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**Case study on Bhutan<sup>1</sup>**

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## **Introduction**

Bhutan is a small landlocked country covering an approximate area of 38,394 square kilometers and surrounded by India to south and the Tibetan Autonomous Region of China to the north and the northwest. Bhutan is entirely mountainous and forested, with land rising from about 200 meters to 7500 meters above the sea level. The population of the country was recorded at 672,425 in 2005 with an estimated annual growth rate at 2.5 percent.

Due to Bhutan's late start to modernization and subsequently a careful government approach, the economy remains in a developing state. The economic structure remains shallow and narrow, overly reliant on certain specific growth areas, notably hydropower and government services and investment.

In 2005 the Bhutanese economy recorded a real growth of 6.5 percent with its GDP at US \$ 837.1 million in the same year. However, Bhutan still being an agrarian country with more than 70 percent of its population engaged in the subsistence farming, the agriculture sector still dominates the economy with its share of 22.4 percent of GDP although it has been gradually decreasing since last past five years .

The other large contributors to the GDP are construction sector with 17 percent of GDP, followed by community and social services and transport, storage and communication with share of 12 percent and 10 percent respectively.<sup>2</sup>

## **Bhutan's Trade Scenario**

### **Background**

Bhutan's trade is heavily concentrated in the region. India constitutes to be the major trading partner covering almost 75% of Bhutan's total trade although the share of trade with other countries has picked up over the years. India accounted for almost 80% of total exports and 70% of total imports. Apart from India, the other major trading partners on the export front are Bangladesh, Singapore, Thailand, Hong Kong, and Nepal. On the import front, major trading partners other than India are Indonesia, Russia, Singapore, South Korea and Japan.

Internally Bhutan has a very small market and the capacity to sustain growth is limited. As a result, one of the key objectives of the Royal Government is gradual integration into the regional and global trading system. Further Bhutan has a very narrow range of exports with the five top exports accounting for over 76% of our total exports. Hence diversification of the export base has become a priority.

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<sup>2</sup> National Accounts Statistics 2000-2005, December 2006, NSB, RGoB

## **I. Trade with India**

The first Trade Agreement between Bhutan and India was signed on 17 January, 1972 and has been periodically revised. The current one signed in Delhi in July 2006 is valid for ten years.

The most important feature of the Trade Agreement is the provision for free trade between the two countries. With the trend for free trade growing worldwide, the existence of a total free trade between India and Bhutan from the very beginning has been cited as being visionary and ahead of times. The rapid growth of trade between our countries is attributed to the Free Trade Agreement. The other important aspect of the Agreement is Bhutan's transit right for its trade with third countries. Bhutan has been able to improve and strengthen this right in every successive agreement.

**Trends:** India is Bhutan's largest trading partner. Trade between the two countries have increased dramatically in the past few years with imports from India touching Nu. 12,795.09 million and exports from Bhutan Nu. 9,969.83 million in 2005<sup>3</sup>.

Electricity accounted for Nu.3,439.94 million of the total exports. Other major export items were: wire cables, calcium carbide, ferro-silicon, portland cement, ingots, texturized polyester yarn, particle board and mineral and aerated water.

Major imports from India were diesel, iron & steel, electrical transformers & static converters, rice, beer, passenger cars and hydraulic turbines & parts.

## **II. Trade with Bangladesh**

The first Trade Agreement and Protocol to the Agreement between Bhutan and Bangladesh were signed in September 1980 and February 1984 respectively. The current Agreement was signed in Dhaka on 12 May 2003 and is valid for a period of five years. The Trade Agreement provides for a preferential treatment on goods traded between the two countries. Though trade relations were established as far back as in 1980, actual trade picked up only by 1988 when the Royal Government granted 30% cash incentive to third country exports generating hard currency revenues.

**Trends:** Bhutan's exports to Bangladesh in 2005 stood at Nu. 561 million and mainly consist of apples, oranges, limestone, dolomite lumps, talc, gypsum and mixture of juices. Imports were worth Nu. 147 million consist of ready-made garments, tableware, melamine, biscuits, waffles and chips, aerated waters, noodles, batteries for cars and cooking oil.

Though small, the trade balance has been in Bhutan's favour from the beginning itself.

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<sup>3</sup> 1 US Dollar is approx. Nu. 40

### **III. Trade with Thailand**

Bhutan's trade with Thailand started with the introduction of Druk Air (Royal Bhutan Airline) flights to Bangkok in the 90s. Imports from Thailand have witnessed substantial increase averaging over Nu. 240 million in the past five years. A wide range of products comprising of basic food preparations and garments to electronics, automobile spares and aircraft parts come from Thailand. Bhutan's exports to Thailand is however almost non-existent and is limited to mushrooms.

There is no formal trade agreement between the two countries. However, both are members of Bay of Bengal Initiative for Multi sector Technical and Economic Cooperation (BIMSTEC) where the negotiations are on to establish a free trade regime for trade between contracting member states.

### **IV. Regional Trade Initiatives**

#### **a. SAARC Agreement on Free Trade Area (SAFTA)**

Bhutan is a member of the SAFTA whose objective is to promote intra-SAARC economic cooperation through trade by eliminating tariff and non-tariff barriers to trade. The Agreement was signed on 6 January 2004 during the 12<sup>th</sup> SAARC Summit at Islamabad, Pakistan and comes into force from January 1, 2006. The Agreement will be implemented through the following instruments

#### **b. Bay of Bengal Initiative for Multi sector Technical and Economic Cooperation (BIMSTEC)**

Bhutan became a member of the BIMST-EC and signed the Framework Agreement on BIMSTEC Free Trade Area in February 2004. Bhutan has since been actively participating in all the meetings organized under the aegis of BIMSTEC. There are several groups and sub-groups of which the Trade Negotiating Committee and the Task Force to review sectors and sub-sectors for economic cooperation are the two most important negotiating forums.

### **V. Trade with other countries:**

Japan, Singapore, South Korea, Indonesia and Germany are among the other major trading partners especially in terms of imports. Bhutan's export market outside India is still small. In the recent past, export of jewellery and computer software to Hong Kong and Singapore have picked up.

### **Bhutan in the WTO**

Bhutan's engagement with the Multilateral Trading System (MTS) dates back a few years when we initially joined the World Trade Organization (WTO) as an observer in April 1998. During this period, Bhutan participated in various WTO Ministerial meetings and

other WTO related activities, which has proven to be invaluable in familiarizing Bhutan's representatives and negotiators with the complexities of the MTS. A WTO Reference Center was also established in the Department of Trade with technical assistance (TA) from the WTO to introduce its officials to the workings of the MTS.

Ever since the approval of its accession application by the WTO member states in 1999 Bhutan has completed the relevant WTO accession process including submission of Memorandum of Foreign Trade Regime (MFTR) and the Legislative Action Plan (LAP), Offers on Goods and Services to the WTO, Questions and Answers (Q&A) round and the Working Party meetings within the specified time lines between 2004-2006. as of today, Bhutan is working on the Draft Working Party Report and will be having its 4<sup>th</sup> Working Party Meeting this fall.

UNCTAD has been keenly involved from the beginning of the process and has provided the technical expertise in every stage of our submission of the foreign trade memorandum. As part of their assistance, they have also conducted in-house training for our officers on specific issues such as negotiation techniques, tariffs and services. In addition UNCTAD has been instrumental in the capacity build up of our key negotiations- an attribute to which the Royal Government has appreciated very much.

## **Department of Trade**

The Department of Trade under the Ministry of Trade and Industry was established to spearhead the growth of a dynamic trade sector leading to the greater prosperity of the nation. The vision was to be achieved by creating an enabling environment and providing promotional services to the private sector.

The Department of Trade comprises of two divisions, namely, the Internal Trade Division and Foreign Trade Division. The Internal Trade Division is responsible for wholesale and retail trade within the country, and the Foreign Trade Division is responsible for international trade.

The objectives of the Department are as follows:

- To stimulate the growth of the export sector and enhance export earnings
- To create an open, liberal and stable enabling environment that is conducive for the growth of the private sector and trade.
- To promote the integration of the nation into the regional and international trading system.
- To promote competitive and fair trade practices within the country.
- To increase trade's contribution to the GDP
  
- To strengthen the institutional and professional capacity of the Department to fulfill its mandate.

The key strategies adopted for achievement of the objectives are as follows:

- Integration in the regional economy through membership in BIMST-EC, SAFTA etc.
- Strengthen long-term trade relations with principal trading partners and initiate formal bilateral PTAs with potential trading partners
- Integration into the global trading system through accession into the World Trade Organisation (WTO)
- Diversification of export markets and products and exploit niche markets
- Trade facilitation and export promotion
- Progressive reduction of import tariffs and abolition of export taxes
- Simplification of current regulations and procedure for export and import activities
- Development of Trade facilitation infrastructure
- Institutional and manpower strengthening

## **Trade Policy of Bhutan<sup>4</sup>**

Trade plays an important role in taking the economy forward, creating new opportunities for business and employment generation. Bhutan's strategic location between the two most populous states - India and China also offers immense opportunity to become a vibrant trading nation. Furthermore with the increasing globalization, trade with the international community opens up many opportunities and prospects.

Considering the fact the trade has the high potential in economic growth and development the Royal Government of Bhutan has established a transparent and liberal trade policy that is conducive for the development of trade sector. The following paragraph sets out the Royal Government of Bhutan's policy on both internal and external trade and highlights the key measures to be pursued.

### **Policy Objectives**

The objectives for international trade for the 9<sup>th</sup> Five Year Plan (2002-2007) are the following:

- To stimulate the growth of export sector and enhance export earnings during the plan period
- To create an open, liberal and stable policy environment that is conducive for the growth of private sector and trade
- To promote the integration of the country into the international and regional trading system
- To build an information base including trade statistics to assist the private sector to keep abreast of the trends and opportunities in international markets for goods and services.

To meet the above objectives, the main strategies are as follows:

- Accession to the World Trade Organization (WTO)
- Promote the process of trade liberalisation initiative within the framework of the SAARC Free Trade Area (SAFTA)
- Simplification of administrative procedures, establishment of a transparent and liberal export and import regime and creation of incentives to encourage and support exporters
- Encourage trade in services including knowledge based industries
- Strengthen long term trade relations with principal trading partners and negotiate preferential trade treaties with new trading partners
- Develop dry ports and warehousing facilities at major border towns, and
- Strengthen interaction and networking with relevant government and international agencies and the private sector within as well as outside Bhutan to facilitate the flow of information through Export Promotion Center.

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<sup>4</sup> Ref: International Trade Policy of Kingdom of Bhutan

## **Import Policy**

The Royal Government is committed to establish a transparent and liberal import regime to facilitate economic growth and support the efficient allocation of its resources.

Maintaining a simple, clear and transparent import regulation, liberalization of import regime through rationalization of tariffs, promoting trade liberalisation initiatives with existing and potential trading partners, no quantitative restriction on imports and planning imports as a medium of export development are some of key elements of the import policy of Bhutan

## **Export Policy**

Similarly the export regime of the Royal Government shall be open, clear and simple to reduce transaction costs of exports.

For the purpose the following export strategies are adopted:

- Simplification of all export procedures and documentation
- Continue zero export taxes in the future
- Identification of Special Economic Zones (SEZ)
- Establish inland ports and warehousing facilities at the entry points
- Streamline import-export procedures and set up greater transparency to enhance competitiveness
- Extend support for participation of exporters in regional and international trade fairs
- Improve market access for Bhutanese products through strategic negotiations and international relations, and targeted assistance to exporters.
- Institute the annual Export Award to motivate the export community
- Provide appropriate export incentives
- Provide export finance and insurance

The above paragraphs provides a factual summary of Bhutan's positions as well as objectives, strategies and policy options for the development of trade sector in the country.

In spite of several initiatives undertaken by the government we are still posed with several challenges that are detrimental in our endeavor to promote the sector.

Some of the challenges that we face today are the lack of capacity among our producers in this globalized world dominated by knowledge-intensive products. We still lack the capacity to produce goods that can compete in terms of quality, quantity and price in the export markets.

We are also posed with lack of physical infrastructure, technology, institutional weakness and demand constraint. Our production units are ill equipped with modern machineries and technology to produce quality products.

The high transport costs and poor connectivity due to geographical location of the country are also detrimental to our development initiatives. The long duration taken to transport goods affect our ability to compete in the export market. Such delay makes the goods more expensive, and attracts lesser price in the market especially in the case of perishable goods.

Given the challenges faced in the trade sector, some important measures that will be pursued includes, **1.** Simplification of administrative procedures for import and exports and reducing sectoral requirements, **2.** Improving productive capacity and quality by encouraging the use of internationally recognized standards, norms and quality controls by facilitating the necessary legal and institutional arrangements, including appropriate international instruments and testing and certification facilities, **3.** Facilitate trade and transit through the establishment of dry ports, **4.** Improve market access for Bhutanese products through strategic negotiations and international relations, and targeted assistance to exporters, **5.** Encourage efforts towards maximizing Bhutan's comparative advantage and identify and promote high value niche products for niche markets, **6.** Improve capacity and competitiveness of local industries to meet the demands of local and overseas markets and **7.** Work towards closer partnership with the private sector to assess and meet producer's and exporters' needs, towards trade facilitation and improve awareness of export potential.

## **UNCTAD's Intervention**

The Department of Trade would like to express its gratitude to UNCTAD for all the support it has rendered especially in assisting us towards our accession process to the WTO right from the beginning, framing of the Consumer Protection Bill and several other capacity development initiatives undertaken by it.

In coherence to the ongoing support and initiatives, UNCTAD should continue and strengthen its work in the area of trade and development, and help the LDCs achieve their MDGs. Specifically, it should:

- Analyze best practices and policies to promote trade and its contribution to the country's development and support our efforts in formulating/designing policies and regulations in the area of trade
- Identify ways of overcoming challenges facing our country in our Endeavour to promote trade as a mean of economic growth and development
- Continue to assist us in harnessing the gains from multilateral trading system
- Help us to strengthen the institutional and professional capacity to fulfill our mandate and objectives

Finally, I would like to sincerely thank UNCTAD for giving me the opportunity to attend this very important meeting. I am positive that there would be a lot to learn from this meeting which could be beneficial to me and to the Department in carrying out our exercises to achieve our goals and objectives.