to deteriorate once the interest moratorium and forbearance measures are phased out. The capital adequacy ratio (CAR) also fell from 14.2 percent in December 2019 to 12.4 percent in September 2020. Thus it remained above the minimum 10 percent requirement (although this was after the minimum CAR requirement was revised from 12.5 percent to 10 percent, by removing the 2.5 percent capital buffer as a regulatory forbearance measure to address the COVID-19 impact). Provisions for NPLs, estimated on a conservative gross basis, stood at 57.7 percent in December 2019, which is high. However, NPLs are concentrated in NBFIs, which account for 15 percent of Bhutan’s total financial sector assets, but 41 percent of total NPLs. NBFIs are permitted to undertake retail lending activities although, relative to commercial banks, they are more prone to maturity mismatches and weak supervision, and have a lower capacity to absorb losses.

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20 Phase I monetary relief measures included a debt moratorium and an interest waiver (including for NPLs). The cost of the interest waiver was shared equally by the government, funded through the National Resilience Fund (NRF), and the financial sector institutions.
21 The first review of around 800 loan accounts (Nu 1.8 billion) has been completed. The NPL resolution framework includes (i) NPL asset transfer framework where eligible NPLs will be temporarily parked by the FIs with subsequent freezing of interest to provide relief to borrowers; (ii) segregation of NPLs into viable and non-viable loans based on broad principles. Viable loans may include borrowers that may be facing temporary financial difficulties, which can however be revived/rehabilitated. The process of rehabilitation will involve bilateral engagements between the borrower and the financial institution.
22 The NPL ratio increased from 10.9 percent in December 2019 to 15.5 percent as of September 2020, although this increase partly reflects mid-year cyclical factors. The financial sector experiences significant fluctuations in its NPL ratio for the following reasons: (i) overdue loans are downgraded to NPL status (provisions are created), and provisions are ‘written back’ when loans are recovered; (ii) financial instruments are not well aligned with borrowers’ expected cash flow distribution; and (iii) there are seasonal repayments based on the borrowers’ activities.
23 A systemic insurance company, in particular, is experiencing significant balance sheet pressures.
Box 2. Supporting access to finance amid the COVID-19 crisis

Restricted access to credit compounded the impact of the COVID-19 shock on companies, particularly CSI. The CSI experienced reduced demand and increased operational costs as a result of COVID. As per the Economic Census 2018, around 90 percent of companies have less than 5 employees (Figure 12), however micro, CSI and small companies only accounted for 13 percent of total outstanding loans at financial institutions as of September 2020 (Figure 13). And, given high levels of NPLs, banks are increasingly hesitant to take further risk and lend even to viable businesses.

The RGoB established the NCGS in October 2020 to support access to credit by the CSI. The NCGS was launched with the participation of the three largest public sector banks. While the scheme is targeted to CSIs, it is also available, with lower coverage ratios, to medium and large industries. The partial guarantee coverage is expected to induce banks to issue loans, while still carrying out due diligence. As of mid-March 2021, 38 projects have been approved under the scheme in all sectors (amounting to US$1.8 million, of which US$160,000 have been disbursed).

Figure 12: Number of companies by employment size, 2018

Source: NSB, Economic Census 2018

Figure 13: Total credit by company size, as of September 2020

Source: RMA. Note: excludes loans to non-enterprise.

24 https://kuenselonline.com/ncgs-disburses-nu-11-7-million-to-10-projects-so-far/
Macro-financial

The RMA issued its first ever treasury bond (T-Bonds) in FY2020/21. The domestic debt market is nascent and concentrated in treasury bills (T-Bills), used mainly for cash management purposes. A 3-year bond was issued in September 2020 in the amount of US$41 million, followed by a 10-year bond offering of US$9.6 million in January 2021, which was oversubscribed by three times, yielding a coupon rate of 3.98 percent. A gradual deepening of the corporate bond market would increase investment opportunities for financial institutions, notably NBFIs, which are currently matching long-term liabilities with short maturity loans.

The stock exchange has been largely unaffected by the pandemic-induced crisis. The Royal Securities Exchange of Bhutan (RSEBL), established in 1993, trades 20 companies with a market capitalization of around Nu48 billion (US$657 million) as of February 2021. Financial institutions, particularly the Bhutan National Bank (BNBL), Royal Insurance Corporation of Bhutan (RICBL) and Druk PNB Bank, account for more than half of shares in the market. Following the restrictions on dividend payouts to create capital buffers against the impacts of the pandemic, the Bhutan Stock Index (BSI) decreased from 1,014 points in early February 2020, when it was first launched, to 946 on February 17, 2021.

1.4. External Sector

The deficit in goods trade narrowed in FY19/20, y-o-y, as hydropower exports increased and imports were subdued. The CAD narrowed from 21.1 percent of GDP in FY2018/19 to 12.2 percent of GDP in FY2019/20 (Figure 14, Table 1). Hydropower exports (48 percent of total goods exports) doubled as a share of GDP (to 12.7 percent) in line with higher production. This more than offset a decline in non-hydropower exports, mainly mineral products (boulders) and base metals (ferro-silicon), which were severely impacted by the border closure and tepid external demand. Meanwhile imports also declined. The pandemic depressed public investment projects and hydropower projects, leading to a decline in capital goods imports. Imports of essential goods increased slightly as the government stocked up food reserves and fuel (Figure 15).

The balance of trade in services also improved in FY2019/20, despite a sharp decline in service/tourism exports in the second half of FY2019/20. Services exports, which

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mainly comprise tourism and transport services, increased to 5.5 percent of GDP in FY2019/20. This is because service/tourism exports grew strongly in the first half of the fiscal year in line with an increase in tourist arrivals (Figure 2), before declining sharply (by 55.2 percent) in the second half of FY2019/20. Meanwhile, services imports also declined sharply in the second half of FY2019/20 (y-o-y). On balance, therefore, the services trade deficit shrunk in FY2019/20.

Table 1. External accounts

<table>
<thead>
<tr>
<th>Percent of GDP</th>
<th>FY15/16 (act)</th>
<th>FY16/17 (act)</th>
<th>FY17/18 (act)</th>
<th>FY18/19 (act)</th>
<th>FY19/20 (est)</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Export</td>
<td>31.0</td>
<td>31.1</td>
<td>31.5</td>
<td>30.1</td>
<td>31.8</td>
<td>1.7</td>
</tr>
<tr>
<td>Goods</td>
<td>24.0</td>
<td>24.2</td>
<td>24.0</td>
<td>24.8</td>
<td>26.4</td>
<td>1.6</td>
</tr>
<tr>
<td>Hydro</td>
<td>7.7</td>
<td>8.5</td>
<td>6.8</td>
<td>6.3</td>
<td>12.7</td>
<td>6.4</td>
</tr>
<tr>
<td>Non-hydro</td>
<td>16.2</td>
<td>15.7</td>
<td>17.2</td>
<td>18.5</td>
<td>13.7</td>
<td>(4.8)</td>
</tr>
<tr>
<td>Services</td>
<td>7.1</td>
<td>6.9</td>
<td>7.5</td>
<td>5.3</td>
<td>5.5</td>
<td>0.1</td>
</tr>
<tr>
<td>Import</td>
<td>(60.0)</td>
<td>(54.1)</td>
<td>(50.2)</td>
<td>(49.1)</td>
<td>(44.5)</td>
<td>4.6</td>
</tr>
<tr>
<td>Goods</td>
<td>(49.9)</td>
<td>(44.9)</td>
<td>(41.1)</td>
<td>(40.4)</td>
<td>(36.2)</td>
<td>4.2</td>
</tr>
<tr>
<td>Services</td>
<td>(10.0)</td>
<td>(9.2)</td>
<td>(9.1)</td>
<td>(8.7)</td>
<td>(8.3)</td>
<td>0.4</td>
</tr>
<tr>
<td>Primary income</td>
<td>(8.3)</td>
<td>(8.6)</td>
<td>(8.4)</td>
<td>(9.0)</td>
<td>(6.5)</td>
<td>2.6</td>
</tr>
<tr>
<td>Secondary income</td>
<td>7.0</td>
<td>7.6</td>
<td>8.1</td>
<td>6.8</td>
<td>6.9</td>
<td>0.1</td>
</tr>
<tr>
<td>Current Account</td>
<td>(30.3)</td>
<td>(24.0)</td>
<td>(19.1)</td>
<td>(21.1)</td>
<td>(12.2)</td>
<td>8.9</td>
</tr>
</tbody>
</table>

Source: RMA, WB staff estimates

Recent Economic Developments
The current account turned to a surplus in the first quarter of FY2020/21. Goods exports increased by 6 percent (y-o-y) in the first quarter of FY2020/21. A sharp increase in hydropower exports (which rose by 39 percent) outweighed a decline in non-hydropower goods exports by 44 percent. Meanwhile, goods imports fell by 35 percent (y-o-y) as infrastructure projects, including hydropower plant construction, slowed.

The CAD has been financed by capital flows from India for hydropower and investment projects. Large-scale hydropower development has resulted in large trade deficits, given that it requires significant imports of capital goods, equipment and fuel during construction, while exports materialize only over time. The resulting CAD is covered by large capital inflows in the form of loans directly tied to hydropower development and their future revenue streams, but also grants for investment projects from India. The capital and financial accounts have continued to register net inflows in FY2019/20 (Figure 16): a decline in grants for hydropower investments was partially offset by an increase in grants for investments (both registered in the capital account), and loans (including for hydropower investments) have increased FY2019/20.

Direct investments in Bhutan remain small. Foreign direct investment (FDI) inflows are estimated to have decreased from US$10.7 million in FY2018/19 (0.4 percent of GDP) to US$0.2 million in FY2019/20, reflecting disruptions from COVID-19 in the second half of FY2019/20. The total FDI stock stood at 4.9 percent of GDP as of June 2020, concentrated in the services sector (mainly hotels and IT services).

International reserves remain at comfortable levels. With the narrowing of the CAD and higher net inflows in the capital and financial accounts, gross international reserves increased in FY2019/20. They reached US$1.43 billion in November 2020 (an increase of 22 percent y-o-y), equivalent to 14.9 months of goods and services imports (Figure 17). International reserves have grown steadily over the recent years and reserve adequacy measures are met by a wide margin.

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27 The CA has been financed by surpluses in capital and financial accounts.
28 Budgetary grants, other than for investments, are covered under net transfers.
1.5. Fiscal Sector and Debt Sustainability

The fiscal deficit widened in FY2019/20, on account of a salary increase and reduced non-hydropower revenues. Total expenditure increased rapidly between FY2018/19 and FY2019/20—by 30.1 percent in nominal terms, and from 25.9 to 32.7 percent as a share of GDP (Figure 18). The increase was primarily driven by salaries and wages (which rose by 40.4 percent, y-o-y—in line with a decision taken prior to the COVID-19 outbreak—and capital expenditures (which increased by 35.4 percent, y-o-y). Total revenues and grants have also increased, but to a lesser extent and thanks to the one-off profit transfer from the commissioning of the Mangdechhu hydropower plant (2.2 percent of GDP) and external grants (which mainly cover capital expenditures under the 12th Five Year Plans (FYP)) (Figure 19). In contrast, non-hydropower revenues fell due to the discontinuation of the excise duty refunds from India and a drop in tourism receipts. As a result, the fiscal deficit widened from 1.6 percent of GDP in FY2018/19 to 3.2 percent of GDP in FY2019/20 (Figure 20, Table 2). The resulting financing needs have been mainly covered by external borrowing from multilateral and bilateral partners on concessional terms, while domestic borrowing has been limited.

Budget execution was weak during the first half of FY2020/21, particularly for capital expenditures. In response to the crisis, the FY2020/21 budget targeted a scale up of public investment spending (including through the ECP),30 a rationalization of non-essential current expenditures and the mobilization concessional resources. According to preliminary data for the first six months of the fiscal year,31 domestic revenue collection was above 50 percent of the annual estimate, driven by non-tax revenues from the hydropower sector (Figure 21). However total spending was only 28 percent of the annual budgeted estimate, due to lower-than-expected capital spending (16 percent of the annual estimate), presumably on account of continued COVID-19-related disruptions and labor shortages (Figure 22). While the government has allowed skilled and professionals workers to enter the country, since June 2020, only a small number of foreign workers have returned.32 Despite the slow execution of capital expenditures over the first half of the year, the budget was revised in December 2020 to include additional capital expenditures (amounting to 7.3 percent of the original amount), in line with an expected increase in external grants (by 12.9 percent).

In the first half of FY2020/21, the government has spent about 6 percent of projected GDP on its COVID-19 response. Efforts to alleviate the social and economic impact of COVID-19 include the DGRK, as well as fiscal and monetary measures, such as the interest rate waivers and deferral of tax payments. In the first half of FY2020/21, COVID-19-related expenses have amounted to US$22.5 million (0.9 percent of FY2020/21 GDP), covering health and quarantine-related expenses and measures to facilitate trade. Additional expenses through the National Resilience Fund (NRF)33 for the interest waiver and the DGRK are estimated at US$102 million (4 percent of GDP) and US$27 million (1.1 percent of GDP) as of December 2020. In addition, to ensure that its COVID-19 response was as effective as possible, the RGoB has continued to implement the public financial management (PFM) reform agenda during the crisis (Box 3).

30 The budget of the ECP is estimated at 2.4 percent of FY2020/21 GDP.
31 The Ministry of Finance has published the first quarterly Budget Performance Report (BPR) in October 2020.
32 The MoLHR has approved the entry of 7,000 foreign workers since June. However, less than 3,000 have entered the country so far. The hiring of foreign workers takes between 40 days to two months due to a lengthy application procedure and the 21-day mandatory quarantine period. https://kuenselonline.com/double-trouble-prolonged-recruitment-procedure-hits-construction-sector/
33 The government has set up the NRF to implement additional COVID-19 related policy measures, including the DGRK and the interest waiver. The NRF with a size of BTN 30 billion (16.8 percent of FY2019/20 GDP) will be managed by the MoF. Spending of the NRF in FY2020/21 will be reported separately from the budget. The Finance and Accounts Manual 2016 requires that trust fund disbursements, including from the NRF, are facilitated through the budgetary process, and that a trust fund statement of receipts and payments is included in the Annual Fiscal Accounts (AFS) report.
Box 3. PFM reforms for an effective government response to COVID-19

**PFM reform has been an integral part of the government’s response to the COVID-19 pandemic.** They have helped to strengthen: accounting for and reporting on resources and expenses, the disbursement of funds to appropriate delivery units, and continuity of operations during the lockdown. The measures, outlined below, are expected to strengthen efficiency, accountability, and transparency of public expenditure going forward.

- **E-governance programs as part of the government’s digitalization initiative:**
  
  i. **Electronic Payments (ePEMS):** The ePEMS is an online accounting and payment system to promote cashless and digital payments, introduced in July 2019. The e-GP system facilitated disbursement of the income support program (DGKR) during the pandemic. Electronic payments were made directly to beneficiaries’ bank accounts.
  
  ii. **Electronic Government Procurement (eGP) System.** The eGP system supports government-wide procurement through an online platform. Phase II was launched in July 2020, linking the tool with various government agencies and procuring agencies.
  
  iii. **Electronic Daily Allowance and Travel System (eDATS).** The eDATS is an online travel authorization and claims system for civil servants, launched in February 2021 and expected to be rolled out in July 2021. The eDATS is expected to reduce processing time and minimize risks of fraud while providing real-time reports for monitoring and decision-making purposes.
  
  iv. **Business Income Tax (BIT) estimated tax app (BETA).** BETA is an electronic tax filing app, launched in February 2021. It is expected to facilitate tax payment for small and micro businesses and reduce physical interaction during the pandemic.

- **Simplified Procurement Rules and Regulations (SPRR).** The SPRR were issued in March 2020 to expedite the implementation of COVID-19 measures, including the frontloading of 12th FYP activities and projects under the ECP.

- **Fiscal and debt transparency:** The Ministry of Finance has published the first in-year *Budget Situation Report* (BPR) and *Public Debt Situation Report* in October 2020, which are expected to enhance fiscal and public debt transparency and facilitate budget monitoring and implementation.

- **Accountability of COVID-19 spending:** The quarterly BPR includes a section on COVID-19 related expenses.

**Public and publicly guaranteed (PPG) debt has increased, but risks are moderate as most of the external PPG debt is on account of hydropower project loans from India and tied to future proceeds.** PPG debt increased from 106.6 percent of GDP as of June 2019 (pre-COVID) to 121 percent of GDP as of December 2020, mainly due to an increase of hydropower debt and low GDP growth (Figure 23). The 2018 *Debt Sustainability Analysis* (DSA) carried out jointly by the World Bank and the International Monetary Fund assessed Bhutan to be at moderate risk of debt
distress. Around 95 percent of PPG debt is external with a long-term maturity. The majority is on account of hydropower project loans from the Government of India (GoI) based on intergovernmental contracts, which reduces re-financing and exchange rate risks. Risks stemming from non-hydropower debt are low. The stock of external non-hydropower PPG debt stood at 30.7 percent of GDP as of December 2020, owed mostly to the Asian Development Bank (ADB) and the International Development Association (IDA), and contracted on concessional terms. Domestic debt is minimal (equivalent to 3.4 percent of GDP).

The FY2021/22 budget anticipates a widening of the fiscal deficit. The fiscal deficit is projected to widen to 9.7 percent of GDP, mainly due to a shortfall in domestic revenues. Current expenditures, which are constrained by existing budget rules, are expected to increase to 17.5 percent of GDP. Capital spending is projected to increase from 18.7 in FY2020/21 (budgeted) to 19.7 percent of GDP in FY2021/22 (although the low execution rate in the first half of FY2020/21 suggests this may be an ambitious objective).

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34 The next joint IMF-World Bank DSA for Bhutan is scheduled for 2020.
35 These loans are governed by an intergovernmental agreement in which the GoI covers both financial and construction risks of the hydropower projects and buys surplus electricity at a price reflecting cost plus a 15 percent net return. This debt is denominated in rupees, electricity export receipts are also in rupees and the Bhutanese currency is pegged to the rupee, which means there are no exchange rate risks. In addition, debt service begins only after the projects are on-streamed.
36 According to the Constitution, Article 14, the government shall finance recurrent expenditures only from domestic revenues.
Ensuring macroeconomic stability, going forward, hinges on strengthening revenue mobilization beyond hydropower revenue. While one-off profit transfers have increased (and masked to some extent the impact of the crisis on revenues) so far in FY2020/21, tax revenues are expected to decrease to 9.8 percent of GDP in FY2020/21, their lowest level since FY2006/07. Over-reliance on hydropower revenue (which accounted for 37 percent of domestic revenue in FY2019/20), increases fiscal volatility, creates pro-cyclicality risks and complicates budgetary management, as temporary one-off profit transfers and large temporary revenue spikes tend to trigger permanent increases in current spending (as evidenced by the recent salary increase in FY2019/20). The planned introduction of the GST in June 2021 is an important step toward increasing revenue collection and reducing volatility (through diversification of the public resource envelope).

Figure 20. Fiscal accounts components (percent of GDP)

![Fiscal accounts components chart](image)

Source: MoF

Figure 21. Revenue collection, H1 FY2020/21

![Revenue collection chart](image)

Source: MoF
Figure 22. Expenditure, H1 FY2020/21

![Expenditure Chart]

Source: MoF

Figure 23. Public debt (percent of GDP)

![Public Debt Chart]

Source: MoF
### Table 2. Fiscal accounts

<table>
<thead>
<tr>
<th>Percent of GDP</th>
<th>FY15/16 (act)</th>
<th>FY16/17 (act)</th>
<th>FY17/18 (act)</th>
<th>FY18/19 (act)</th>
<th>FY19/20 (est)</th>
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<tbody>
<tr>
<td><strong>Resources</strong></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Tax revenues</td>
<td>14.5</td>
<td>14.3</td>
<td>16.6</td>
<td>15.7</td>
<td>12.7</td>
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<tr>
<td>Direct taxes</td>
<td>8.9</td>
<td>8.1</td>
<td>9.6</td>
<td>9.7</td>
<td>8.5</td>
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<tr>
<td>Indirect taxes</td>
<td>5.6</td>
<td>6.1</td>
<td>7.0</td>
<td>6.1</td>
<td>4.2</td>
</tr>
<tr>
<td>of which: Sales tax/GST</td>
<td>2.6</td>
<td>2.5</td>
<td>2.6</td>
<td>2.7</td>
<td>2.8</td>
</tr>
<tr>
<td>of which: Excise tax</td>
<td>1.8</td>
<td>2.4</td>
<td>3.0</td>
<td>2.0</td>
<td>0.5</td>
</tr>
<tr>
<td>Non-tax revenues</td>
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<td>5.3</td>
<td>6.0</td>
<td>4.4</td>
<td>7.6</td>
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<tr>
<td>o/w DHI dividend</td>
<td>1.4</td>
<td>2.7</td>
<td>2.5</td>
<td>1.9</td>
<td>2.5</td>
</tr>
<tr>
<td>o/w Hydropower profit transfers</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>2.2</td>
</tr>
<tr>
<td>o/w Interest receipts from corporations</td>
<td>1.6</td>
<td>1.2</td>
<td>1.1</td>
<td>0.7</td>
<td>0.5</td>
</tr>
<tr>
<td>Other receipts</td>
<td>-0.6</td>
<td>0.0</td>
<td>0.2</td>
<td>-1.8</td>
<td>0.0</td>
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<tr>
<td>Grants</td>
<td>10.9</td>
<td>8.5</td>
<td>9.1</td>
<td>6.1</td>
<td>9.2</td>
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<td><strong>Expenditure and net lending</strong></td>
<td></td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Current expenditure</td>
<td>16.7</td>
<td>15.8</td>
<td>16.8</td>
<td>16.1</td>
<td>19.9</td>
</tr>
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<td>Interest payments</td>
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<td>1.3</td>
<td>1.3</td>
<td>0.9</td>
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<td>Compensation of employees</td>
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<td>6.2</td>
<td>6.0</td>
<td>6.7</td>
<td>10.5</td>
</tr>
<tr>
<td>Goods and services</td>
<td>4.3</td>
<td>4.2</td>
<td>4.1</td>
<td>4.1</td>
<td>4.1</td>
</tr>
<tr>
<td>Social benefits</td>
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<td>1.0</td>
<td>1.0</td>
<td>1.1</td>
<td>1.4</td>
</tr>
<tr>
<td>Subsidies and transfers</td>
<td>2.3</td>
<td>2.7</td>
<td>4.0</td>
<td>2.7</td>
<td>2.9</td>
</tr>
<tr>
<td>Other</td>
<td>0.5</td>
<td>0.5</td>
<td>0.4</td>
<td>0.5</td>
<td>0.5</td>
</tr>
<tr>
<td>Capital spending</td>
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<td>17.0</td>
<td>17.6</td>
<td>9.4</td>
<td>12.4</td>
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<tr>
<td>Advance/suspense (net)</td>
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<td>0.0</td>
<td>-1.0</td>
<td>0.4</td>
<td>0.4</td>
</tr>
<tr>
<td><strong>Fiscal Balance</strong></td>
<td>-2.5</td>
<td>-4.8</td>
<td>-1.6</td>
<td>-1.6</td>
<td>-3.2</td>
</tr>
<tr>
<td>Primary Balance</td>
<td>-1.0</td>
<td>-3.5</td>
<td>-0.3</td>
<td>-0.7</td>
<td>-2.7</td>
</tr>
</tbody>
</table>

Source: MoF, WB staff estimates
Outlook and Medium-Term Prospects
2.1. Medium-term Outlook

Economic growth is projected to contract further, by 1.8 percent, in FY2020/21, before recovering gradually to pre-COVID levels. Services sector output is projected to fall by 3.7 percent in FY2020/21, as tourism activity is not expected to resume until mid-2021. The slowdown in India and trade disruptions are expected to weigh on non-hydropower exporting industries, while labor shortages and disruptions in infrastructure projects are likely to result in a construction slowdown. On the demand side, consumption and investment are expected to contract in FY2020/21 due to domestic containment measures, including two nationwide lockdowns. Output is expected to return to pre-pandemic levels (in real terms) in FY2021/22, when tourist inflows gradually resume and non-hydro industry activities resume at scale. Economic growth is expected to pick up in FY2022/23, as tourism recovers and the Puna II hydropower project begins operations (Table 3).

Inflation is expected to remain elevated in the short term, but to moderate in FY2021/22 and in the medium term. Food prices are expected to gradually decrease, in line with prices in India. Non-food inflation is projected to remain moderate, supported by low oil prices. As a result, headline inflation is projected to increase to 7.2 percent in FY2020/21 before moderating to around 3.7 percent in the medium term.

A slow recovery and continued inflationary pressure could result in further increases in poverty in 2021. The $3.20 poverty rate is projected to increase further from 11.2 percent in 2020 to 12.5 percent in 2021 as a result of continued inflationary pressures and disruptions in economic activities.

Asset quality in the financial sector is expected to deteriorate further. The NPL ratio is expected to increase once the interest moratorium and forbearance measures are phased-out in the second half of FY2020/21. Financial sector supervision and regulations will be crucial to maintain stability.

The CAD is expected to narrow in the medium term. Non-hydropower exports are expected to increase gradually over the medium term, supported by the global recovery, and hydropower exports are expected to increase from FY2023/24 as Puna II comes on-stream. Import growth is also expected to recover, as public investment projects gather pace at the end of the 12th FYP. On balance, the CAD is expected to narrow and international reserves to remain adequate at 12.6 months of imports of goods and services by end-FY2022/23.

The fiscal deficit should remain elevated in the medium term, as revenues remain subdued and the government continues to implement the COVID-19 recovery package. Non-hydropower revenues are expected to remain below pre-COVID levels in FY2020/21 due to subdued economic growth and current expenditure is projected to remain elevated as the government implements the COVID-19 recovery package. However capital expenditures are expected to decrease in FY2020/21 (as a share of GDP) due to containment measures in the first half of the fiscal year and labor shortages, before gradually picking up toward the end of the 12th FYP cycle.

With low tax revenues and elevated recurrent expenditures the fiscal deficit is expected to increase sharply in FY2021/22 and FY2022/23, before narrowing to 2.4 percent in FY2023/24, thanks to a one-off profit transfer from Puna II (2.1 percent of GDP) and the planned introduction of the GST in FY2021/22. Financing needs are projected to be covered mainly by external borrowing from multilateral and bilateral partners and domestic financing.

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37 Economic growth in India is expected to contract by 8.5 percent in FY2020/21 (April 2020 to March, 2021), and to rebound to 10.1 percent in FY2021/22. Forthcoming World Bank South Asia Economic Focus, April 2021.
38 Food price inflation in India slowed from 10.1 percent (y-o-y) in October 2020 to 3.9 percent in December 2020 (preliminary).
39 Bhutan’s development strategy has been guided by FYPs, a series of national development plans initiated in 1961. Historically, expenditures have fluctuated significantly from one year to the next with FYP cycles. While current expenditures have remained largely constant as a share of GDP, capital expenditures tend to increase toward the end of the FYP cycle.
Public debt is expected to remain elevated as a share of GDP due to low economic growth, high financing needs, and an increase in hydropower debt. Public debt is expected to increase to 133.9 percent of GDP in FY2022/23. Debt service is expected to increase from 1.5 percent of GDP in FY2019/20 to 4 percent of GDP in FY2022/23 due to the commissioning of the Mangdechhu hydropower plant in FY2019/20.40

Table 3. Main macroeconomic indicators

<table>
<thead>
<tr>
<th></th>
<th>FY15/16 (act)</th>
<th>FY16/17 (act)</th>
<th>FY17/18 (act)</th>
<th>FY18/19 (act)</th>
<th>FY19/20 (est)</th>
<th>FY20/21 (f)</th>
<th>FY21/22 (f)</th>
<th>FY22/23 (f)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Annual percentage change</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Real GDP growth</td>
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<td>6.3</td>
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<td>-1.8</td>
<td>2.9</td>
<td>4.5</td>
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<tr>
<td>Agriculture</td>
<td>4.4</td>
<td>3.6</td>
<td>3.6</td>
<td>2.7</td>
<td>1.9</td>
<td>2.0</td>
<td>3.0</td>
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</tr>
<tr>
<td>Industry</td>
<td>7.6</td>
<td>4.7</td>
<td>-1.3</td>
<td>-1.6</td>
<td>-1.5</td>
<td>-0.7</td>
<td>2.2</td>
<td>5.4</td>
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<tr>
<td>Services</td>
<td>9.2</td>
<td>8.2</td>
<td>7.8</td>
<td>10.8</td>
<td>1.6</td>
<td>-3.7</td>
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<tr>
<td>Inflation (CPI)</td>
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<td>7.2</td>
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<td>GDP deflator</td>
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<td><strong>Percent of GDP</strong></td>
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</tr>
<tr>
<td>Fiscal balance</td>
<td>-2.5</td>
<td>-4.8</td>
<td>-1.6</td>
<td>-1.6</td>
<td>-3.2</td>
<td>-5.4</td>
<td>-7.4</td>
<td>-5.9</td>
</tr>
<tr>
<td>Resources</td>
<td>30.7</td>
<td>28.0</td>
<td>31.9</td>
<td>24.3</td>
<td>29.5</td>
<td>24.9</td>
<td>23.5</td>
<td>25.7</td>
</tr>
<tr>
<td>Tax revenues</td>
<td>14.5</td>
<td>14.3</td>
<td>16.6</td>
<td>15.7</td>
<td>12.7</td>
<td>9.8</td>
<td>10.9</td>
<td>13.1</td>
</tr>
<tr>
<td>Non-tax revenues</td>
<td>6.0</td>
<td>5.3</td>
<td>6.0</td>
<td>4.4</td>
<td>7.6</td>
<td>8.2</td>
<td>5.0</td>
<td>4.5</td>
</tr>
<tr>
<td>Other receipts</td>
<td>-0.6</td>
<td>0.0</td>
<td>0.2</td>
<td>-1.8</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Grants</td>
<td>10.9</td>
<td>8.5</td>
<td>9.1</td>
<td>6.1</td>
<td>9.2</td>
<td>7.0</td>
<td>7.5</td>
<td>8.1</td>
</tr>
<tr>
<td><strong>Expenditure</strong></td>
<td>33.3</td>
<td>32.8</td>
<td>33.5</td>
<td>25.9</td>
<td>32.7</td>
<td>30.3</td>
<td>30.9</td>
<td>31.5</td>
</tr>
<tr>
<td>Current expenditure</td>
<td>16.7</td>
<td>15.8</td>
<td>16.8</td>
<td>16.1</td>
<td>19.9</td>
<td>20.7</td>
<td>20.5</td>
<td>19.8</td>
</tr>
<tr>
<td>Capital expenditure</td>
<td>15.9</td>
<td>17.0</td>
<td>17.6</td>
<td>9.4</td>
<td>12.4</td>
<td>9.7</td>
<td>10.4</td>
<td>11.8</td>
</tr>
<tr>
<td>Advance/suspense (net)</td>
<td>0.6</td>
<td>0.0</td>
<td>-1.0</td>
<td>0.4</td>
<td>0.4</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td><strong>Total Public Debt 1/</strong></td>
<td>112.5</td>
<td>111.8</td>
<td>110.5</td>
<td>106.6</td>
<td>120.7</td>
<td>121.5</td>
<td>120.5</td>
<td>133.9</td>
</tr>
</tbody>
</table>

1/ PPG debt, including central government debt, central government loans that are on-lent to SOEs, SOE debt (direct debt contracted by SOEs, not routing through the budget) and Central Bank debt (loan/credit facilities for BOP support purposes)

Source: MoF, WB staff estimates.

2.2. Risks and Priorities

Risks to the outlook are on the downside. There is still a high degree of uncertainty pertaining to possible delays in the deployment of COVID vaccines domestically and globally (and specifically in India given significant tourism and trade linkages). Weaker demand from India could adversely impact production and exports from non-hydropower industries. Additional travel restrictions and changing consumer preferences could also delay the recovery of tourism.

40 Debt service begins one year after the projects come on stream.
Delays in domestic vaccination could impact economic activity. Vaccinating a significant share of the population against COVID-19 is a necessary condition to reducing the economic and health burden of the pandemic. Bhutan is receiving vaccines from India under the GoI’s “Vaccine Maitri” grant program, from which it is expecting enough vaccines to cover two doses per individual for an eligible population of 533,500 people. Bhutan will also obtain 20 percent of the required doses from the Global Alliance for Vaccines and Immunization (GAVI)’s COVID-19 Vaccines Global Access (COVAX) facility. The nationwide vaccination program is expected to launch on March 27, 2021.

Other domestic risks include lower-than-expected hydropower production, slippages in revenue measures, and the materialization of contingent liabilities in the financial sector. Delays in hydropower projects, including Puna II, as well as lower-than-expected hydropower output (due to adverse weather patterns) would negatively impact growth and reduce electricity exports and government revenues. Delays in the implementation of revenue measures, including the GST, as well as the materialization of financial sector contingent liabilities could further strain government finances. High and unresolved NPLs would also depress credit to the private sector.

Steadfast implementation of the COVID-19 recovery program would support domestic job creation and growth. Creating new jobs is at the center of the government’s efforts for economic recovery. Growth has been dependent on hydropower generation in the past, which is not labor intensive. Over half of Bhutan's workforce remains employed in agriculture, primarily of subsistence nature, while one-third is employed in low value-added services. Fostering private sector growth in non-hydropower is therefore critical to job creation in Bhutan. The NCGS could facilitate access to credit for small and medium-sized enterprises, thus supporting job retention and creation in the non-hydropower sector. Similarly, the employment programs under the ECP (including the engagement and re-skilling program in tourism and construction), could ease skills mismatches in the labor force and fill labor demand gaps.

Digital trade is likely to emerge as a major growth pillar in the aftermath of the COVID-19 crisis. Trade in goods and services can help produce jobs and increase economic opportunities, especially for a landlocked country with a small domestic market like Bhutan. However, the access of Bhutanese firms to regional and global markets is limited due to bottlenecks in transport infrastructure and logistics performance both domestically and along transit corridors, resulting in high cost of trade. Digital tools and platforms would allow firms to engage in e-trade, lowering trade costs and physical barriers to trade, including in traditional sectors such as agribusiness.

E-trade and online business activity also promotes entrepreneurship, job growth and productivity increases. E-trade initiatives and online platforms can enable local firms to reach higher value export markets, thus increasing competitiveness and export diversification. E-trade can also help make the trading system more inclusive, for example, by linking micro, small, CSI and medium enterprises to new markets, by generating employment for women and youth and by letting consumers to reduce search and transaction costs. The special focus section below outlines opportunities and challenges in harnessing digital trade in Bhutan.

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41 The first 150,000 doses of the Covishield vaccine (Oxford-AstraZeneca) from India arrived on January 20, 2021. An additional 400,000 doses from India arrived on March 22, 2021. The first delivery of the COVAX facility (40,000 doses) is expected by end-March 2021, with the remaining doses expected in the second quarter of 2021. A total of 533,000 people will be vaccinated, representing the total population of 750,000 excluding those under 18 and pregnant and breastfeeding women.


SPECIAL TOPIC: Ramping Up E-trade in Bhutan
3.1. Key Messages

This section assesses the key regulatory and trade facilitation priorities for digital trade in Bhutan and proposes concrete guidance for the development of the country’s e-trade framework.\(^{44}\) It shows that key socioeconomic and business factors such as complementary infrastructure, penetration of mobile ICT devices and computers, digital literacy, and efficient logistical and payment systems are necessary fundamentals for the development of Bhutan’s digital economy and e-trade.

E-trade in goods and services can reduce the cost of distance and remoteness, which is particularly relevant for a landlocked country like Bhutan. The presence of a digital platform could substantially reduce the costs of connecting Bhutanese buyers and suppliers with external markets. This is particularly relevant in the current pandemic context. As technology continues to evolve and as network infrastructure develops, the benefits of digitization will further increase.

In this setting, the RGoB has prioritized ICT developments with the vision of “an ICT-enabled, knowledge society as a foundation for Gross National Happiness.” Initiatives such as the Digital Drukyul flagship program, the Guidelines on e-commerce and the e-commerce Policy Framework are aimed at increasing Bhutan’s digitalization and benefits from greater participation in e-commerce.

Although Bhutan has made progress in recent years by initiating the development of an e-commerce ecosystem in the country, gaps still remain. Constraints in the e-trade environment such as limited Internet connectivity, high costs of payment, an incomplete regulatory infrastructure, and high trade facilitation and logistics costs still hold Bhutan back, resulting in low levels of e-trade participation at the present.

Bhutan’s digital economy, for both goods and services, will need an enabling policy environment to address its specific challenges and facilitate opportunities and growth. E-trade in goods and services requires general supporting policies in areas like data protection, cyber security, consumer protection, competition law and recognition of e-signatures and electronic transactions, which are the basic building blocks of all business online. Issues like intellectual property may have greater significance for the services sector.

Regulations in individual service sectors may need to be adapted to facilitate e-services and cross-border e-trade, in particular. The Ministry of Economic Affairs, the leading agency on e-trade, shall ensure all agencies understand the potential for e-trade and are in agreement on how to support it. Beyond government agencies, it is important for the leading agency to foster government-private sector collaboration including cooperation between policy makers and technology providers and include the perspectives and aspirations of consumers and small and large operators in the digital economy. Bhutan’s government will need to consider afresh how it approaches the taxation of e-goods and e-services, for example, especially as the locations in which the services are provided becomes divorced from the location of consumption once services move online.

A common thread running across every aspect of the policy obstacles outlined above is the need for a consistent approach built around regional consensus. As more South Asian and

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\(^{44}\) Based on the definitions set out in the World Bank Report “e-trade for Development - Opportunities, Challenges, and Policy Considerations” (World Bank, 2016), e-trade refers to internationally buying and selling all forms of goods and services (both traditional and digital) through electronic means. Transactions involving digital goods and services are referred to as “digital trade”. Examples include the online purchase of eBooks, learning courses, photography and digital arts, software, and mobile apps, advertising, or web design. An example would be Nano Bhutan.
ASEAN countries contemplate national e-trade policies it will be important to share good practice from around the region on which Bhutan can benchmark and avoid starting from scratch. The ASEAN agreement on e-commerce signed early 2020 is an important step as it acknowledged the importance of e-trade in the future. Needless to say, the COVID-19 pandemic will have sped up the need for a regional framework not least, to ameliorate the devastating economic effects of lockdowns on traditional services providers. However, much as the framework focuses on cooperation on some of the more problematic issues for firms, future reviews will need to consider the implementation capacity of least developed countries (LDCs) such as Bhutan both in terms of policy development and also in the capacity and expertise in key institutions.
3.2. E-trade in Bhutan’s broader trade and development context

For a small landlocked country such as Bhutan, e-trade\(^{45}\) in both goods and services can be particularly important to strengthen global and regional commercial linkages and bring gains to consumers and the private sector. Digital platforms, marketplaces or electronic payment systems would allow Bhutanese firms to engage in e-trade, overcoming physical barriers to trade and additional obstacles in the current pandemic context. While Bhutan has demonstrated a rapid mobilization in averting the COVID-19 public health crisis, the economy has taken a severe toll due to the unavoidable containment measures. As highlighted in the previous section of this report, the economic impact of the pandemic is significant, especially in the tourism sector and related service industries (RGB, 2020).

To support the private sector during the pandemic, the government has provided short-term measures such as an extension on tax filing, and deferral on tax payments. In the long-term, measures to facilitate the digital economy and e-trade may have a stronger role given how the COVID-19 crisis has impacted the private sector landscape, consumer preferences, and shopping patterns. Customers are now more likely than ever to adopt online shopping, social media use, teleconferencing, and to experiment with new electronic services.

The digital economy including the sale of goods and services online is likely to emerge as a major pillar in the aftermath of the COVID-19 crisis. E-trade can be an economic driver for both domestic growth and international trade, with opportunities and challenges for the private sector, regulatory institutions, and consumers. Opportunities include increased access to markets, suppliers, global value chains, productivity, competition, better consumer choice and jobs, while challenges relate to fraud, adaptation cost, and loss of tax revenues. In this context, public policy can play an enabling role, tackling market failures to guard against risks, and creating an environment in which the private sector can reap the benefits (Ungerer et al, 2020).

Long before the onset of the pandemic, the Bhutanese government has set a target for the country to embrace innovation, technology, and digitization against the backdrop of rising youth unemployment. Bhutan’s focus on information and communication technology in recent years has also accelerated the development of an e-commerce ecosystem, fueled by government efforts in the legal and regulatory framework and an ambitious e-government program.\(^{46}\) The country has then been investing in start-up centers and tech parks and promoting the entrepreneurship culture and innovation institutions such as Fab Lab, DHI and Thimphu TechPark. A snapshot of the digital business sector in Bhutan is presented in Box 4.

\(^{45}\) Based on the definitions set out in the World Bank Report “e-trade for Development - Opportunities, Challenges, and Policy Considerations” (World Bank, 2016), e-trade refers to internationally buying and selling all forms of goods and services (both traditional and digital) through electronic means. Transactions involving digital goods and services are referred to as “digital trade”. Examples include the online purchase of eBooks, learning courses, photography and digital arts, software, and mobile apps, advertising, or web design. An example would be Nano Bhutan.

\(^{46}\) The use of “e-commerce” in this chapter is reserved to describe the purchase of traditional goods and services through digital means. Examples include the online purchase of clothing, houseware or architectural services which result in physical plans and onsite consultations, or sourcing of a hotel room through an online marketplace, or the online purchase of. Examples in Bhutan include Drucksell, Bhutan Buy, Housing.bt or Driselda.
Box 4. Bhutan’s nascent e-business sector

E-commerce in Bhutan covers mainly business to consumer (B2C) or business to government (B2G) transactions, with a small proportion being consumer to consumer (C2C). The most common form of B2C e-commerce includes retail sales (e-retail).

E-commerce exports in 2018 are estimated to be less than US$1 million, accounting for about 0.33 percent of total exports. The largest portion of Bhutan’s e-commerce trade is carried out by few large firms, with a total business value of roughly US$500,000. Small and informal firms are also active in the digital space with a total business value at about US$180,000 per year. Additionally, C2C sale runs into large numbers of transactions although the value of each transaction would be relatively small at no more than US$100 per transaction, with total transactions estimated at about US$150,000 per year.

It is worth noting that both the Bhutan Post (GNHcorner.com) and the RMA of Bhutan have established their own portals for e-commerce, which are used mostly to sell stamps and products “made in Bhutan” certified by standard bodies like the Bhutan Agriculture and Food Products (BAFRA) and the Bhutan Standards Body (BSB). The Bhutan government has also launched an e-procurement system in June 2017, which has the potential to greatly multiply the e-commerce activity presently being carried out in Bhutan, as government procurement amounts to about one-fifth of GDP.

Source: Development of an e-commerce Policy Framework for Bhutan, internal report prepared for Ministry of Finance.

Increased adoption of ICT and participation in e-trade matters for Bhutan for various reasons. First, e-trade plays an important role in reducing transaction costs. The different factors which contribute to the transaction costs of goods and services are summarized in Figure 24. Some of these costs arise from explicit policy decisions, for example, whether the law requires a good or a service to be delivered in a certain form or by particular organizations or individuals. Other policy related transaction costs include tariffs and taxation (in the form of sales tax or GST) and regulatory costs, imposed in the form of market entry costs (authorizations or licensing arrangements) and ongoing compliance, where applicable.

E-trade in goods and services can help overcome non-policy transactional barriers to demand, offering buyers a much wider range of choice and overcoming asymmetries of information. In addition, it can increase the speed and efficiency of contract management. As smart contracts, which use blockchain technology, become more frequently used, there may be further cost/efficiency savings to be gained by allowing for automatic execution of a contract when agreed conditions are met. Safe and verifiable online payment systems can remove much of the risk and administration for both the buyer and the seller, while digital services can also create a more effective payments structure. Cloud computing can make it easier and safer to share data, while the use of artificial intelligence (AI) and chatbots to triage and gather client information, can reduce the time taken on selling a good or providing a service, and developing new and improved products.

47 Unleashing e-commerce for South Asian Integration’ 2020 set out a conceptual framework to illustrate how e-commerce could help to reduce transaction costs for trade in goods, whether policy induced or not. This note explicitly builds on this framework and adapts it to take into account the different nature of services.

Evidence from other countries shows that e-trade increases the share of firms that export and the range of destination markets including for small and medium enterprises (SMEs) (World Bank 2016). This is particularly important for a small LDC like Bhutan with about 90 percent of all firms registered as CSIs. Greater use of online platforms for trade could support greater participation of women in trade by reducing the gender bias in relationships between buyers and sellers through anonymity, and by allowing for more flexible working hours to overcome the time constraints women typically face in traditional sectors (OECD, 2018a). Moreover, digital trade can help to upgrade skills. The country’s talent pool is limited, and technology is critical for scaling up skills, knowledge, and capabilities (Wangchuk, 2020). The Internet and digital technologies are reshaping employment globally, expanding opportunities for higher-skilled workers and linking more low-skilled workers to markets. Also, there is significant potential for ICT-enabled services that could support regional and global trade. ICT investment might encourage innovation in the economy while enabling businesses to participate in the global market and reducing the over-reliance on certain sectors. These opportunities can flow not only from the ICT sector itself but also from the use of ICT in sectors across the economy such as in tourism, transport, and financial services, creating new sources of growth as transaction costs fall and markets expand (World Bank, 2020c).

Although Bhutan has made progress since the 2016 UNCTAD eTrade Readiness Assessment, it remains behind most of its neighbors in terms of digital development. Using the conceptual framework depicted in Figure 24, the special focus section will set out some of the key challenges Bhutan faces in upgrading its competitiveness in e-trade.
3.3. Addressing key socioeconomic barriers that affect Bhutan’s e-trade

This section examines the socioeconomic and business constraints that limit Bhutan’s participation in digital trade and provides recommendations to improve the fundamentals for digital development such as logistics and ICT infrastructure, internet penetration and digital literacy.

**Logistical constraints and limited trade facilitation:** Successful e-commerce is contingent on companies’ ability to smoothly transport the physical goods bought digitally. Without significant improvements over the last decade, Bhutan’s Logistics Performance Index (LPI) remains the second lowest in South Asia. Although Bhutanese traders enjoy relatively low tariff barriers and increasingly efficient customs facilities, the cost of transporting goods to and from external markets has gone up because of deficiencies in the quality of infrastructure and poor logistics performance, both domestically and along transit corridors. Bhutan has only three domestic airports, and air connectivity is subject to frequent delays and cancellations. Also, the *de minimis regime*—which is the valuation ceiling for goods, including documents and trade samples, below which no duty or tax is charged—is not clearly defined in Bhutan.49

Bhutan has embarked on several logistics and trade facilitation reforms following e-commerce evaluations including the UNCTAD e-readiness assessment, with efforts to improve its connectivity, implement the multi-modal solutions to enhance transport services, and make “last mile” deliveries more feasible and improve Bhutanese customs capacity to clear small parcel shipments from beyond SAARC region. Bhutan needs to make further improvements in customs clearance reforms, formalize clear de minimis thresholds, and introduce an automated customs declaration processing system (ASYCUDA Word). International guidelines set out in the World Trade Organization (WTO) Trade Facilitation Agreement (TFA) procedures on Expedited Shipments and the World Customs Organization (WCO) Immediate Release Guidelines provide good practice for managing the cross-border delivery of low-value goods. Also, to be able to make full use of systems and processes required for trade facilitation, Bhutan also needs to increase the use of ICT to allow for paperless clearance. Optimal use of electronic customs clearance and streamlined procedures will help reduce unnecessary delays and abuse of dedicated customs rules and procedures, especially in the current pandemic context. Tackling the logistics underperformance on a regionwide basis through the promotion of e-logistics services, especially at the border, would improve interoperability of services across the region and generate time and money savings across goods and services.

**ICT development constraints:** To be able to access e-commerce services, a country needs a digital infrastructure. Bhutan’s fiberoptic network within the country provides the infrastructure to promote business incubation and potential startups in the ICT sector. However, due to costly, low speed Internet connections and low technical skills, ICT development has been slow. Improved Internet speed and reliability, along with skills development, could greatly help ICT startups. The RMA has begun implementing a payment gateway platform (Bhutan Immediate Payment Services - BIPS) to promote the use of digital payments in the country and provide avenue for domestic e-commerce merchants to expand their global reach. The new payment gateway platform allows people to remit money through different channels, such as Internet banking, mobile phones, and ATMs, to any other receiver in any of participating banks. However, financial inclusion in

49 “De minimis” is defined as a valuation ceiling for goods, including documents and trade samples, below which no duty or tax is charged and clearance procedures, including data requirements, are minimal. International Chamber of Commerce (ICC) Customs Guidelines.
Bhutan remains low and restricts significant digital payments uptake. Only one-third of Bhutan’s population has an account with a financial institution.

**Digital literacy:** Most micro and small enterprises in Bhutan lack information on the possibilities afforded by digital technologies, while the workforce is usually not educated in basic ICT skills or more sophisticated organizational skills, such as order handling, quality control, and processing of online payments. Bhutan needs to fully implement a strategy for improving digital literacy and skills by embedding digital curriculum within schools and higher educational institutions. For the adult out-of-school population, implement programs to train in ICT skills through training institutes, coding schools and community programs.

Appropriate policies can help Bhutan to take advantage of digital technologies and to use ICT to make its people and its businesses more productive and better connected. High priorities are to (a) improve access to affordable and high-quality Internet across Bhutan so that all individuals and businesses can be part of the digital economy; (b) encourage greater digitization of financial services and other key sectors of the economy; and (c) create an environment that enables digital innovations like e-commerce to reach smaller businesses and rural areas so that they can benefit from Bhutan’s digital future.

### 3.4. Addressing regulatory and institutional issues that affect Bhutan’s e-trade

The presence or absence and quality of regulations can shape in various ways the ability of e-trade in goods and services to reduce transaction costs. As the conceptual framework for e-trade (Figure 24) illustrated earlier in this section, public policy considerations have a key role to play in promoting the growth and development of the digital economy.

**Enabling policies:** E-trade in goods and services requires supporting policies in areas like data protection, cyber security, consumer protection, competition law and recognition of e-signatures and electronic transactions. These are the basic building blocks of all business online. However, there are some additional issues, like intellectual property and sector-specific regulation which have greater significance for the services sector.

**Data protection:** In a digital transaction, there is a high likelihood that sellers of goods and services will need to collect, use and store data which includes sensitive, personal information such as current location, interests or medical records. In order to improve public confidence, appropriate regulations must be implemented to cover both how private companies must handle and store data, as well as what they should do in the unfortunate event of a data breach. Bhutan enacted a sectoral privacy law in 2018. The “Information, Communications and Media Act” gives Bhutan a minimal data privacy law; it covers electronic information and enables for the creation of a partly independent Media Authority that is able to investigate and resolve complaints. Although this law is a useful step in the right direction to ensure data protection, its privacy coverage does remain extremely limited. Data protection and privacy would benefit from regional regulatory standardization, allowing consumers to be confident that their data is being treated with the same care when handled by other regional service providers. Bhutan could use the ASEAN Framework on
Personal Data Protection (2016) as an approach to manage data privacy. The framework sets out key principles and aspects of a data privacy regime, including, for instance, notification and consent on the use of personal data; security with which personal data are held to avoid breaches; and holding organizations accountable for the use of personal data.

**Consumer protection:** Consumer protection is important for both goods and services, but it is particularly relevant for e-trade-in-services because information asymmetries are far greater in services transactions than in goods trade. The RGoB has enacted the Consumer Protection Act in 2012 detailing duties of manufacturers of goods and service providers. Although it has facilitated consumer protection and grievance redressal, Bhutan would need to ensure that the Act address new issues, for example in relation to online apps and services offered for “free” in exchange for gaining access to the user’s personal data, or how national and regional consumer protection regimes will be enforced for product safety and recalls in the context of cross-border e-commerce. Provisions on data privacy, consumer protection, and cybersecurity regarding e-trade would need to be developed. At a regional level, the ASEAN Strategic Action Plan for Consumer Protection (ASAPCP) 2025 and the ASEAN Online Business Code of Conduct provide good examples for consumer protection frameworks focused on information-sharing between regulators and commitments for consumer protection in e-commerce transactions.

**Competition law:** The rise of digital economies presents new challenges – and opportunities – for national and regional competition authorities. Bhutan issued a new Competition Policy in 2020, and it is important to clearly specify how it will be applied to and enforced in e-commerce in Bhutan. Also, it is important to clarify how price regulations comply with competition rules and

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50 Available at https://asean.org/storage/2012/05/10-ASEAN-Framework-on-PDP.pdf
regulations. The ASEAN guidelines could provide guidance in this regard. UNCTAD recommends that younger competition authorities with limited resources, particularly in developing countries, could join together at the regional level to develop policies and regulations that could facilitate inter-regional trade and ensure a level playing field for local SMEs (UNCTAD, 2019). ASEAN issued guidelines for the establishment of a regional competition policy in 2015. This was an important step especially as not all ASEAN member states have domestic competition laws or enforcement agencies. Moreover, the recommendations made in those guidelines could provide guidance to or be implemented by countries beyond ASEAN countries.

E-documents and e-signatures: Instead of a single legislation on electronic commerce, Bhutan enacted various laws and regulations (the Information, Communications and Media - ICM Act) in 2018 to govern information technology and information technology-enabled services. Although the country has the basic legal framework in place that recognizes electronic and paper documents, as well as electronic and digital signatures, there is significant room to improve the practical implementation of regulations and policies meant to recognize electronic documents—for example, in complying with border clearance requirements. Ensuring electronic documents and signatures are recognized by all public agencies facilitates remote electronic transactions.

Intellectual property (IP): An important aspect to consider in creating an enabling policy environment for innovation and development of e-trade is an intellectual property rights (IPRs) regime. The Copyright Act of Bhutan protects literary and artistic works of the proprietors and regulates reproduction of the same only for information purposes, but it is still not clear whether copyrighted work and their broadcasting or reproduction or publishing over the internet falls within the scope of the Act, which is currently being revised by the Department of Intellectual Property. The Industrial Property Act also regulates IPR by covering inventions, patents, trademarks (including domain names), and industrial designs. Bhutan’s Department of Intellectual Property maintains an Online IPR Registry, which event authorized agents of foreign companies can file complaints about violation of their IPRs in Bhutan. There is potential for regional collaboration in future agreements on the strength, standardization and enforcement of national regulation, in order to ensure that companies operating across a region can have a relative degree of certainty in the strength of their IP rights.

New Technologies – Cryptocurrencies, Blockchain and Artificial Intelligence: In developing e-commerce policies, policymakers should be aware of digital technologies such as high-level encryption, the Internet of Things, blockchain, or AI, and be prepared for the need to consider the regulatory implications of these innovations. Bhutan does not have a legal framework to regulate crypto currencies. Digital currencies could provide consumers and businesses in the region with a secure and verifiable transfer system, at significantly reduced cost and risk, compared to traditional cross-border and national payment systems. Financial, transport, real estate and professional services can develop new services using this technology and its potential both as a register and as a mechanism for executing smart contracts. A well-formed, enabling policy framework for the ethical use of AI services can balance consumer interest and the fostering of innovation and entrepreneurship, whilst ensuring essential public interests, such as security, public health and safety. To date, such frameworks are not yet in evidence within the region, with the notable exception of Singapore. The industries which are best placed to benefit would include telecommunications, financial services, utilities, transportation and logistics, retail, education, construction, professional

51 https://www.mckinsey.com/~/media/McKinsey/Featured%20Insights/Artificial%20Intelligence/4
services, travel and tourism. Whilst there are fears that AI could replace some jobs, many new opportunities could open up at the same time.

**Taxation:** The growth of e-commerce has led to new taxation issues since parties to a commercial transaction tend to be located in different countries. The taxation of the increased number of low value goods crossing borders is also a topic of discussion in many countries—both in terms of duties levied, and value-added tax/goods and services tax (VAT/GST). The Goods and Services Tax Act of Bhutan (2020) includes provisions related to e-trade, such as the liability of GST in the case of a taxable supply of imported B2C services through electronic platforms. Further discussions around taxing such as exchanges are currently taking place in Bhutan.

**Sectoral legislative frameworks and regulatory approaches in services:** Although at this stage e-services are underdeveloped in Bhutan, they have the potential to generate great benefits (Figure 25). The existence of asymmetries of information often prompts policy intervention in the form of regulation which can create barriers to entry and service supply. Professional services, for example, are often highly regulated, whilst lengthy approval mechanisms may be required in order to provide financial or audio-visual services. As a result, regulation needs to be calibrated and designed carefully to achieve the public interest justifications which motivate its introduction, without raising costs, reducing efficiency, or creating rigidities in industries. Regulation can be an even greater issue for digital services because the ability of such services to develop and be commercialized will often require positive action on the part of regulators.

**Figure 25. Benefits of e-services**

| E-health | Consultations and even treatment can be delivered remotely via secure telemedicine portals | Benefits: Increasing choice of services, reducing cost, widening access |
| E-education | Digital platforms offer access to new forms of online training and a marketplace to choose traditional providers, including internationally | Benefits: Facilitates search and widens access and choice |
| E-distribution | Can be managed through web interface. Order, pickup, tracking and delivery all available via the web | Benefits: Speed, transparency, international interchange |
| E-financial services | Encourage more competition and new services | Benefits: More choice, improved access and inclusion |
| E-construction | ICT enables more offsite pre-planning; allows buildings to be constructed in a modular and pre-fabricated way; can incorporate smart technologies | Benefits: Makes construction cheaper and more efficient. Reduces waste and pollution |
| E-culture | New services can be made available online and access to traditional services can be widened | Benefits: IP can be curated and managed more effectively |
| E-professional services | Can be delivered remotely, marketed via e-commerce platforms can be digitized (e.g. accounting software, legal forms, online ODR). Regulatory approvals can be automated. | Benefits: Helps search and selection, increases accessibility, competition and choice of services and providers |
| E-transport | Electronic data interchange (EDI) and cloud services allow transport data to be exchanged easily | Benefits: Increased speed and transparency of transport supply chain. Better logistics at international ports |

One of the key challenges of combining national regulation and international trade is heterogeneity of regulatory regimes among countries (Nordas, 2016). Complying with the requirements of differing regional regulations can be daunting, particularly for small business who struggle to meet the administrative and cost barriers. By encouraging mutual recognition of standards this barrier can be greatly reduced. Another concern arising from national regulation is the creation of regulatory grey areas (OECD, 2018b). Due to unclear regulatory environments many digital services providers operate in an environment where they are permitted to continue operations provided that a specific regulation is not enforced. A transparent and homogenous national regulatory environment helps to protect consumer interests and makes compliance as easy as possible for companies. Attempting to harmonize it across the region could also reduce risk and lack of clarity, thus encouraging innovation and investment.

Market access conditions for digital services are also relevant to the more traditional issues around trade in services, in regulated industries such as medical, financial or legal services. This challenge increases when the services are traded at a regional level thus requiring mutual recognition and standards agreements by regulatory bodies ideally in a regional forum. It is also important to note that domestic policy requirements for technology transfers by incoming foreign operators as a condition to operate in a particular country can be problematic. Whilst the goal of such policies can range from being able to break private encryption and fully understand the products, to helping local industry, they can ultimately damage the prospects for growth and investment in that sector depending on the cost-benefit analysis the company employs to determine the value of the market. If the goal is to encourage smaller, domestic SMEs to work with larger partners the goal should be proactive promotion or local knowledge and expertise, rather than mandatory transfer of know-how.

Examining the possibility of regional sandboxes is an option for adopting innovative technologies in more highly regulated spheres. A sandbox refers to a test environment where innovations can be tested under the close supervision of regulators. For example, the development of sandboxes in medical, education or legal technology could lead to enormous societal benefits as well as huge degrees of innovation by giving developers a stakeholder role in the development of regulation. For Bhutan, participation in such fora to consult with industry and businesses providing e-services and trading across borders in South Asia and ASEAN would be invaluable.

### 3.5. Conclusion

**The emergence of national e-trade policies in Bhutan is a welcome development.** Bhutan is in the process of designing a national e-commerce policy with additional initiatives that are relevant for the development of e-trade including the Guidelines on e-commerce (2019), the Cottage and Small Industry Policy (2019), the ICT Industry Development Plan (2016-2020)-iDzodrak, or e-government Master Plan 2014: G2C and G2B services. Although basic building blocks in terms of addressing key socioeconomic constraints and the legal and regulatory framework for e-trade are in place, gaps remain. Public policy considerations have a key role to play in promoting the growth and development of the digital economy. These policy considerations include:

- The digital economy, for both goods and services, will need enabling policies to be developed to address its specific challenges, in areas such as data privacy and consumer protection.

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52 A sandbox refers to a test environment where innovations can be tested under the close supervision of regulators.
• The government will need to consider afresh how it approaches the taxation of e-goods and e-services, as the location in which the service is provided becomes divorced from the location of consumption once services move online.

• Beyond this, individual sectors may need to be adapted to facilitate the supply of e-services and cross-border e-trade, in particular. This may require the adaptation of existing legislative frameworks or the creation of new ones.

• Regulation will need to adapt to new forms of goods and services and regulators could in turn be required to develop new tools and skills to manage a wider range of increasingly innovative services. Sectoral legislative frameworks and regulatory approaches need to be considered in services.

The section has highlighted the need for strong personal data protection, consumer protection, clarification of the e-commerce tax regime and the trade facilitation regime, and the development or adaption of sector-specific regulatory frameworks to build a strong eco-system for promoting e-trade in Bhutan. It will have spillover effects not only in the digital marketplace but on conventional trade, banking transactions, development of software, youth employment and skills of CSIs.

Importantly, it emphasizes the need for intra-governmental coordination in implementing a new policy. The Ministry of Economic Affairs, the leading agency on e-trade, must ensure all agencies understand the potential for e-trade and are in agreement on how to support it. Beyond government agencies, it is important for the leading agency to foster government-private sector collaboration including cooperation between policy makers and technology providers and include the perspectives and aspirations of consumers and small and large operators in the digital economy. This will ensure the identification of current and future impediments and facilitate early remedies.

A common thread running across every aspect of the policy obstacles outlined above is the need for a consistent approach built around regional consensus. As more South Asian and ASEAN countries contemplate national e-trade policies it will be important to share good practice from around the region on which Bhutan can benchmark and avoid starting from scratch. The ASEAN agreement on e-commerce signed early 2020 is an important step as it acknowledged the importance of e-trade in the future. Needless to say, the COVID-19 pandemic will have sped up the need for a regional framework not least, to ameliorate the devastating economic effects of lockdowns on traditional services providers. However, much as the framework focuses on cooperation on some of the more problematic issues for firms, future reviews will need to consider the implementation capacity within member states both in terms of policy development and also in the capacity and expertise in key institutions.
3.6. References


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