Gross National Happiness-Based Economic Growth

Recommendations for Private Sector Growth Consistent with Bhutanese Values

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List of Acronyms

BCCI	Bhutan Chamber of Commerce & Industry
CSME	Cottage, Small, and Medium Enterprises
CSO	Civil Society Organization
DHI	Druk Holding & Investments
EU	European Union
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GNH	Gross National Happiness
GPP	Green Public Procurement
HDI	Human Development Index
ICT	Information and Communications Technology
IT	Information Technology
MW	Megawatts
PAE	Policy Analysis Exercise
S&P	Standard & Poor's Ratings Services
US	United States of America

<u>Executive Summary</u>

Despite the foreign misperception that Gross National Happiness (GNH) is a cumulative measure of epicurean or temporal happiness, its use still represents a fundamental shift away from Gross Domestic Product's emphasis on productivity and towards a more holistic ideation of development. Since its conception in 1972 by the Fourth King, Jigme Singye Wangchuk, GNH has been well-integrated into all corners of Bhutanese society. Most impressively, Bhutan has also been able to achieve very fast economic growth over the last two decades while remaining true to GNH's four pillars of good governance, sustainable development, cultural preservation, and environmental conservation. This has primarily been made possible through large investments in hydroelectric power generation projects. However, Bhutan's high rate of growth has been largely public sector-driven and will be short-lived without significant reforms and economic development initiatives. The future of the country's economy is dependent on the ability to facilitate GNH-aligned private sector growth.

Utilizing a methodology that both identifies socio-culturally specific conditions and holistically analyzes how these conditions interact, this Policy Analysis Exercise (PAE) first identifies the following constraints to private sector growth. An adequate intervention must address:

1) Quickly improving, yet poor levels of infrastructure (especially in transportation)
2) A unemployment surge of highly educated, yet technically inexperienced youth
3) Complex and continuously changing regulations
4) Low levels of coordination between stakeholders
5) Expensive capital, predominantly caused by an extremely large trade deficit with India.

These constraints interact and manifest themselves through uniquely Bhutanese challenges such as the issue of *fronting* and the Indian Rupee Crisis of 2012.

An initiative that systematically addresses all of these constraints to private sector growth is fulfilling the sustainable development component of GNH, but an appropriate intervention must also fulfill the other domains of GNH, have positive political implications, and be reasonably implementable. With these four criteria taken into account, this analysis proposes five recommendations for Bhutan:

1) In order to continue the status quo of benefiting from continued investment in hydroelectricity, the country must establish a stabilization fund.

The country can improve upon this status quo by:

2) Strengthening the role of industry associations to improve market coordination in a way that resembles the German economy.
3) Improving institutional conditions by developing new markets through business clusters (as opposed to special economic zones), with partnerships resembling Costa Rica's collaboration with Intel in 1997.
4) Increasing support for the Green Public Procurement initiative by directing increased political recognition and financial resources.
5) Researching the establishment of a new corporate form that can screen out exploitive investors and allow for full access to foreign direct investment.

Evaluations of how each of these initiatives performs according to the previously mentioned four criteria highlight different benefits and challenges that will be faced as they are implemented.

Economic Development According to Gross National Happiness

Gross Domestic Product, Its Implications, and Its Shortcomings

As the only country to completely adopt an alternative form of measuring economic activity to Gross Domestic Product (GDP), any political analysis of Bhutan must begin with an examination of the very significant role that GDP plays throughout the world.

Efforts to measure a country's total economic activity have occurred since the dawn of civilization in ancient Egypt, but its importance was especially highlighted during the onslaught of the Great Depression in the 1930's. The resulting rise of Keynesian economics highlighted the importance of a strong system of measuring national accounts. It was during this time that the work of economist Simon Kuznets, working at the non-profit National Bureau of Economic Research, attracted the attention of the US Department of Commerce. Kuznets had led the calculation of the US's most recent national income accounts and was able to publish an assessment of the crucial 1929-1932 time period in 1934.[1] Kuznets was then hired by the Department of Commerce to help standardize their calculation processes, leading to the publishing of accounts by the US government beginning in 1940s. Other countries quickly followed this growing movement, culminating in the development of the United Nations System of National Accounts standards in 1953.[2] These standards have gradually shifted over time, with the most recent version released in 2008,[3] but continue to be tied to the core principle of calculating a country's total economic output.

The use of GDP as a measure of a country's economic health is popular for good reasons. As a single value that calculates total productivity in a (seemingly) straightforward manner, it allows for easily publicized, quick comparisons across countries and time. Additionally, as a monetary indicator, GDP standardizes the values of an enormously wide variety of goods and services in an objective manner. Rather than prescribing subjective evaluations regarding the value of different products, the use of market value is less controversial. As a simple and objective indicator, GDP has become an extremely powerful measure of economic health. Comparative measures of GDP rankings, GDP per capita, and GDP growth have become so influential that their roles have spread beyond indicators of national income and have come to represent stages of societal development and overall welfare. This has occurred despite warnings from Kuznets himself, who warned in 1934 that, "The welfare of a nation can scarcely be inferred from a measurement of national income."[4]

The use of GDP as a measure of social welfare throughout the world is problematic for multiple reasons. Practically, it more accurately values goods rather than services and ignores the informal economy. It also fails to address damages to future economic growth. For example, despite the tremendously negative long-term impact that the 2010 Deepwater Horizon oil spill on the fishing and tourism industries in the United States, the large expenditures made on cleanup efforts resulted in minimal changes to GDP.[5] These shortcomings reflect the recommendation of Kuznets that, "distinctions must be kept in mind between quantity and quality of growth, between its costs and return, and between the short and long term. Goals for more growth should specify more growth of what and for what."[6]

In addition to its practical shortcomings, GDP fails to incorporate more fundamental social values that are not captured by productivity, such as economic equality and emotional well-being. These concerns are especially troublesome when GDP is used as an indicator of general social welfare. In such contexts, it is implicitly suggested the primary function of government is to facilitate an economy that maximizes productivity, without attention to other quality of life concerns.

Taking into account these other concerns can dramatically change the perception of a country's state of economic development. For example, in the United States, the share of the total population's income earned by the top one percent has reached levels that have not been matched since the late 1920's.[7] While some economists argue that certain levels of inequality are a necessary component of overall growth and serve to promote investment, such extreme inequality can mean that the grand majority of the population is experiencing little to no improvements in economic conditions or has even suffered worsening circumstances. One might attempt to calculate the potential long-term damage to overall productivity that the political instability of inequality can cause, but GDP ignores the pursuit of equality as a societal value worth pursing in itself. The Gini Coefficient, developed by Italian sociologist Corrado Gini in 1912, is one effort at addressing this blind spot. However, despite its large attention within academia, it has yet to achieve the same level of political significance as GDP. This political inattention to inequality, given the power of GDP in shaping economic policy, can be considered to be one factor contributing to the fact that the US ranks 10th in per capita GDP,[8] yet significantly below the global average in its Gini coefficient.[9]

More recently, the concept of GDP as an indicator of social welfare has been directly challenged by scholars interested in measuring levels of happiness. The assumption that a more productive economy would automatically increase the emotional health of its citizens was most famously challenged by Richard Easterlin in 1974. Easterlin's work suggested that increasing levels of income produced higher levels of self-reported life satisfaction only up to a certain extent. With a focus on the US, he found that while per capita GDP steadily increased between 1946 and 1970, life satisfaction remained unchanged.[10] Psychologist David Halpern, who currently heads the British government's Behavioral Insights Team (established in 2010), has emphasized greater attention to life satisfaction and sources of "hidden wealth" such as social trust.[11] He argues that these factors explain the "Easterlin Paradox" and that by targeting issues such as social bonds, the environment, and inequality, the conditions for economic growth are also improved. Efforts to prioritize the improvement of life satisfaction as the goal of government are gradually becoming more popular, with especially innovative and forward thinking local governments, such as the city of Somerville in Massachusetts, implementing and tailoring their services according to life satisfaction surveys.[12]

Gross National Happiness and Its Impact within Bhutan

While the term was first coined nearly a half century before Halpern's *The Hidden Wealth of Nations* was published, the ideation of Gross National Happiness (GNH) for driving growth and policy in Bhutan is closely aligned with these newly popular concerns regarding holistic development. Introduced by the Fourth King, Jigme Singye Wangchuck, GNH's four pillars of good governance, sustainable development, cultural preservation, and environmental conservation represent the efforts of a visionary leader seeking to align the country's values with economic growth. These four pillars are further detailed through the use of nine domains: psychological wellbeing, health, time use, education, cultural diversity & resilience, good governance, community vitality, ecological diversity & resilience, and living standards.[13] In turn, these nine domains are evaluated through a combination of thirty-three objective and subjective indicators.[14] Carefully planned and executed surveys are carried out on five-year cycles, with the first full-scale survey in 2010 involving over seven thousand respondents.[15] The timing of these surveys is consistent with the country's tradition of presenting five-year plans, which serve as guiding strategic documents for government operations and are heavily embedded within the context of the goal of increasing GNH.

While most Bhutanese would assert that GNH extends from the country's Buddhist background, it is important to substantiate that both the unique nature of the concept and its pervasiveness throughout Bhutanese society is primarily due to the efforts of the country's political leaders. GNH's most explicit origins exist in the country's first legal code in 1729, which states "if the government cannot create happiness for its people, there is no purpose for the government to exist."[16] The beginning of the articulation of GNH by the Fourth King also carries significant implications. King Jigme Singye Wangchuk, who was coroneted at the age of 16, had already been appointed Chairman of the Planning Commission and would lead Bhutan through the first stages of planned agricultural development, signed the first hydropower project with India, stabilized foreign relations with neighbors India and China, countered a domestic rebellion, established strong initiatives in cultural and ecological preservation, shaped the tourism industry, and guided the transition to a constitutional monarchy. The shape of modern Bhutan is predominantly the result of the leadership of the Fourth King, and the fact that GNH was ideated during his rule lends tremendous political capital and legitimacy to the concept.

GNH is very well-integrated throughout the Bhutanese government. The Constitution explicitly identifies the responsibility of government to "promote those conditions that will enable the pursuit of Gross National Happiness"[17] and both the Center for Bhutan Studies and the GNH Center are dedicated to the research and development of GNH. Perhaps the most well-known example of this integration is the Ministry of Education's consistent efforts to shape its curriculum in alignment with GNH.

However, the challenge of how to incorporate GNH into the country's private sector, given its relative distance from government's typical purview, is one that has received heightened attention. A controversial attempt in 2012 at banning the use of cars in the capital on Tuesdays[18] facilitated a discourse over GDP vs GNH tradeoffs (particularly in the international media) and might have played a role in the first winning election of the country's opposition party. However, within the Bhutanese political class, economic growth does not stand in opposition to GNH, but rather fits perfectly within the pillar of sustainable development. In comparison to a misinterpreted GDP vs GNH discourse that foreign media have been attracted to, Bhutan has steadily been transitioning into a public dialogue of how to continue to channel GNH into specific initiatives and policies, rather than a nebulous goal. For example, the Prime Minister, Tshering Tobgay, has continued to emphasize the importance of GNH, but campaigned on four specific concerns: the national debt, the Indian rupee shortage, youth unemployment, and the perception of corruption.[19] From the ground it is clear that the argument is not whether GNH sacrifices economic growth, but rather how to improve encourage GNH-aligned economic growth in specific ways. These conversations are reflected in the heightened dialogue and use of Western terminology such of corporate social responsibility, social enterprise, and Green Public Procurement. While there is clear alignment between these ideas and Gross National Happiness, it should be pointed out that the conception of GNH predates these other ideas, and that the challenge of holistic economic growth is inherently and historically Bhutanese, rather than the adoption of relatively new Western initiatives.

- **As a more holistic interpretation of social welfare, the use of GNH in development policy represents a fundamental shift from GDP.**
- **Developed by King Jigme Singye Wangchuk, GNH is a distinctly Bhutanese conception that is closely tied to national identity.**
- **Economic growth strategy in Bhutan must both address the typical challenges faced by other countries and be well-integrated into country's overall guiding principle of GNH.**

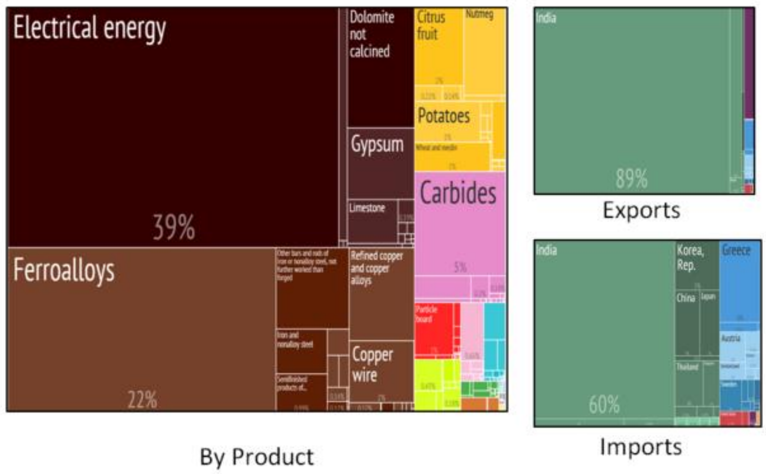
Bhutan's Underdeveloped Private Sector

An Overview of the Bhutanese Economy

Despite its image as an insular and exotic Himalayan kingdom, Bhutan's economy has been continuously growing above a 5% rate over the last twenty years (with the exception of 2013).[20] With a per capita GDP of $7,700, the country's economic output is similar to that of Morocco and Guatemala.[21] Additionally, as one of the few countries with neutral carbon emissions[22] and a Gini coefficient (38.65) closely matching the global average (38.0),[23] Bhutan has managed to achieve this tremendous economic growth in a manner consistent with GNH. Between its two GNH surveys in 2010 and 2015, GNH has increased from 0.743[24] to 0.756.[25] According to the Human Development Index, a multidimensional indicator similar to GNH, Bhutan has improved along the lines of life expectancy, education, and per capita income with an increase in HDI value from 0.573 in 2010 to 0.605 in 2014.[26]

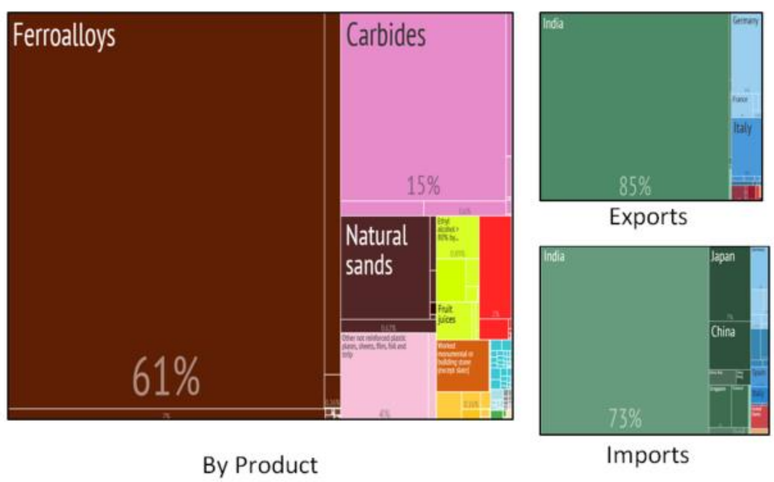
While Bhutan's rate of economic growth and the manner in which it has been consistent with GNH have been impressive, there are two key features that highlight its fragile nature. First, the Bhutanese economy is very homogenous, with a very strong dependence on publically-owned and distributed electrical energy. While Bhutan's civil service has more than doubled over last 12 years, only 66% of non-agricultural jobs are in the private sector.[27] In comparison, despite its large defense expenditures, 85% of non-agricultural jobs in the US are in the private sector.[28]

Figure 1: Trade Data for Bhutan (2012)



Source: Atlas of Economic Complexity

Figure 2: Trade Data for Bhutan (2014)

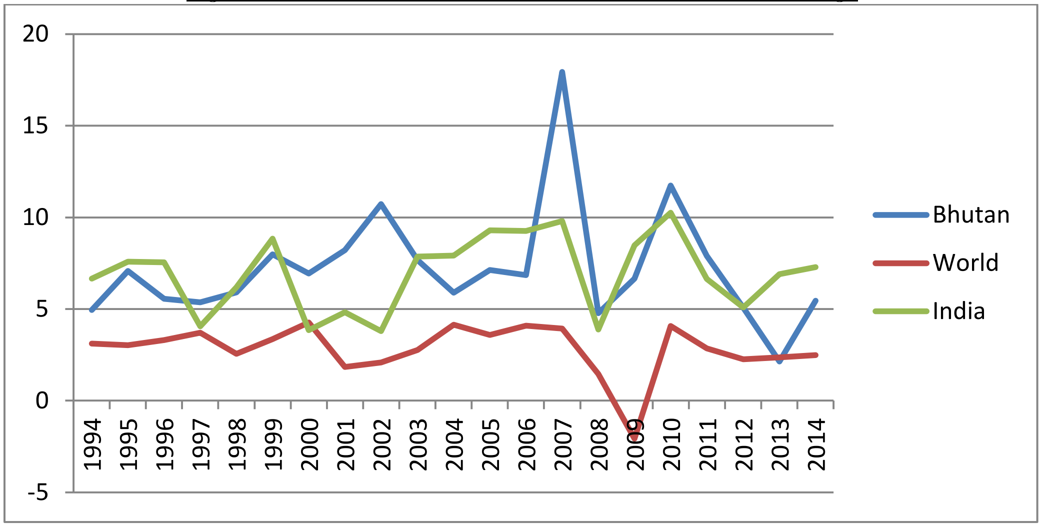


Source: Atlas of Economic Complexity

Secondly, Bhutan's politically beneficial relationship with India has produced an economic dependence that transcends the influence of the rest of the global market. We can see this at play when analyzing the country's exports and imports and the percentage makeup of its trade partners. As shown in figure 2, 73% of Bhutan's imports and 85% of its exports were traded with India in 2014. While this can be attributed to a possible lack of accurate data, comparing these numbers to the latest year for which electrical energy was included in Bhutan's export package demonstrates similar results. Also visible in the more accurate representation of Bhutan's exports in 2012 is the dominance of the public sector in trade; the sale of electrical energy makes up 39% of all exports. Of the total of 1,500 MW of hydroelectric power generated by the country's power plants, 70% is exported to India,[29] and the taxes and dividends from these publically-held companies make up more than 40% of the country's total revenue.[30]

A high-level analysis of Bhutan's homogenous economy and trade ties with India demonstrates that while the country has maintained relatively high levels of growth, its economic productivity is not only closely correlated with that of India, but is also more volatile given its lack of access to other markets.

Figure 3: GDP Growth - Bhutan, India, and the Global Average



Source: World Bank, World Development Indicators

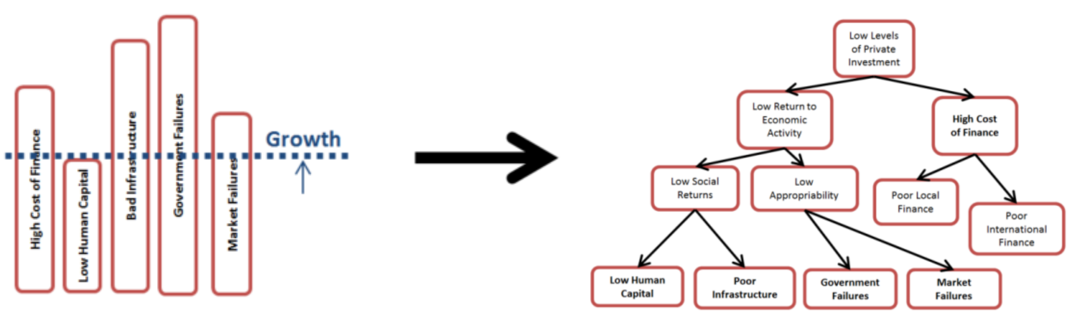
The Challenge: How to Promote Holistic Growth in Bhutan's Private Sector

The manner in which Bhutan's strong political ties to India and the domination of hydroelectricity within the economy have constrained the development of the country's economic diversity demonstrates the importance of a need for the government to pursue the development of a vibrant, dynamic and diverse private sector. Therefore, this paper examines the question of how Bhutan can develop its private sector in a way that is aligned with the principles of GNH.

Analyzing Bhutan's Constraints to Economic Growth

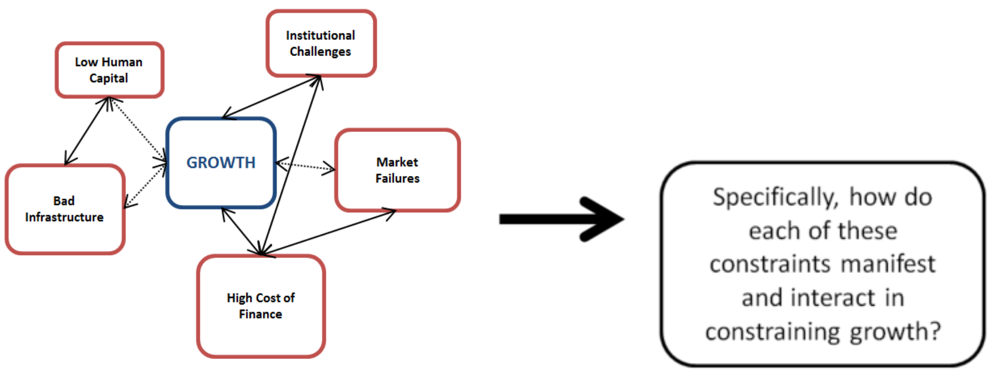
Beginning in the mid-2000s, economists Ricardo Hausmann, Dani Rodrik, and Andrés Velasco advocated for the use of what they call the "growth diagnostics approach" in identifying barriers to economic growth for a country.[31] With the goal of identifying a "binding constraint," that is a country's most significant barrier to growth at a specific time, the diagnostic involves the use of a decision tree to first identify whether low returns to economic activity or high finance costs are more strongly constraining growth. Once this is ascertained, the diagnostician moves down the decision tree to more specific growth constraints such as poor infrastructure, poor property rights legislation and low rates of domestic savings. The resulting priority or "binding constraint" should demonstrate four characteristics: coordinated movements with overall growth or investment, high prices for access to the binding constraint, evidence of actors attempting to bypass the binding constraint, and the presence of more economic activity in areas that are less constrained.

Figure 4: The "Binding Constraint" Growth Diagnostics Model



The growth diagnostic approach is extremely powerful in identifying a priority area for a country's economists to focus upon. However, it limits the space for the development of innovative solutions that can address multiple areas of concern. More importantly, it also shifts attention away from the ways in which constraints to growth can interact. With the intention of evaluating innovative and cross-cutting solutions to Bhutan's need to facilitate private sector growth, this analysis will utilize all major categories of the growth diagnostic approach, rather than using a decision tree. However, it will be similar in its use of the categories identified in the binding constraints growth diagnostics approach (in order to be exhaustive) and in its effort to specify the exact nature of each constraint. For example, if human capital is identified to be a constraint to growth, the analysis will specify what types of human capital shortcomings are relevant to Bhutan. This "interacting constraints" methodology both examines socio-culturally specific conditions and holistically analyzes how those conditions relate to each other.

Figure 5: The "Interacting Constraints" Growth Diagnostics Model



In addition to using quantitative data from the World Bank, the Economist Intelligence Unit, and multiple ministries within the Bhutanese Government, this analysis utilizes a bottom-up approach by targeting local perspectives and knowledge to inform its analysis of constraints to economic growth.[i] This qualitative data is sourced from interviews with Bhutanese stakeholders conducted in January 2016. These businesses, agencies, and associations include, but are not limited to: Tshejor's Ayzey, Bhutan Media and Communications Institute, Mountain Hazelnuts, Druk Wang Alloys, Pelden Enterprises, Nob Bhutan Farmers, Druk Ferro Alloys, the Thimphu TechPark, the Association of Bhutanese Tour Operators, the Association of Bhutanese Industries, the Evaluation Association of Bhutan, the Loden Foundation, Druk Holdings and Investments, the Youth Development Fund, the Bhutan Foundation, the Green Procurement Program, the Ministry of Economic Affairs, and the Institute for Management Studies.

Infrastructure

As a land-locked country with China to its north and India to its south, Bhutan is at a geographical challenge that suggests that its infrastructure must meet especially high standards to make up for its natural disadvantage of inaccessibility to seaports. Unfortunately, it has yet to meet these standards.

The fact that transportation infrastructure is a major barrier to economic growth in Bhutan is highly evident. The country's main industrial hub is located in Phuentsholing, a city located on the border and essentially an extension of its neighboring Indian city of Jaigaon. Nearly all heavy industries, particularly the production of ferroalloys and carbides, take place in Phuentsholing, while the center of all of the country's political and financial activity is based in the capital of Thimphu. Interestingly, many businesses have separate offices in both Phuentsholing and Thimphu. While administratively costly, the use of two separate offices occurs because the transportation of products between the two cities is even more expensive. Travel between the two cities takes nearly six hours and is largely made up of one-lane roads. As a comparison, the

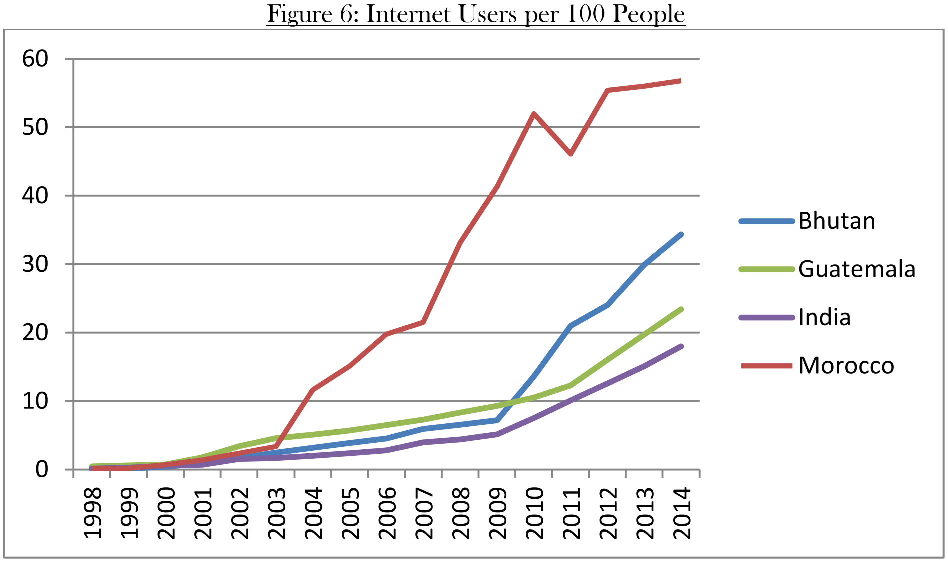
[i] Refer to Appendix 1 for a more detailed review of this report's methodology.

168km distance usually takes about two hours to travel in the United States. Access between Thimphu and the country's international airport in Paro is better; the distance of 55km is covered in approximately an hour and a half. The impact of the poor quality of transportation infrastructure in Bhutan is augmented by burdensome transport regulation. The World Bank's logistics performance index, which includes the evaluation of the efficiency of customs clearance process, quality of infrastructure, ease of arranging shipments, quality of logistics services, and ability to track consignments and shipping reliability, places Bhutan well below its competitors with a score of 2.52 out of 5. In comparison, Guatemala scores 2.8, Morocco 3.03, and India 3.08.[32] Fortunately, the improvement of its transportation infrastructure is one of Bhutan's main priorities, and it is actively conducting construction projects between Phuentsholing and Thimphu, as well as between Thimphu and the country's previous capital of Punakha.

Bhutan's historical infrastructure deficiencies and strong efforts to improve them can be seen in electricity and internet connectivity rates as well. Despite enormous investments in hydroelectric projects, Bhutan has yet to accomplish its goal of universal electricity access. Based on the World Bank's 2012 figures, its electricity access sat at 75.56%, compared to 78.5% in Guatemala, 78.7% in India, and universal access in Morocco. However, it seems as though electricity access has improved significantly over the last couple of years, with Druk Holding Investments (which owns the Bhutan Power Corporation) reporting that 97% of the country had access to the grid by the end of 2013.[33] This is an enormous feat, especially given the fact that the rate of access was 36% as recently as 2005.[34]

Via the International Development Association, the World Bank collaborated with the Bhutanese Government in 2010 to establish the Thimphu TechPark, the country's first public-private partnership project.[35] The IT Park, particularly the construction of a central startup incubator/telecommunications center, was designed to help the country's overall IT infrastructure as well. The country has been able to leverage this investment into significantly greater internet access and the TechPark has gradually begun to flourish as well. By housing seven companies, it hires about 700 employees.[36] The country has gone from less than 10 internet users per 100 people to nearly 35% within the span of five years.

Figure 6: Internet Users per 100 People



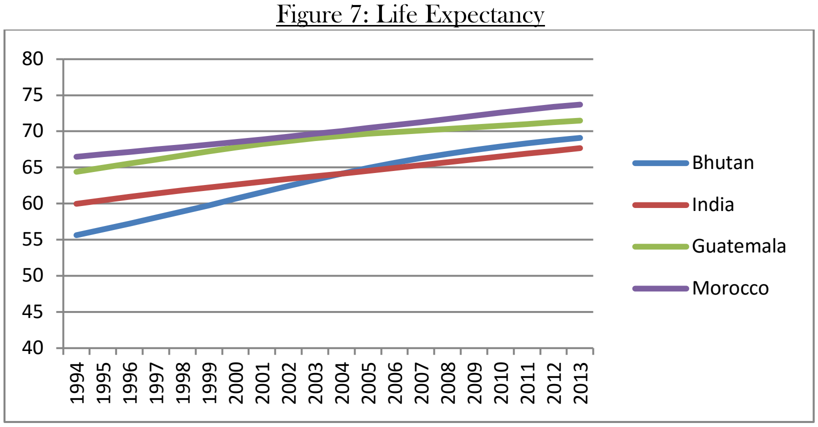
Source: World Bank, World Development Indicators

Altogether, while Bhutan faces significant infrastructure challenges that are exacerbated by difficult geography, it has made significant efforts to improve among this dimension. While poor transportation beyond the two largest cities of Phuentsholing and Thimphu and the western region may continue to constrain economic growth, investments in access to electricity and information technology provide critical avenues through which private sector growth can be facilitated.

Human Capital

Government investments in human capital have been very significant, with 4% of GDP (9% of government spending) between 2010 and 2011 going towards health expenditures and 7.3% of GDP (16.7% of government spending) going towards education.[37] The investment in healthcare has produced very tangible results, with the country surpassing India in expected life expectancy in 2004. Unfortunately, the country's investments in education have not yet had a similar widespread impact. Bhutan's HDI education index sits at .421, which is slightly below the world average.[38]

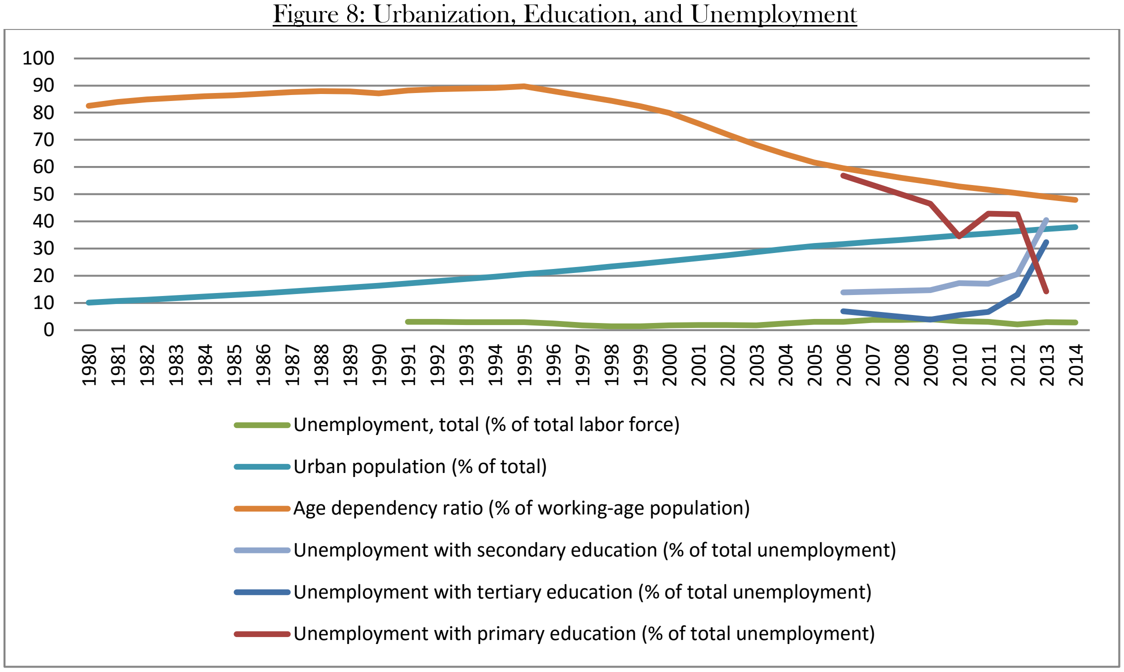
Figure 7: Life Expectancy



Source: World Bank, World Development Indicators

While health and education indicators usually have a generally positive impact on a country's economic trajectory, a closer look at specific education and employment levels produces a more nuanced analysis of Bhutan's human capital situation. Throughout several interviews with businesses in the Thimphu area, there was a running theme of high turnover among low skilled workers compared to stagnant unemployment among high skilled workers. These mixed signals are matched by a growing youth unemployment rate, which stands at 9.5%, that stands in stark contrast to an overall unemployment rate of 2.1%.[39] Figure 8 sheds some light on how these dynamics interact.

Figure 8: Urbanization, Education, and Unemployment



Source: World Bank, World Development Indicators

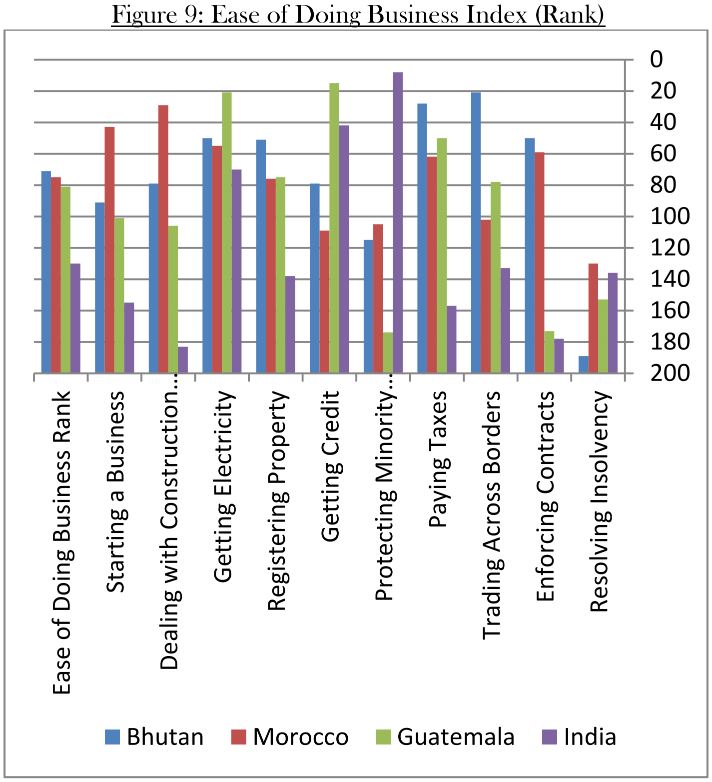
The two concurrent forces of a lowering age dependency ratio and increasing urbanization have contributed to a shift of unemployment among those with a primary education to those with secondary and tertiary levels of education. This matches the observations of one association member who explained, "Rural parents have put everything they have into their children's education. That's wonderful, but as these children graduate, they come to Thimphu expecting a desk job with the government [and are unable to obtain one due to high competition]."[40] Despite a shift in unemployment to those that are more educated, multiple business leaders at larger companies reported that it was difficult to find employees with specific types of skillsets. In such an environment, the previously mentioned Loden Entrepreneurship Program is justified on the argument that the promotion of social entrepreneurship is the most effective way at addressing Bhutan's growing challenge of unemployment among its educated youth in urban areas.[41]

The relationship between human capital and economic growth in Bhutan is complex. On an aggregate level, health and education indicators are low, but consistently improving. However, as the population becomes younger, more urban, and more educated, the expected career trajectory of entering a stable, white-collar civil service job has failed to play out. Well-educated youth no longer deem blue-collar jobs to be worthy and lack the technical skills needed at many private firms. It can be said that while education levels are increasing, there is a shortage in the technical skills needed for entrepreneurship. In addition to this supply shortfall, there is also a shortage in demand for human capital; other conditions are limiting the number of businesses that require and can develop specialized skills amongst their employees.

Government and Institutions

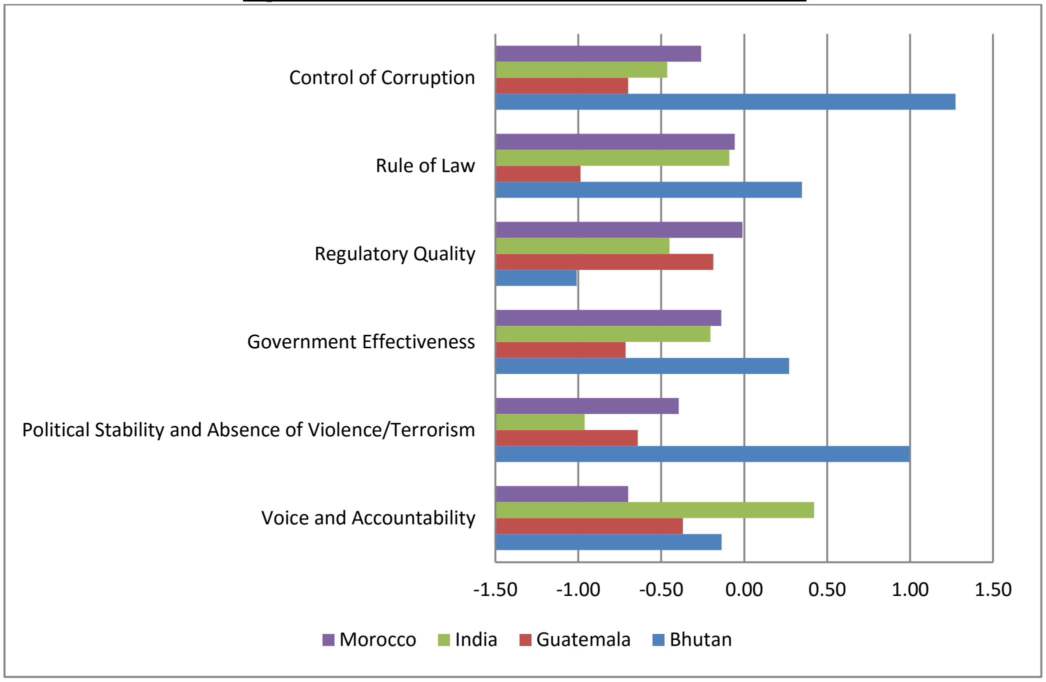
The institutional development of a country is often tracked by two standards: the Worldwide Governance Indicators and the Ease of Doing Business index. On the aggregate level, Bhutan performs exceptionally well compared to its peers on the issue of institutional quality. However, a closer look at specific components within each of these indices provides insight into specific private sector growth constraints caused by institutional shortcomings.

Figure 9: Ease of Doing Business Index (Rank)



Source: World Bank, Doing Business

Figure 10: Worldwide Governance Indicators (Score)

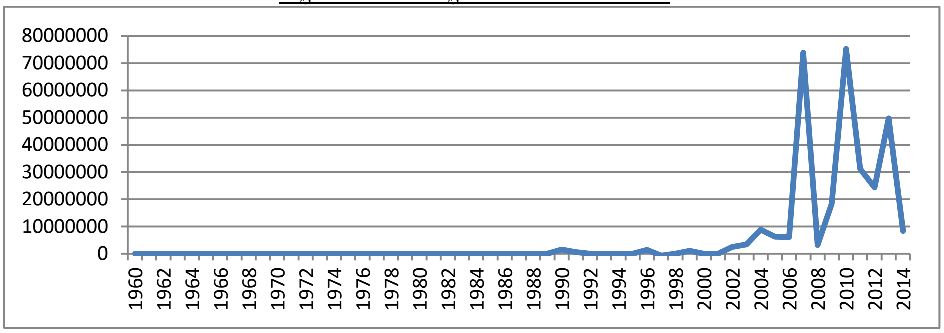


Source: World Bank, Worldwide Governance Indicators

Within the Ease of Doing Business index, Bhutan lags behind its peers in resolving insolvency. In the World Governance indicators, it is shown to rank very low in regulatory quality. "Regulatory quality" refers to "the ability of the government to formulate and implement sound policies and regulators that permit and promote private sector development" while resolving insolvency refers to a very specific component of this area. These specific shortcomings demonstrate that while Bhutan's ability to deliver public sector services is strong, its institutional support of private sector development is very weak. Anecdotally, the impact of regulations that support public service delivery but constraint private sector growth is visible in the difference between Jaigaon and Phuentsholing. While the strength of Bhutan's overall rule of law is demonstrated by a more orderly environment and better infrastructure in Phuentsholing, many Bhutanese consumers cross into Jaigaon for cheaper prices.

Throughout interviews with business owners and associations, there were two themes that were continuously mentioned: influential businessmen in Bhutan are often at the forefront of corporate policy and their work involves enormous amounts of political involvement and partnership in the development of legislation, and that this piecemeal process has set into place in a complex web of incentives and disincentives. These personal insights are reinforced by figures 9 and 10, and suggest that Bhutan faces a catch-22 situation where corporate law is underdeveloped due of limited exposure, but interaction with the private sector is rare because it is underdeveloped and has a business culture of avoiding risk. For example, Bhutan's low score regarding resolving insolvency is largely based on the fact that not a single foreclosure, liquidation, or reorganization procedure had occurred within the past year (as of June 2015).[42]

Figure 11: Foreign Direct Investment



Source: World Bank, World Development Indicators

The underdeveloped nature of legislation and the complex web of incentives created by them are especially reflected in the history of Bhutan's Foreign Direct Investment (FDI) policy. In part due to its history of monarchy-based governance, Bhutan's approach towards the development of policy has generally resembled a gradual departure from centralized power. The country's first foreign investor, Citi Bank, was limited to a 19.9% share of the Bhutan National Bank and left by 2001.[43] With the intention of making sure that local investors are able to maintain their positions as majority stakeholders, the country adopted a general policy of a maximum foreign investment limit of 49%.[44] However, Bhutan's growing visibility as a tourist destination and its hydroelectric projects with India led to industry-specific exceptions. Once held to a 30% local equity minimum, investments in hotels are now divided into two categories based on their five-star or four-star status, with complete foreign equity possible for five-star hotels and up to 74% for four-star hotels.[45] The most recent FDI legislation from 2012 (amended in 2014) includes a list of 15 approved industries along with 7 "negative" and 9 "prohibited" industries.[46] As of January 2016, out of 44 companies with FDI, only four are entirely foreign-owned, 13 are joint ventures with investors from India, and 18 are hotel projects.[47]

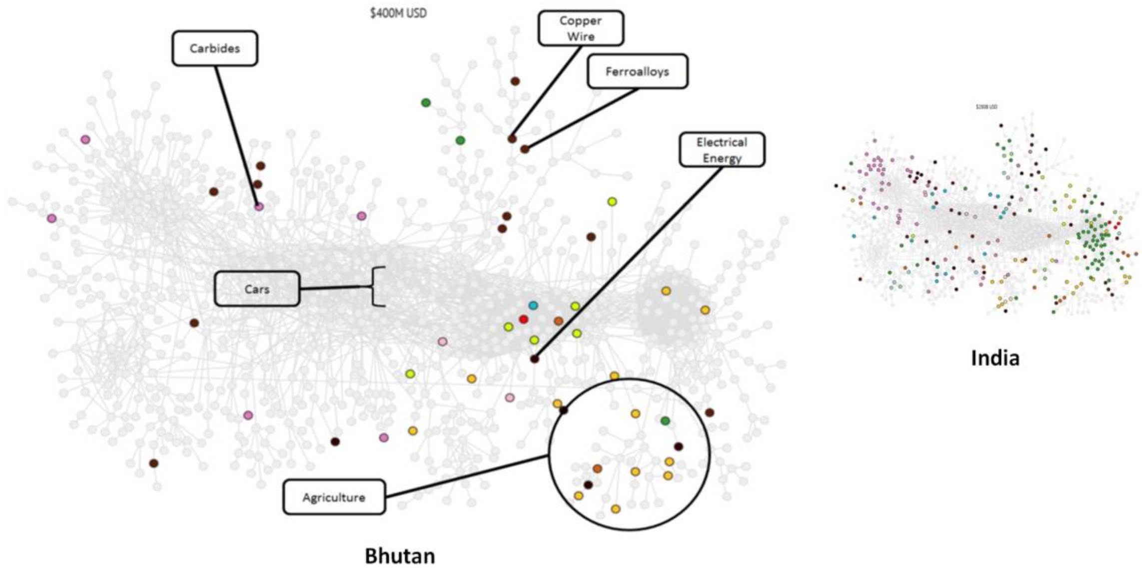
The fluid nature of corporate legislation creates complex scenarios for aspiring business leaders. The United Nations Conference on Trade and Development reported in 2013 that foreign managers and investors appreciate the government's "open, flexible and forthcoming approach" and a "readiness to entertain innovative ideas that are in line with the country's development philosophy" but that "some processes are still perceived as overly complex, time consuming, or unclear."[48] Amongst the interviews conducted for this report, multiple business leaders continued to reflect this sentiment. While grateful that government administrators were willing to accommodate to their business needs in FDI, tax incentives, property transactions, and product regulation, the process of engaging political stakeholders was time consuming, added unnecessary risk in the eyes of investors, and made their business models overly dependent upon specific individuals in strategic positions within government ministries and the royal family.

Overall, while the Bhutanese government has demonstrated strong initiative in working towards developing their institutional support for private sector development, the political and time-costly nature of this process has had significant consequences on the country's early investors. The Bhutanese government faces the challenge of finding out how to continue to quickly learn from new private sector activity in a manner that is more stable and coherent.

Market Failures

In analyzing the market failures that contribute to private sector underdevelopment in Bhutan, Ricardo Hausmann's concept of economic complexity is extremely useful. He argues that know-how, or the development of complex technical ability, is the primary driver of economic development (particularly when coordinated in groups). Therefore, he proposes the analysis of growth through the lens of how certain products with similar types of know-how are more easily achieved than those that are very different. The result is an *Atlas of Economic Complexity* and its *product space*, which demonstrates the kinds of new industries a particular country may pursue.

Figure 12: Export Product Spaces (2012)

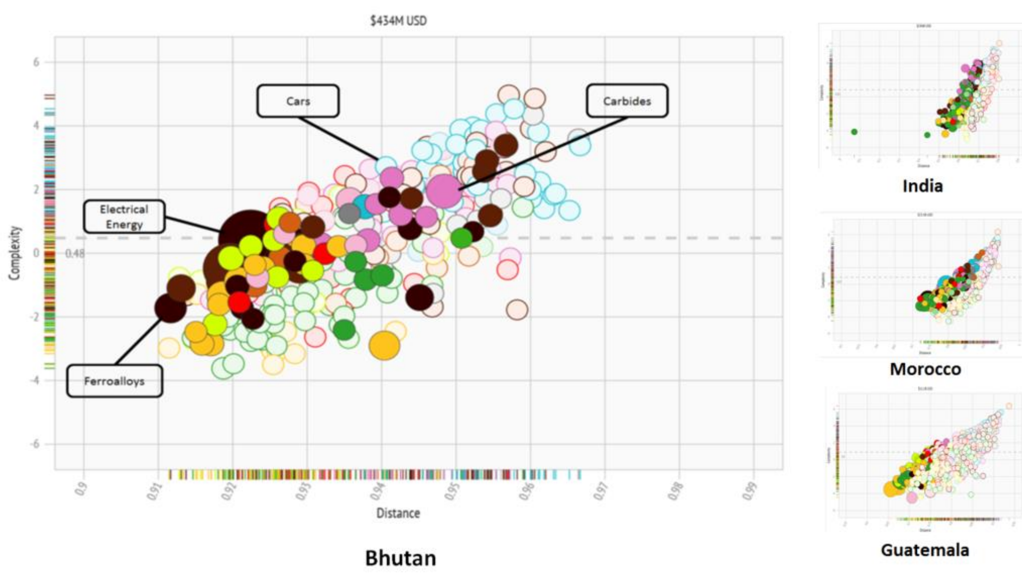


Source: Atlas of Economic Complexity

While the lack of accurate and consistent data is a consideration, there are two features regarding Bhutan's product space: 1) there is no clustering of similar products within a product space region and 2) its product space has not changed very substantially over time. Generally, developing countries develop clusters towards the right side (agriculture and textiles) and then gradually move towards the center and left side of the product space as they develop more complex products.

Another key tool is the *product feasibility chart*. By placing *distance* (or product similarity) on the x-axis and complexity on the y-axis, a diagnostician can identify products that can produce greater economic returns (greater complexity) for less risk (smaller distance). Again, Bhutan's product feasibility chart is unique in that its major exports do not align along a single vertical boundary but are randomly spread apart.

Figure 13: Product Feasibility Charts (2012)



Source: Atlas of Economic Complexity

One way of understanding the implications of complexity in a country's economy is to focus on a single target product. For example, BCCI's most recent annual report includes a recommendation for developing an automobile manufacturing sector, pointing to the potential competitive advantage of being the first such facility in the northeast India/Bhutan region.[49] The product space location of cars demonstrates that this would also create large positive externalities via the development of technical skills that can be used for a large variety of highly-valued products. The product feasibility chart suggests that it *might* also be reasonably feasible, as carbides, also a relatively distant product, is already produced.

Bhutan's product space and product feasibility chart positioning is very unique and difficult to evaluate for specific forms of market failure. Market failures can be categorized into two categories: information externalities and coordination failures. Information externalities refers to various factors that inhibit investors' abilities to identify and pursue opportunities while coordination failures occur when multiple firms need to collaborate their activities and are unable to do so. In Bhutan's case, while there is strong evidence of market failure in general, it is difficult to determine whether it is more prominently a result of information externalities or coordination failures.

Despite the unclear quantitative data, it was quite evident from interviews with businesses and business associations that the country's private sector is overly dependent on the government to coordinate activity and seek out new opportunities. Nearly all of the industries in Phuentsholing, including food and beverage processing, carbides, and ferroalloys, depend on their ability to gain access to government-funded industrial zones. Within the tourism industry, the government-led Tourism Council of Bhutan facilitates collaboration between hotels, transportation services, tour guides, and marketing. At the Thimphu TechPark, resident companies are connected with potential employees through the Ministry of Labor, rather than an open database of all tech-related job seekers.[50] Even small business owners turn to the government for support in identifying new partnerships or for guidance regarding supply chain sourcing. While reliance on the government does produce very positive results when the service is well-provided (and government intervention is definitely required at certain levels), the assumption that the government bears the responsibility for *all* coordination initiatives significantly constrains private sector flexibility and adaptability.

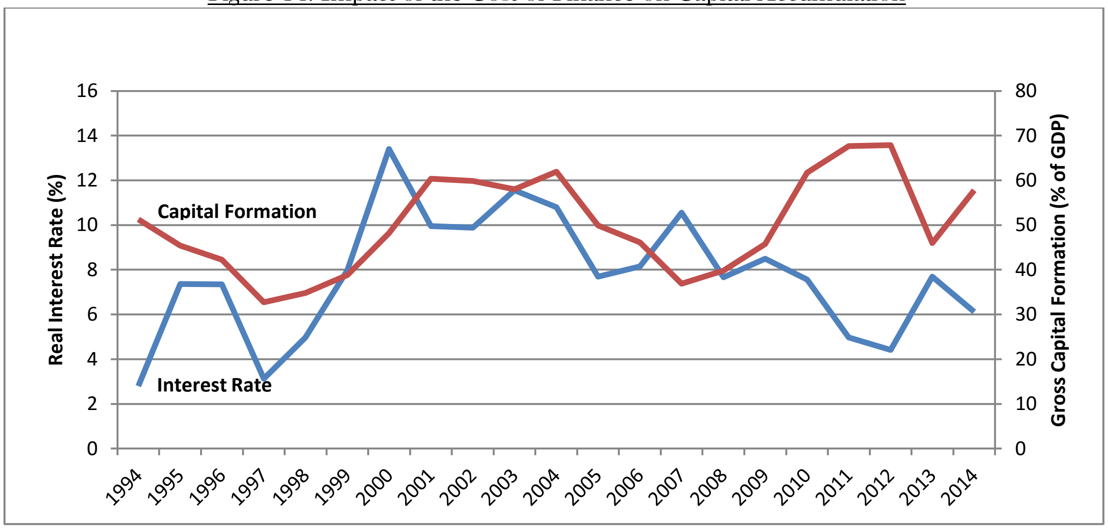
Overall, it is very apparent that there are significant market failures extending from overdependence on the government for support in research and in the coordination of activities. Business leaders seeking new business opportunities by conducting research or through supply chain and marketing coordination face large barriers to carrying them out independently and expect the public sector to actively partake in these efforts rather than simply removing constraints to greater agency.

Finance

Access to reasonably priced finance is often cited as one of the primary barriers to private sector growth in Bhutan. Anecdotal signs that firms are seeking ways to circumvent this constraint are prominent throughout all levels of investment. Large initiatives almost always rely on foreign capital and those that do not are often funded by a portfolio of family-based business operations through which a gradually expanding pool of personal reserves is used for initial investments. Small-scale enterprises heavily compete for and greatly benefit from the few low-interest loans provided by nonprofit venture capital organizations. For example, one of the most influential organizations in Bhutan is the Loden Foundation. Acting in accordance with findings from the Ministry of Economic Affairs that identify access to credit as the primary barrier to starting a business,[51] one of its primary initiatives is the Loden Entrepreneurship Program, which grants zero-interest loans to aspiring entrepreneurs. While the technical training components of these programs are also significant, the impact that these loans have had is clearly visible and undeniable. All three of the well-established small businesses that were interviewed had received the support of such a loan by either the Loden Foundation or the Bhutan Foundation (another influential nonprofit organization). Even business conglomerates and foreign entrepreneurs reported that the process of finding appropriately priced credit is one of the largest barriers to scaling-up and to faster current growth.

These qualitative observations are strongly backed by macroeconomic data. One of the most direct ways of observing the impact of finance on private sector growth is to track the relationship between interest rates with capital accumulation. Generally, if the cost of finance is the most influential factor on how business owners decide to make capital investments (rather than the future expected state of the market as a whole or the presence of other growth constraints), an increase in interest rates will lead to a tightly associated, inverse correlation with capital accumulation. As shown in figure 14, this has been the case in Bhutan since 2005.

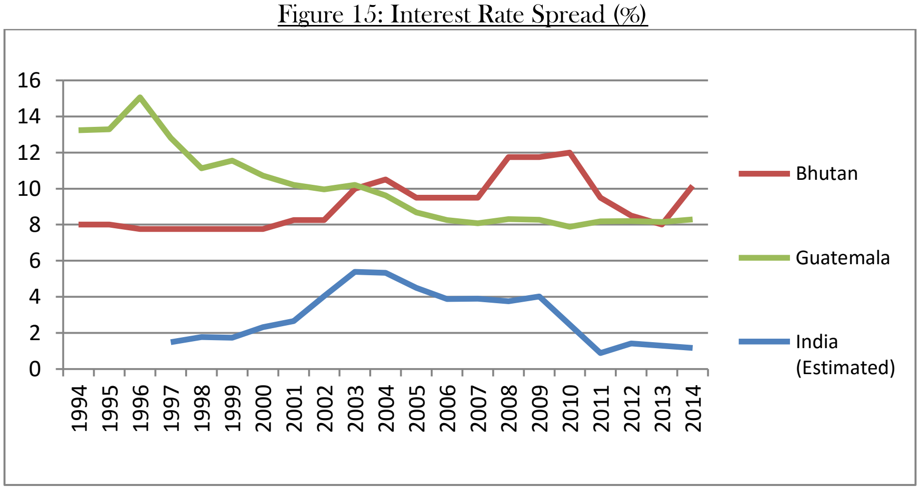
Figure 14: Impact of the Cost of Finance on Capital Accumulation



Source: World Bank, World Development Indicators

One method of exploring the underlying factors behind how high interest rates are correlated with poor private sector growth is to distinguish between finance from domestic sources compared to that of international sources. As shown in figure 15, Bhutan's interest rate spread (the difference between lending and deposit rates) has generally been very high, which suggests that local financial services are operating inefficiently. This has occurred despite several finance sector reforms in the late 1990s and late 2000s, during which standardized lending and deposit rates were liberalized and four more banks were established to compete with the government-financed Bank of Bhutan.[52] While nonperforming loans did fall from 10.2% to 8.5% between 2010 and 2011, the liberalization of interest rates failed to facilitate more activity in incorporating credit or liquidity risk assessments in loan pricing.[53] Since these reforms have taken place, Bhutan's interest rate spread has shown mixed results, with a brief return to 2000 levels in 2013, but a subsequent return to previous rates in 2014.

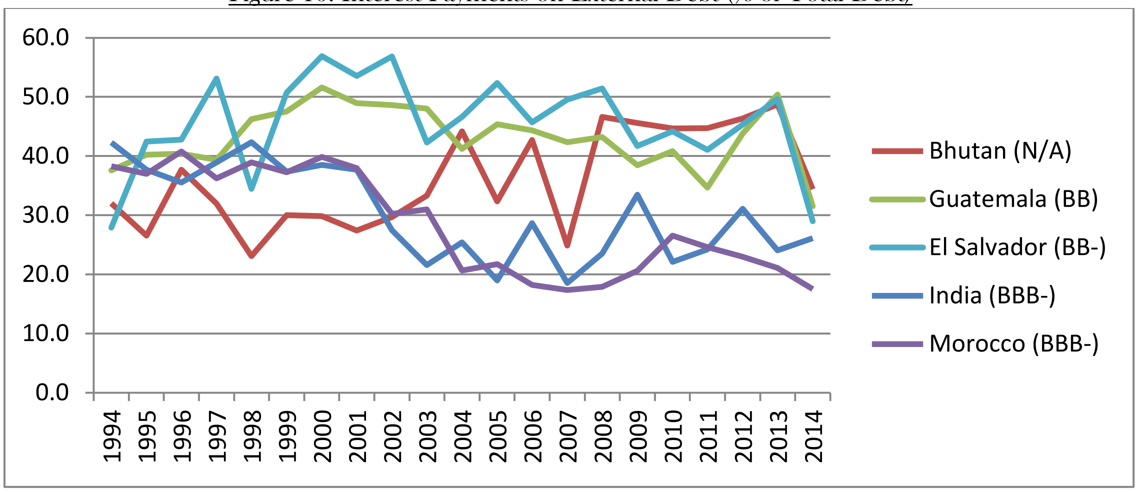
Figure 15: Interest Rate Spread (%)



Source: World Bank, World Development Indicators

A country's access to international finance is normally easily evaluated by referencing the country's credit score, but Bhutan is unfortunately not rated by any of the three most popular rating agencies. In the absence of an official rating, one way to approximate Bhutan's credit score is by comparing its interest payments on external debt to other countries. As shown, Bhutan makes very similar payments to those paid by Guatemala and El Salvador, therefore making it arguable that Bhutan would most likely receive a BB- rating from Standard & Poor's. A BB- rated bond is considered speculative grade, but is very close to the BBB- cut-off for an investment grade rating. Therefore, Bhutan's access to external finance can be said to be slightly below average.

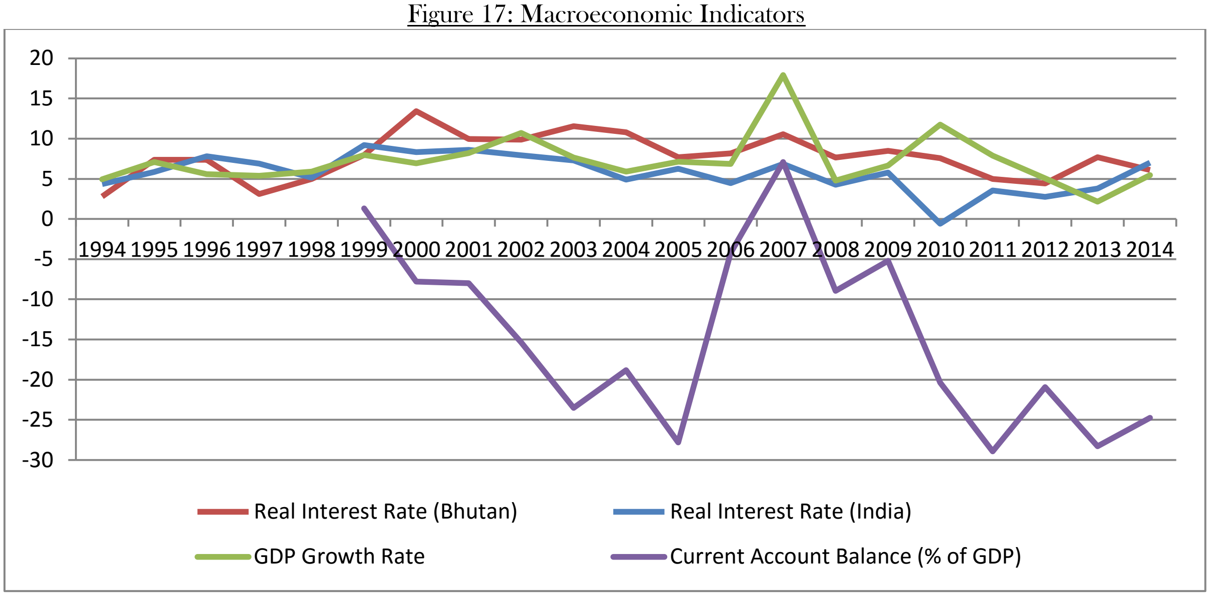
Figure 16: Interest Payments on External Debt (% of Total Debt)



Sources: Data from the Economist Intelligence Unit; Ratings from Standard & Poor's Rating Services (2011)

In addition to specifying how Bhutan fares in terms of domestic and international finance, another way to understand how poor access to finance has constrained private sector growth is through a broader analysis of macroeconomic factors that influence interest rates. It becomes evident that the depth of Bhutan's negative current account balance (primarily the result of an enormous trade deficit to India in particular) has been closely tied to the country's overall economic growth since 2006.

Figure 17: Macroeconomic Indicators

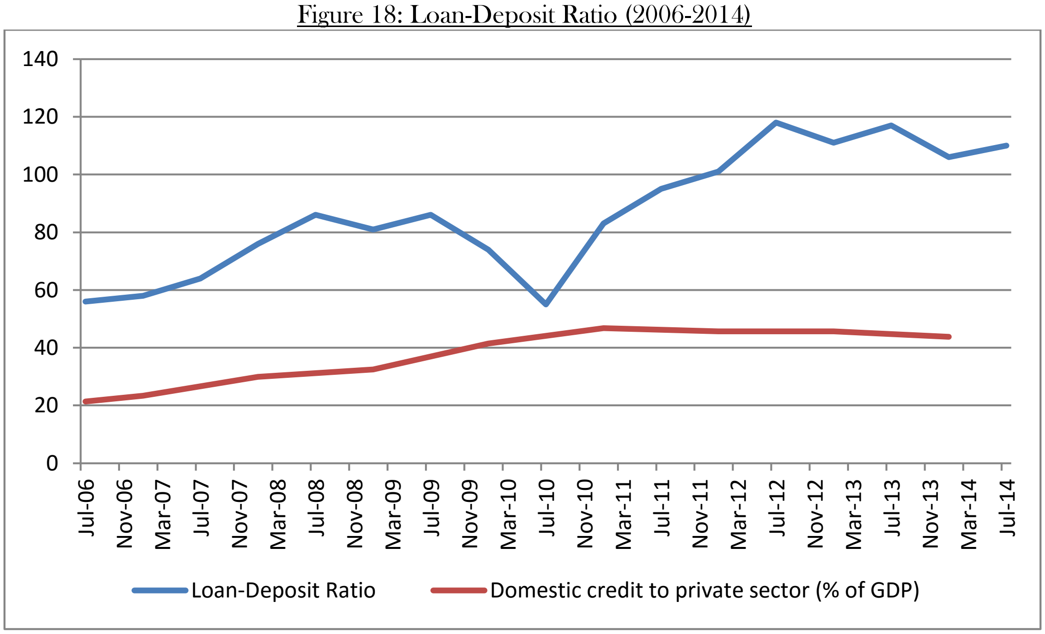


Source: World Bank, World Development Indicators

Reports from the Asian Development Bank (which has been especially influential in helping to analyze and shape Bhutan's finance sector) provide important historical context to the impact of Bhutan's negative current account balance. In particular, the Indian rupee shortage in March 2012, which effectively halted all Bhutanese-Indian economic activity for a week,[54] marked an especially visible example of how monetary policy shortfalls matched with a large current account deficit can directly produce enormously negative consequences for the private sector.

One additional influential phenomenon within the Bhutanese financial sector is the fact that the country's loan-deposit ratio has increased over time and is currently at a level above 100%. This may appear to contradict earlier statements regarding the high interest rate spread and inverse correlation between interest rate and capital accumulation. A high loan-deposit ratio often implies that there is healthy competition between banks and that the private sector is adequately acquiring financial capital for investments. Additionally, while domestic credit to the private sector has increased over two-fold since 2006, it has plateaued around 40% since 2010.

Figure 18: Loan-Deposit Ratio (2006-2014)



Sources: Loan-Deposit Ratio from the Royal Monetary Authority (Jan 2015 Monthly Statistical Bulletin); Domestic Credit data from the Economic Intelligence Unit

At first, these indicators may appear to be contradictory; access to finance appears to be limiting growth, but domestic borrowing has actually been very high. However, when the Bhutanese government's enormous investments in hydroelectricity are taken into account, the picture becomes quite clear. While the liberalization of banks did allow for more credit to be accessed, this came at a time during which liquidity concerns were exponentially increasing due to government debt payments for its hydroelectric projects and a continuing trade deficit.[55] This means that liquidity (rather than solvency) is Bhutan's primary barrier to a healthier financial sector.

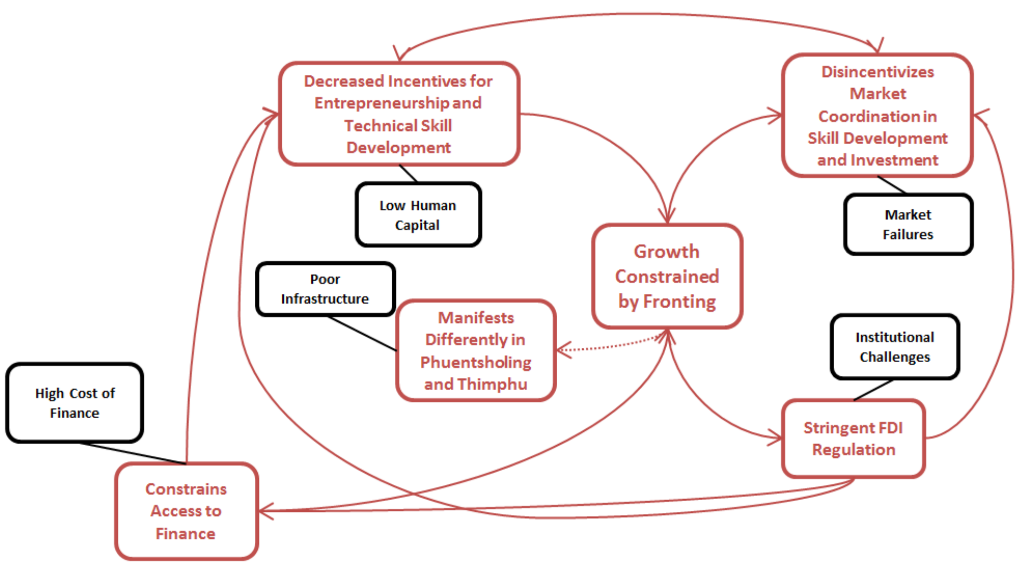
Overall, there are signs that Bhutan must continue to encourage competition in order to facilitate greater efficiency among its banking institutions. However, the country's ability to provide reasonably priced financial capital to its young private sector is ultimately dependent on its ability to transition from debt payments to revenue on its hydroelectric projects and to address its trade deficit by increasing the competitiveness of its local businesses relative to those of India.

Applying the Interacting Constraints Model

The value of utilizing an interacting constraints model rather than the binding constraint-based growth diagnostics model is particularly evident in the unique issue of Bhutan's extremely large concerns of *fronting*. Fronting refers to the illegal practice in which a foreign businessman (predominantly from India) pays a Bhutanese national to open a business license on their behalf. The foreign businessman then runs the entire business independently and pays the license holder a portion of their profits.

The problem of fronting cuts across multiple categories, but interacts with them in the specific ways outlined in the previous analysis. For example, the incentive for Bhutanese nationals to participate in fronting is very evident: due to difficult access to finance, it is much easier to similar reap the rewards of foreign investment. The lack of technical skills, the preference for more stable government jobs and the growing unemployment rate among the highly educated also suggest that Indian businessmen are filling a human capital gap in Bhutan's private sector. The concentration of different types of fronting cases is also demonstrative of infrastructure constraints, with industrial and trade operations primarily taking place near the border in Phuentsholing and IT and software development operations in Thimphu.[56] These foreign investors are looking to profit from cheaper electricity prices and balance the impact that transportation costs will have on their businesses in a tradeoff with access to Thimphu's position as the country's financial and governmental core. Many of those involved in fronting take on short-term projects for which they can gain immediate returns, thereby contributing to a lack of interest in partnering across industries and promoting the development of the economy as a whole (a coordination failure).[57] These concerns then make Bhutan legislators very cautious of foreign investment in general, contributing to the complex and piecemeal nature of the country's FDI policy.

Figure 19: Fronting According to the Interacting Constraints Model



Overall, the interacting constraints model allows for solutions that cut across analytical categories and address multifaceted issues such as fronting in a more holistic fashion. By utilizing this model, this analysis seeks solutions that address Bhutan's entire private sector ecosystem, rather than a singular component. We have found that:

1) **Infrastructure:** Bhutan's geography as a land-locked nation implies higher standards for infrastructure development. Although its infrastructure is currently very poor, there are many signs that the country is in the process of dramatically improving, especially in transportation, information technology, and access to electricity.
2) **Human Capital:** While performing well in the realm of healthcare, the impact of rising education levels in Bhutan is significantly more complex. While Bhutan is still struggling to raise its aggregate education indicators, highly educated youth are quickly moving into urban areas, where the

economy has been slow to adapt. The result is relatively consistent overall unemployment, but an enormous boom in unemployment among those with a secondary or tertiary degree.

3) **Government and Institutions:** While Bhutan's ability to deliver public services via its institutions is strong, its institutional support of the private sector is very weak. While ranking very high in low levels of corruption and in political stability, its corporate regulation quality is extremely poor. This is especially evident in its complex and fluid FDI policy.
4) **Market Failures:** Private sector leaders are very dependent on the government for support in research and in the coordination of activities. Those that attempt to conduct research or seek to improve supply chain and marketing coordination either expect the public sector to perform these activities for them or face large barriers to carrying them out independently.
5) **Finance:** There are signs that Bhutan must continue to encourage competition in order to facilitate greater efficiency among its banking institutions. However, the country's ability to provide reasonably priced financial capital to its young private sector is ultimately dependent on its ability to transition from debt payments to revenue on its hydroelectric projects and to address its trade deficit by increasing the competitiveness[ii] of its local businesses relative to those of India.

- **Bhutan's ability to sustain its rate of economic growth is dependent upon its ability to develop its private sector.**
- **An analysis that identifies the manner in which specific economic growth constraints interact with each other is required for systemic solutions that are appropriate for Bhutan's unique sociopolitical context.**
- **The causes and implications of *fronting* are heuristically powerful examples of how multiple economic growth constraints interact with each other within the Bhutanese context.**

Policy Recommendation Evaluation Criteria

In determining the most suitable course of action for developing Bhutan's private sector, the previously analyzed five constraints to growth must be addressed in a comprehensive manner. However, the ability to completely address all of these growth constraints is not the only criterion that must be fulfilled. The most suitable policy recommendation must also match Bhutan's GNH framework, address the demands of the young democracy, and have limited financial and institutional barriers to implementation. These four criteria similarly match commonly used categories of impact, political feasibility, political implications, and cost/administrative feasibility.

Holistically Address Growth Constraints

As mentioned, the first criterion for policy recommendation is the ability to address all interacting growth constraints. To review, a policy recommendation must:

1) Either contribute to infrastructure development or be independent of geographical constraints
2) Target the employment or self-employment of highly educated, yet technically inexperienced youth
3) Either decrease or have no impact on the level of regulatory complexity and instability

[ii] It is important to note that *competitiveness* does not necessarily refer to the ability for Bhutanese businesses to outperform Indian businesses that produce the same goods and services nor to *strategic advantage*, which in the Bhutanese context usually refers to leveraging access to cheap electricity. For example, given much of the Indian private sector's ability to successfully engage in large-scale production, there is an opportunity for the Bhutanese economy to focus on niche goods with high levels of specialization that are more dependent on an engaging producer-consumer relationship. An appropriate model for such an economy is the success of Germany's *Mittelstand* small and medium-sized firms.

4) Facilitate research, capital reinvestment, and the coordination of private sector activities
5) Continue to encourage competition among banking institutions and improve Bhutan's trade balance

Alignment with Gross National Happiness

As discussed at the opening of this report, the values of Gross National Happiness are extremely well integrated throughout life in Bhutan, but are especially evident among political realms. Every government ministry explicitly describes how their services contribute to GNH on most of their published materials, including websites, banners, and informational pamphlets. Supporting GNH is analogous to the expression of support for the royal family, and portraits and murals of the Fourth and Fifth Kings are commonly paired with references to GNH. The universal importance of GNH in Bhutan means that a detailed stakeholder analysis is not particularly insightful; all political players are held to the same standard of arguing that their interests are aligned with GNH. As a result, the political feasibility of a political initiative is tied to the ability to frame it within GNH. However, the process of framing GNH within the context of economic growth is not as straightforward.

When confronted with how to begin implementing his visionary concept of Gross National Happiness, the two most influential economic initiatives of King Jigme Singye Wangchuk provided a powerful blueprint for future practices. First, he rapidly signed the Chukha Hydropower Project less than two years after the passing of his father and even before his official coronation.[58] Upon completion of the project, exports of hydroelectricity to India immediately became the kingdom's primary source of revenue. Continued investment in hydroelectricity demonstrates how important this initiative is to continuing Bhutan's commitment to environmental preservation. The country's continuing investment in over fifteen major hydroelectricity initiatives demonstrates that its perceived relationship with GNH is straightforward: generally, investments in hydroelectricity improve Gross National Happiness.

The Fourth King's approach to tourism was more nuanced and demonstrates how to approach industries that do not inherently align with GNH. Five months after his signing of the Chukha Hydropower Project, the first group of tourists was permitted to enter Bhutan.[59] Rather than directly contributing to GNH, tourism was an opportunity to reap the financial rewards of a society built upon GNH, particularly from ecological, environmental, and cultural preservation. However, he was also aware that completely unrestricted tourism could negatively impact upon these values and hurt Bhutan's long-term sustainability. He therefore instituted a policy of "High Value, Low Impact" tourism, which manifests itself today through a mandatory "daily tariff" of at least $200 per day for a set of services such as accommodation, food, and a tour guide.[60]

The Fourth King's foresight, as well as the success that these two policies have had on the country's commitment to GNH, provide a framework for how to address private sector growth as a whole. Depending on a company's business model, its growth can either contribute to or inhibit GNH. A growing tourism industry (usually termed "high volume" in business circles) is not inherently incompatible with GNH. Large companies (especially in nascent industries) can provide leadership in research, technical skills development, product quality, and supply-chain standards in a way that encourages other business to compete in their ability to contribute to GNH. However, the "High Value" (usually inversely termed "low margin") component of the tourism industry's policy is absolutely critical. A low margin, high volume business strategy encourages lower wages and increased natural resource consumption. Although such a business may perform CSR activities to improve its relationships or increase efficiency in its use of resources and is not necessarily an inherently "bad" business, it will remain in a state where its financial survival and its contributions to GNH are in contention, especially if the good or service being produced does not contribute to GNH in itself. In order to align their business practices to GNH principles in the long term, such companies should be encouraged to add value to their products, rather than continuing to expand their scope as their primary strategy in remaining profitable.

Potential policy recommendations will be evaluated for their ability to promote Gross National Happiness. In particular, this can be done in a consistent, broadly-applicable manner by encouraging businesses to pursue and continuously invest in developing products and services with greater value as a means to increased profitability, rather than depending on increasing volume or cutting wages.

Impact on the Bhutanese Government's Image - Political Implications

While political feasibility in Bhutan is nearly entirely determined by the ability to frame an initiative within the context of GNH, the political implications of a particular initiative are also an important component of evaluation. In particular, many of the young and educated in Thimphu express a growing sense of disenchantment and cynicism regarding specific methods through which GNH can be facilitated. Gross National Happiness as a concept was developed at the beginning of the Fourth King's reign, but nation-wide surveys of GNH have only occurred since 2010. While its values have been well integrated into Bhutanese society as a whole, the country's two boldest GNH-related initiatives (investment in hydroelectricity and its tourism policy) began more than forty years ago and it's more recent push towards democracy has not met the expectations of the politically active youth, many of whom have studied abroad in Australia and the United States. Recent policy initiatives have seemed to be more of a process of "catching up" to western or Indian standards, laws, and regulations, rather than original Bhutanese initiatives.

A policy recommendation that has positive political implications will increase the application of GNH as a tool for shaping Bhutanese society. The country's upcoming generation of leaders seeks the development of GNH beyond a nebulous concept and branding mechanism to a level of legitimacy both domestically and on a global scale. An initiative that demonstrates GNH in practice will help mobilize the citizens of Bhutan's young democratic system and improve the image of its government.

Barriers to Implementation

Finally, the overall economic and administrative abilities of the Bhutanese government must be taken into account. While quickly growing, Bhutan faces significant challenges and limitations to the policy changes that it can adopt. The country faces a debt to GDP ratio of approximately 100% and the country's ability to carry out public services does not always meet the high standards that it has set for itself. Some policy initiatives have not been properly executed due to bureaucratic constraints. Under such circumstances, an acceptable policy initiative must be financially feasible and should not depend on unrealistic administrative abilities. If difficult to execute by the government, carefully vetted non-governmental actors must be identified.

- **Solutions to the challenge of developing Bhutan's private sector must address all of the previously identified economic growth constraints.**
- **Additionally, they will be evaluated according to their ability to align with the principles of GNH, improve the image of the Bhutanese government, and be easily implemented.**

Evaluation of Policy Recommendations

This evaluation of policy recommendations begins with an assessment of what can be considered to be an extension of the status quo; continued investment in hydroelectricity. The four subsequent policy recommendations are all ways in which the Bhutanese government can improve upon this status quo. Industry associations and business hubs are already utilized, but this analysis offers specific ways in which each initiative can be improved. The fourth recommendation, Green Public Procurement, is already being implemented, but deserves greater attention given its potential impact. Finally, the fifth recommendation is the creation of a new corporate form for businesses that either integrate GNH-aligned goals directly into their business models or seek to transition into more value-added products/services. Each of these recommendations should be pursued, but with attention to the particular benefits and concerns that are brought to attention in this analysis.

Recommendation 1: A Stabilization Fund for Continued Investment in Hydroelectricity

Since the completion of the Chukha Hydropower Plant in 1986, the Bhutanese government has steadily continued its investment in hydroelectricity by systematically integrating hydroelectricity plans into its five-year plans.[61] In addition to the Chukha plant, the Kurichhu and Tala Hydropower Projects were all constructed by the Indian government, with a 60% grant and 40% loan financing plan.[62] With the Basochhu Hydropower Project (constructed in partnership with the Austrian government),[63] these four plants make up over 99% of the country's entire 1,488 Megawatt hydroelectric capacity.[64] These hydroelectricity projects were consolidated into the Druk Green Power Corporation (under the ownership of Druk Holding & Investments, the holding company for all government-owned corporations) in 2008.[65] As of 2013, Druk Green was worth nearly $1 billion USD and employed over 1,700 employees.[66] While it is commonly cited that only 5% of the country's total hydropower potential has been captured, Druk Green represents 27% of government revenue and 14% of the country's total GDP.[67] It aims to install 10,000 MW of hydroelectric capacity by 2020.[68] As these initiatives have been extremely well-integrated into the everyday administrative duties of the Bhutanese government, an analysis of continued investment in hydroelectricity and its impact on the development of Bhutan's private sector is essentially an exercise of evaluating the implications of maintaining the status quo. As described below, in order to maintain the benefits of this status quo, Bhutan will have to establish a stabilization fund.

Evaluating a Stabilization Fund for Continued Investment in Hydroelectricity

Continuing the status quo of further investment in hydroelectricity projects would be a considerably large failure in the first criterion of holistically addressing the private sector growth constraints that Bhutan experiences. Improving electricity sourcing in itself a form of infrastructure development and the additional infrastructure upgrades necessary for transporting materials will help general private sector development. However, beyond this specific category of growth constraints, continued investment in hydroelectricity either has no impact or further worsens conditions. Besides some potential technical expertise development in early planning stages and in high-level construction skills, infrastructure projects predominantly employ low-skill labor. Hydroelectricity projects also have very little impact on research, product development, and coordination within the private sector and have no impact on the level of regulatory complexity.

Within the criterion of addressing growth constraints, continued investment in hydroelectricity is most damaging in how it further decreases the banking sector's ability to provide efficient services by furthering deepening Bhutan's need for larger rupee reserves, as described in the previous analysis of Bhutan's financial sector and the Indian Rupee Crisis of 2012. Even if this concern is mitigated as Bhutan's hydroelectric plants gain more revenue relative to interest payments, it will decrease the market incentives to address the India-Bhutan trade deficit through investment in other products/services and increase Bhutan's propensity to fall into Dutch Disease-type dynamics. This occurs through the appreciation of the Bhutanese ngultrum and resulting decrease in competitiveness of other goods and services (dangerous levels of inflation are already evident in the amount of Indian labor being imported into Thimphu). When paired with the high volatility of specializing in one specific industry, a shift in global prices can completely destroy Bhutan's economy, as has occurred in Venezuela since the early 2000s. While such a situation can be avoided through the use of stabilization funds (effectively used in Norway and Kazakhstan), a continuation of the status quo of further investment in hydroelectricity would still continue to hinder Bhutan's need to increase its overall competitiveness by continuing to constrain the private sector's access to finance.

As a business model that aligns with the principles of Gross National Happiness, increased investment in hydroelectricity generally increases GNH. However, the enormous scale of these investments can limit its historically positive impact. While hydroelectricity is a renewable source of energy, its impact on private sector development makes its overall impact on sustainable development unclear. The provision of universal electricity access is democratic in nature, but the ownership of government-funded Druk Green Power Corporation can also centralize political power. Finally, hydroelectricity has a relatively low ecological impact compared to other energy sources, but there are some concerns regarding its impact on the wetlands habitat of the endangered white-bellied heron.[69] Overall, these concerns are small technicalities, but they become more prominent as the scale of hydroelectric investments increase.

The exponentially increasing scale of Bhutan's hydroelectric projects will also produce very quickly decreasing returns in terms of its political implications. While the original Chukha Hydropower Project (and the currently largest Tala Hydropower Project) was an opportunity to demonstrate GNH in action and contributed to Bhutanese pride as an unprecedented project that would establish a clear economic competitive advantage, it is difficult to imagine that any future projects would achieve a similar impact.

Finally, while the implementation process of one specific hydroelectric project is relatively straightforward for Bhutan, it faces new challenges as the scale of these projects increases. As mentioned earlier, monetary policy administrators must improve their ability to predict the cash flow streams of these projects to avoid another rupee crisis. Of greater concern is the political expertise and coordination necessary to establish and comply with the conditions of a stabilization fund.

	Holistically Address Growth Constraints	Alignment with Gross National Happiness	Political Implications	Ease of Implementation
Stabilization Fund for Continued Investment in Hydroelectricity (Maintain Status Quo)	◔	◕	◑	◑

The diagram above summarizes the potential benefits and concerns of continuing to invest in hydroelectricity, with very large concerns regarding its ability to holistically address growth constraints and strong alignment with Gross National Happiness. As the status quo, continued investment in hydroelectricity will be used as a reference point for the following analysis of the four remaining recommendations.

Recommendation 2: Market Coordination through Industry Associations

Bhutan has a small, yet vibrant number of trade associations, including the Association of Bhutanese Industries, the Bhutan Exporters Association, the Association of Bhutanese Tour Operators, and the Bhutan ICT & Training Association. These trade associations primarily act as a means of consolidating and communicating the policy concerns of local businesses to the government, sometimes through and in coordination with the BCCI. For example, the Association of Bhutanese Tour Operators has produced reports that recommend that a proportion of Bhutan's minimum tourist tariff be specifically allocated towards ecological and cultural preservation initiatives.[70] Similarly, the Association of Bhutanese Industries has identified specific tax policies that it argues are constraining economic activity within its ferroalloy sector.[71] The role of these associations within policy advocacy is extremely important, especially within the context of the GNH goal of good governance, but they can also be utilized more effectively to coordinate market activity.

In *Varieties of Capitalism*, economists Peter Hall and David Soskice identify two categories of capitalist economies: Liberal Market Economies (such as the United States) and Coordinated Market Economies (such as Germany). Coordinated Market Economies involve negotiated and interdependent interactions between groups of stakeholders, such as unions, banks, and vocational schools. These economies tend to have higher wages, shorter hours, more equal income distribution, and are built upon identifying niche markets of specialized products.[72] Given that these characteristics match the goals of GNH, one way by which Bhutan can grow in the direction of a coordinated market economy would be to encourage the status of trade associations as forums of communication with labor forces, schools, banks, and other industries, in addition to the government. One model of how such an association may look is Bhutan's Tourism Council, which is currently a government entity. The Tourism Council's internal structure of specific divisions dedicated to marketing, product development, services, and quality assurance reflect a coordinated effort that supports the entire industry.[73] Allowing such associations to be independent would improve their effectiveness by eliminating the constraints of government bureaucracy. The potential for greater independent market coordination can also be applied to Bhutan's IT initiatives, especially in its investment in the Thimphu TechPark. Currently, businesses that lease space in the TechPark hire employees through the Ministry of Labor and Human Resources.[74] Instead, the Ministry could support the TechPark with job candidate outreach, but information regarding the talent pool should be directly shared with the TechPark, allowing it to market its talent pool to attract foreign investors. Stronger industry associations (and Coordinated Market Economies in general) also allow CSMEs to explore more individualized and flexible supply chain opportunities locally, rather than depending on Indian suppliers, which are usually only able to provide supplies in bulk.

<u>Evaluating Market Coordination through Industry Associations</u>

Encouraging business associations to serve as platforms for the coordination of market activity addresses the vast majority of constraints to private sector development in Bhutan. Coordinated market activity lowers the barriers to entry for businesses seeking to expand into new markets or pursue new products and services, thereby facilitating more capital reinvestment. Coordinated Market Economies are also more likely to depend on commercial banks (rather than private investors) and organize vocational training in partnership with schools.[75] As many of these activities are currently organized by the Ministry of Labor and Human Resources, an economic system with stronger industry associations will eventually alleviate pressure on the government to implement new programs and policy guidelines. However, given infrastructure challenges, the impact of these increasingly active associations would most likely be limited to the economic hubs of Thimphu and Phuentsholing (where they are currently located).

Generally, stronger trade associations allow for the production of more specialized, value-added products and services, which would align with Gross National Happiness and the "High Value, Low Impact" precedent set by the tourism industry. However, without the proper monitoring mechanisms in place, it is also possible for large companies with low margin business models to overtake smaller enterprises and become de facto monopolies. Therefore, while facilitating trade associations to take on stronger roles will most likely align with GNH, the process must be carefully monitored to avoid manipulation by influential businesses. This will require increased levels of trust between stakeholders as well as institutionalized transparency standards.

While strengthening the role of trade associations may promote the development of more internationally competitive industries, and therefore help improve general satisfaction with the economy as a whole, its connection to GNH is not as visible. Additionally, the incremental nature of such an initiative will produce gradual, discreet changes to the economy. Therefore, it is likely to have a moderate impact on the public's perception of the government.

Improved market coordination through trade association reform requires minimal financial costs and administrative efforts, but also involves significant cultural barriers for the Bhutanese economy. In what is currently a relatively collectivist country, the strengthening of trade associations will contribute to the development of a healthy Coordinated Market Economy depending on the ability for association leadership to self-initiate partnerships with key stakeholders while holding each other accountable to fair competition rather than consolidation and monopolization.

	Holistically Address Growth Constraints	Alignment with Gross National Happiness	Political Implications	Ease of Implementation
Stabilization Fund for Continued Investment in Hydroelectricity	◔	◕	◑	◑
Market Coordination through Industry Associations	◑	◕	◑	◕

Recommendation 3: Institutional Development through Business Clusters

One of the most integral components of the success of the industrial city of Phuentsholing is the industrial town of Pasakha. The majority of industrial production activity in the country, including ferroalloy, carbides, and beverages, depend on factories within Pasakha, which is one of the few areas where facilities can be built or rented. Unfortunately, Pasakha serves little purpose beyond its facilities, as company offices are predominantly located either in Phuentsholing or in Thimphu.

A more recent initiative is the establishment of Special Economic Zones, where participating foreign businesses are invited to create local jobs in exchange for special tax breaks and access to certain infrastructure standards. DHI reports that the concept plan, master plan, business models, and possible tenants were established for three zones (Montanga, Jigmiling, and Dhamdum), with investments already made for basic infrastructure such as walls and roads.[76] However, land ownership challenges have significantly hindered these projects and implementation management has been passed onto the Ministry of Economic Affairs.[77]

There are two significant areas for improvement in these initiatives. First, similar to the role of trade associations in Coordinated Market Economies, industry hubs can serve as opportunities for coordination between important stakeholders. A key component that has been missing from previous cluster initiatives in Bhutan has been the lack of institutionalized coordination between actors, especially in research and development. One well-known example of this is the success of Silicon Valley in the United States. Through a combination of research initiatives led by Stanford University, funding from the US Department of Defense, and innovative entrepreneurs, Silicon Valley is now the global center of activity related to Information Technology.[78] Secondly, rather than establishing special conditions for foreign companies, Bhutan should refer to Costa Rica's intensive efforts in recruiting Intel to establish a microprocessor factory by promising direct communication with government stakeholders and general infrastructure development initiatives, without the provision of exclusive incentives and with minimum requirements regarding the training of technical skills.[79] Due to Costa Rica's emphasis on education and health, as well as its large tourism industry, Bhutan should look to the country's economic development history (especially its recent challenges in transitioning to research and development) as a guide for properly leveraging the potential benefits of industry hubs.

Evaluating Institutional Development through Business Clusters

A business cluster that is planned and structured in partnership with key economic stakeholders is very similar to the strengthening of trade associations in its ability to impact most growth constraints. Industry-specific infrastructure is developed, and if the economic stakeholders are appropriately organized, partnerships between businesses and schools will facilitate research and development. If managed well by policy makers, more experienced foreign companies can help support the development of stable corporate policy that adequately promotes growth and help to develop technical skills. These skills and investments provide an opportunity for the country to become more competitive and address its negative trade balance. However, much of the infrastructural impact of a business cluster will likely remain localized to the specific geographic area where the cluster is based.

Similarly to the impact of strengthened trade associations, the proper establishment of business clusters encourages specialized, value-added products that would otherwise be difficult for individual firms to pursue. However, while one specific industry will be substantially promoted, a growth strategy that relies solely on business clusters will not establish an entire ecosystem from which multiple industries that align with GNH can grow. Much like how its infrastructural impact will remain local to a specific geographic region, its impact on GNH will be limited to one specific industry.

If well-implemented, the political impact of a business hub can come close to matching that of the earliest hydroelectric projects. While the focus on a specific geography and industry may limit this initiative's impact on economic growth and Gross National Happiness, it would make it easier to direct public attention to a specific way in which GNH is being practically implemented. It would therefore significantly improve the Bhutanese government's image, and more specifically, its ability to align private sector growth with GNH.

Despite its reasonably positive impact on private sector growth, alignment with Gross National Happiness, and potential for improving the government's image, the implementation of a properly coordinated specific economic zone will be very difficult because of its bureaucratic requirements. For example, the three Special Economic Zones currently in development (Motanga, Jigmiling, and Dhamdum) have been in planning since the late 2000s and their management was recently transferred from the government holdings firm DHI to the Ministry of Economic Affairs due to challenges securing land permits.[80] The challenges facing these significantly straightforward initiatives shows that establishing a truly functional industry hub would be substantially more difficult.

	Holistically Address Growth Constraints	Alignment with Gross National Happiness	Political Implications	Ease of Implementation
Stabilization Fund for Continued Investment in Hydroelectricity	◔	◕	◑	◑
Institutional Development through Business Clusters	◕	◕	◕	◑

Recommendation 4: Increased Attention and Resources for Green Public Procurement

The implementation of Green Public Procurement (GPP) is a European Union (EU)-funded project led by the International Institute for Sustainable Development that has been adapted to reflect Bhutan's GNH values of sustainable development. While GPP in the European context refers to the "means that public authorities seek to procure goods, services and works with a reduced environmental impact,"[81] the GPP team in Bhutan seeks to incorporate preferences for local and smaller-sized business as well, allowing it to address many of the growth constraints described earlier. Since the 2009 Procurement Rules and Regulations stipulate that goods, works and services be procured according to "value," rather than price, the legal framework for GPP has already been established.[82] Instead, the GPP Bhutan project is primarily focused on developing awareness and capacity among both the general public and government bureaucrats. Therefore, much of its current work involves the development of evaluation criteria that can be easily utilized by stakeholders for defining "value."[83]

Evaluating Increased Attention and Resources for Green Public Procurement

The Green Public Procurement initiative holds very large potential in being able to holistically address growth constraints. Rather than depending on renting equipment and sourcing material from India, an increase of government expenditures towards local construction companies should bolster the country's long-term abilities in addressing infrastructure demands in its less-developed eastern regions. An increase in business opportunities for CSMEs would facilitate a growing emphasis on entrepreneurship and therefore incentivize more opportunities to develop technical skills. The availability of steadier and more predictable revenue streams from the government would allow for more opportunities for research and capital reinvestment. In the long-run, these conditions will allow local businesses to become more competitive, thereby addressing trade balance concerns. However, there are two barriers to the full impact that Green Public Procurement can have. First, given the highly centralized nature of Bhutan's government, much of the short-term benefits to the private sector will be limited to the Thimphu area. Secondly, the proper implementation of Green Public Procurement depends on more a more impactful and capable bureaucratic system, rather than a leaner one.

The central component of the Green Public Procurement initiative is the realignment of the government's assessment of "value" towards those that more closely resemble Gross National Happiness. By shifting away from a focus on financial cost to the support of local and green businesses, this project is perfectly aligned with the tenants of GNH.

While the administration of Green Public Procurement in Bhutan would perfectly align with the values of Gross National Happiness and be the perfect representation of GNH in practice, its European nomenclature detracts from the potential political impact it would have in Bhutan. Rather than a uniquely Bhutanese initiative, it is likely to be interpreted by the public as a situation in which Bhutan adopts the practices of "more developed" nations.

While the financial costs of research and the implementation concerns of training government administrators are the primary concerns of the GPP project, it is also its main focus. Currently the project is well-funded by the EU and involves the participation of key Bhutanese stakeholders, including the BCCI, the Royal Society for Protection of Nature, the Royal Institute of Management, and the Collaborating Centre on Sustainable Consumption and Production.[84] Therefore, while there are implementation concerns for GPP, the project is directly focusing on capacity-building and therefore alleviates most of this concern.

Overall, the GPP project more effectively addresses every criterion for private sector development than the status quo of continued investment in hydroelectricity. Its impact can be made especially more powerful with the visible support of prominent politicians, who can help develop national pride and awareness for the initiative.

	Holistically Address Growth Constraints	Alignment with Gross National Happiness	Political Implications	Costs and Administrative Barriers to Implementation
Stabilization Fund for Continued Investment in Hydroelectricity	◔	◕	◑	◑
Increased Attention and Resources for Green Public Procurement	◕	●	◕	◕

Recommendation 5: Dividend Distribution Tax and a New Corporate Form

As analyzed in the previous growth diagnostic, the quality of a country's institutions has a significant impact on economic growth. However, one specific institution, corporate law, holds the potential for directly influencing the entire ecosystem upon which a country's private sector develops. The structure of corporate law both acts as the last intermediary between economic growth conditions and the manner through which the private sector can influence society at large. In the United States, the inclusion of health insurance requirements on businesses as part of the 2010 Affordable Care Act addresses human capital concerns that would normally manifest themselves as constraints to growth. In turn, more recent Supreme Court cases have endowed religious rights to businesses, thereby shaping the influence that the private sector can have on the US as a whole. In Bhutan, stringent FDI policy has been implemented as a result of concerns of fronting, but industry-specific exceptions have influenced the ability for certain companies to access different levels of finance and technical skills. These exceptions are made with the intention of aligning the impact of Bhutan's private sector with GNH.

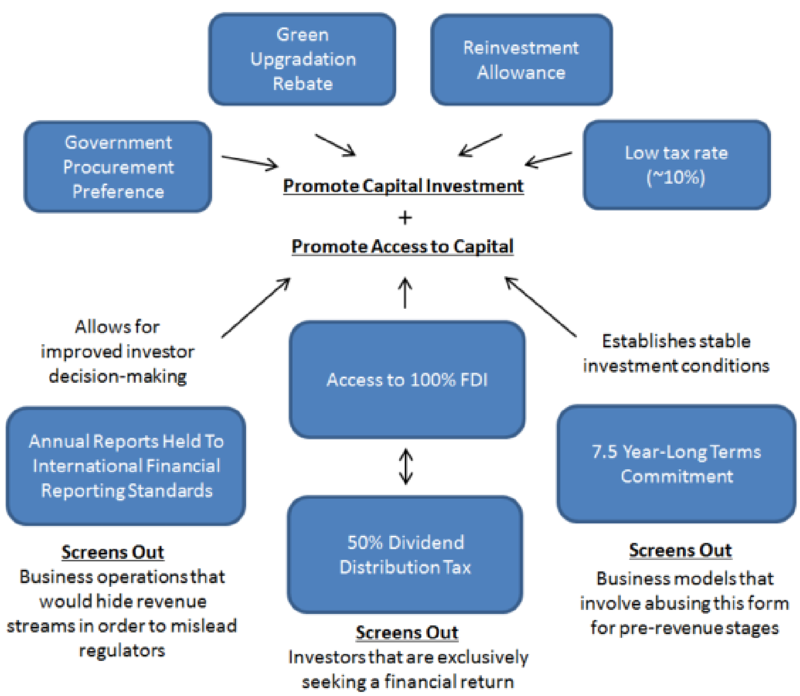
Overall, there are three general concerns with Bhutan's current corporate law.[iii] First, it is extremely complex and cross-cutting across different dimensions, with different tax rates defined in both the Income Tax Act and the Fiscal Incentives Rule and exceptions based on company size, location, and industry. Secondly, since the rules are assessed and implemented on a five-year basis in accordance with Bhutan's five-year plan model, the 2010 fiscal incentives were set to expire in December 2015, with an unclear situation as to which incentives will be renewed. This puts many companies in a precarious position of continuous negotiations with policy makers and influencers. Finally, the dramatic differential between a 0% tax rate for small companies and a 30% tax rate for companies with more than 20 employees creates a

[iii] Refer to Appendix 2 for a more detailed review of corporate law in Bhutan.

significantly strong perverse incentive to self-restrain growth. For example, one small business owner expressed that she was skeptical about entering a partnership with an investor due to concerns that a larger company would face an overwhelming tax burden and would not be able to continue to contribute to social causes with its small profits.[85]

Given this context, the fifth policy recommendation is the creation of an alternate corporate form (referred to here as a Social Limited or Social Private Limited form) as an additional alternative to the current Private Limited and Limited forms (which are either privately or publically held). This Social Limited form, to which a company must make a minimum 7.5-year commitment, would be tied to unrestricted access to FDI, a low tax rate, government procurement preference, and fiscal incentives that promote reinvestment and research and development, thereby institutionalizing the intended goals of the Fiscal Incentives and FDI rules into permanent legislation. This would allow for simplification and increased stability in business regulation and moderate the concerns of growing CSMEs. Businesses would also be subject to complete transparency in accordance with international financial reporting standards. Most importantly, a tax on dividend payouts would aim to screen for exploitive investors and attract entrepreneurs looking to either implement a business model centered on positive social impact or those seeking to contribute to the Bhutanese economy as a whole through long-term investments in capital.

Figure 20: An Overview of the Social Limited Corporate Form



Evaluating a Dividend Distribution Tax and a New Corporate Form

The Social Limited corporate form performs exceptionally well at addressing Bhutan's growth constraints. By directly addressing the country's concerns regarding exploitative investors practicing fronting, the legislation supports the growth of urban CSMEs, the development of technical skills, and opens businesses to foreign financing. By institutionalizing incentives for research and investment in capital, while allowing for the simplification of regulation, it also answers market failure and governance concerns. Finally, as a broad institutional initiative, rather than a targeted program, this recommendation is not constrained by infrastructure constraints and will help facilitate private sector development in areas that are geographically difficult to access.

The combination of the dividend distribution tax and incentives for reinvestment also tightly align this policy recommendation with the principles of Gross National Happiness. As mentioned earlier in this analysis, there are already a substantial number of entrepreneurs in Bhutan whose main priority is the social impact that they will have through their business, rather than their ability to produce a profit. A dividend distribution tax allows these business leaders to adequately address the practical need to produce returns to investors and access the capital needed to expand the impact that they have in a way that that a revenue limit would not. Additionally, reinvestment incentives allow for the tourism industry's "High Value" model to be promoted across the Bhutanese private sector, such that even companies that do not have an explicit business model based on impact can develop goods and services that produce a greater economic return for a smaller negative environmental and/or cultural impact.

The political implications of a Social Limited corporate form are also overwhelmingly positive. First, as an example of how the Bhutanese government can implement policy specifically made for promoting GNH, it can reinvigorate and engage the country's young political leaders. Secondly, as an initiative that would be the first of its kind in the world, Bhutan would once again drive international political dialogue as the beginnings of its tourism and hydroelectricity projects did under the Fourth King. A corporate form tailored specifically for companies with either business models focused on impact or a long-term perspective will be closely watched by western governments interested in promoting social enterprise and corporate social responsibility.

Finally, as an institutional policy initiative rather than a targeted government program, the Social Limited corporate form would have minimal financial costs and administrative concerns once it has been fully implemented. However, given the breadth of impact that the new corporate form would have, regulatory details will need to be fully vetted before permanent adoption. For example, the specific level of the dividend distribution tax and types of fiscal incentives will need to be carefully balanced to screen out exploitative investors while avoiding the disengagement of well-intended investors. It is recommended that the Social Limited form be developed in coordination with multiple stakeholders, such as policy analysts, business leaders, and consultants. It is also recommended that initial research primarily focus on different levels of the dividend distribution tax. Success can be evaluated according to four factors: the cumulative size of the new companies to incorporate, the longevity of these new companies, the extent to which the business operations of these companies match the principles of GNH, and the impact that the new corporate form may have on other institutions, such as the banking sector. The complex nature of such an analysis, as well as the need for cooperation over a wide set of stakeholders, makes this policy recommendation especially difficult to implement.

	Holistically Address Growth Constraints	Alignment with Gross National Happiness	Political Implications	Ease of Implementation
Stabilization Fund for Continued Investment in Hydroelectricity	◔	◕	◑	◑
Dividend Distribution Tax and a New Corporate Form	●	●	●	◔

- **All of the previously analyzed recommendations will better facilitate private sector development than the status quo of continued investment in hydroelectricity.**
- **Each recommendation is able to address each criterion to different extents. These evaluations help define tradeoffs, important stakeholders, and implementation strategy.**

Conclusion: A Gross National Happiness Approach to Development

King Jigme Singye Wangchuck's Gross National Happiness index for measuring development is not only revolutionary because of its alignment with the values of Bhutan, but also for its underlying assertion that development be viewed in a holistic manner that takes into account the interdependence of different indicators. This analysis has adopted GNH's socio-culturally specific, yet holistic view of development and applied it to a question that is at the forefront of Bhutanese political dialogue: how can Bhutan sustain its incredible speed of economic growth in a way that is consistent with its values?

After identifying Bhutan's fragile and underdeveloped private sector as the primary concern behind sustainable growth, economic growth was also analyzed with a holistic, yet specific approach. Using an interacting constraints growth diagnostics model, the nature of private sector growth constraints in Bhutan were identified. An intervention must help businesses circumvent poor infrastructure (especially in transportation), utilize a sudden surge of highly educated, yet technically inexperienced and unemployed youth, simplify and standardize regulations, promote increased coordination between stakeholders, and facilitate access to capital, particularly by improving the country's trade deficit.

In evaluating five recommendations for driving increased private sector development, the ability to holistically address these growth constraints made up the first criterion of "holistically addressing growth constraints." With the addition to three other criteria, which generally represent political feasibility, political implications, and administrative feasibility, we find that each of the recommendations represent a significant improvement over the status quo of continued investment in hydroelectricity, but with varying strengths and weaknesses:

	Holistically Address Growth Constraints	Alignment with Gross National Happiness	Political Implications	Ease of Implementation
Stabilization Fund for Continued Investment in Hydroelectricity	◔	◕	◑	◑
Market Coordination through Industry Associations	◑	◕	◑	◕
Institutional Development through Business Clusters	◕	◕	◕	◑
Increased Attention and Resources for Green Public Procurement	◕	●	◕	◕
Dividend Distribution Tax and a New Corporate Form	●	●	●	◔

These findings do not represent an affirmation that one particular policy recommendation should be prioritized over the others, but rather serve to highlight the specific potential benefits and concerns for each recommendation. Instead, all five recommendations should be pursued in tandem. The potential benefits of each one could be mitigated by failing to implement the other four recommendations. For example, the failure to establish a stabilization fund would produce Dutch Disease dynamics that would completely derail the entire Bhutanese economy, even with active implementation of the other recommendations. In conclusion, the following immediate steps regarding each of the previously described policy recommendations are recommended:

	Primary Implementation Step	Key Stakeholder Groups
Stabilization Fund for Continued Investment in Hydroelectricity	Vocal support for a stabilization fund from prominent politicians and support for research in its implementation	Prominent politicians, such as Prime Minister Tshering Tobgay, and government agencies, such as the Ministry of Economic Affairs and Ministry of Finance
Market Coordination through Industry Associations	Research into Coordinated Market Economies, such as Germany	Trade Associations, Business Councils, and the Ministry of Labor
Institutional Development through Business Clusters	Research into Business Clusters, with a focus on Costa Rica	The BCCI and the Ministry of Economic Affairs
Increased Attention and Resources for Green Public Procurement	Vocal support for GPP from prominent politicians	Prominent politicians, such as Prime Minister Tshering Tobgay
Dividend Distribution Tax and a New Corporate Form	Research into a Dividend Distribution Tax as a means to removing FDI restrictions	The BCCI and consulting groups

In keeping with GNH's emphasis on a context-specific, yet holistic development approach, all of these recommendations should be implemented by coordinating and leveraging the specific strengths of a broad range of stakeholders. Despite the identification of primary stakeholders, implementation should involve (and is not limited to) the following organizations: the Bhutan Chamber of Commerce, government ministries such as the Ministry of Economic Affairs and the Ministry of Finance, trade associations such as the Association of Bhutanese Industries, nonprofit organizations such as the Bhutan Youth Development Fund and the Loden Foundation, consultant groups, and businesses owners of all sizes and industries.

Although the experiences of other countries such as Germany and Costa Rica can help inform the implementation of these recommendations, the leadership and coordination of these stakeholders is crucial to the analytical process of applying these lessons to the Bhutanese context. In the same manner that King Jigme Singye Wangchuk led the country into modernity with the bold and uniquely Bhutanese idea of Gross National Happiness, the young democracy's citizens can firmly secure Bhutan's status as a global through leader by establishing the groundwork for a healthy private sector and demonstrating the effectiveness of GNH in practice.

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International Monetary Fund – World Economic Outlook Database

United Nations Development Program – Human Development Reports

The World Bank – Ease of Doing Business Index

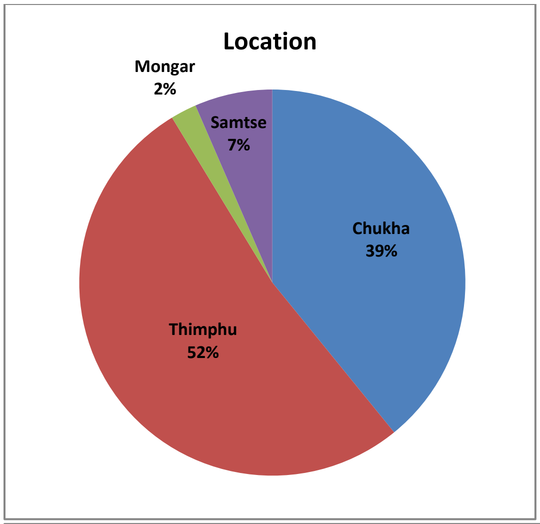
The World Bank – World Development Indicators

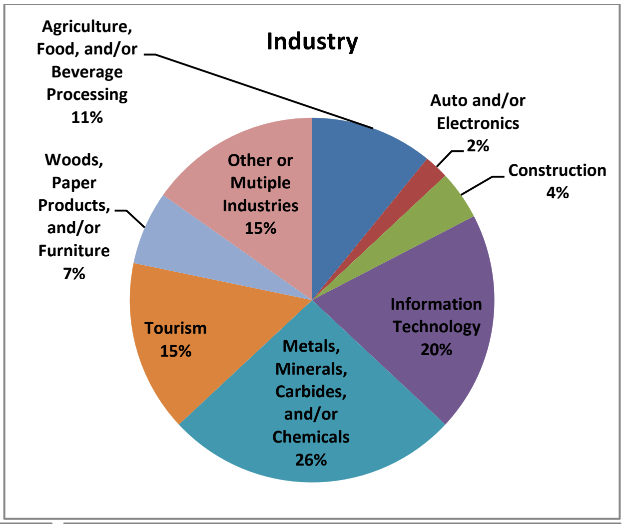
The World Bank – Worldwide Governance Indicators

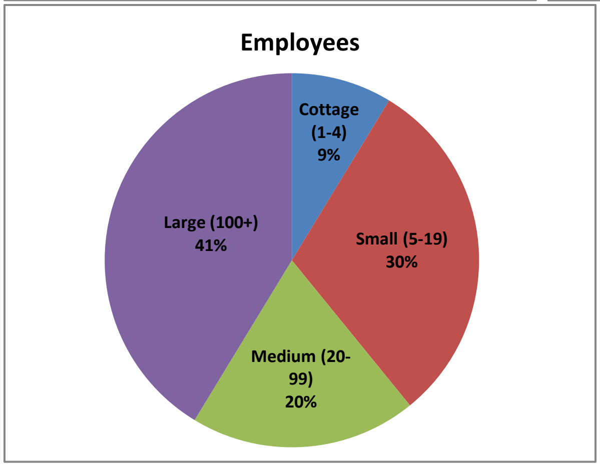
Appendices

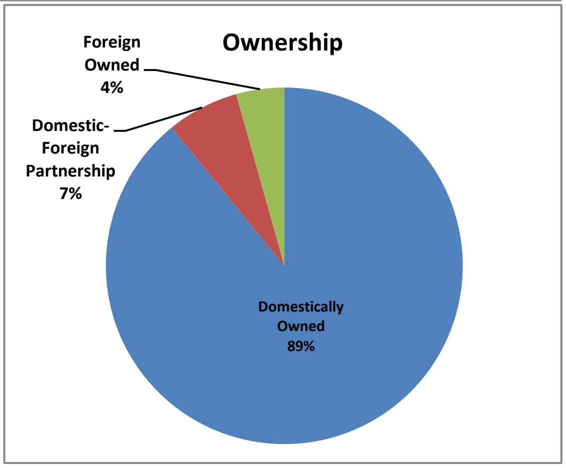
Appendix 1: Methodology

As described, the use of a methodology that both identifies socio-culturally specific conditions and holistically analyzes how these conditions interact is in alignment with the GNH paradigm and its emphasis on development driven by uniquely Bhutanese values evaluated in a holistic manner. These two themes of specificity and comprehensiveness also had implications for how interviewees were identified. In December 2015, the BCCI member list was used to survey 46 businesses. This survey was performed to capture the breadth of Bhutan's private sector and to gather initial data regarding possible constraints to growth. The characteristics of these businesses are described below:









Business interviewees were selected based upon the extent to which they represented a business category and their positioning within stakeholder relationships. These stakeholders (who were also interviewed) were identified according to their roles either representing, supporting, or regulating businesses. Approximately 25 interviews were conducted during January 2016 with occasional follow-ups for clarification and to assure sufficient confidentiality. Information from these interviews was either kept anonymous or disclosed with approval of the interviewee.

Appendix 2: Corporate Law in Bhutan

As of January 2016, corporate law in Bhutan has largely been modeled off of other countries, with heavy influence from India. Corporate structure is largely determined by the Companies Act of 1989, with periodic revisions and amendments, most notably in 2000. Similarly, Cottage, Small, and Medium-Sized Enterprises (CSMEs) are regulated by Enterprise Registration Acts and Civil Society Organizations (CSOs) are regulated by Civil Society Organization Acts. The financial circumstances of each of these types of organizations are determined by a combination of the Ministry of Finance's Income Tax Acts and Fiscal Incentives Rules, and the Ministry of Trade & Industry's Foreign Direct Investment Rules.

Business licenses, which require approval from the Ministry of Economic Affairs, are administered with a registration fee that is based upon investment or share capital size. Generally, all businesses are charged an income tax of 30%, but all cottage and small-sized companies (with an entity size of less than 19 employees or investment/share capital of less than 10 million ngultrum) receive a 10-year tax holiday, with an additional 10 more years if they are located in "interior areas" (a reference to areas further from the Indian border, therefore effectively a tax on businesses in Phuentsholing). Similarly to the previously described FDI Rules, the Fiscal Incentives Rules also outline tax holidays of varying lengths for certain companies within the agricultural, information and communications technology, tourism, film and media, construction, transport, education, and health sectors. For example, in comparison to the 10-year tax holiday granted to companies operating within the Thimphu TechPark, ICT companies operating outside the TechPark are granted a 5-year tax holiday. Other relevant fiscal invectives in the 2010 rules include a tax deductible reinvestment allowance of 25%, tax deductions for all research and development, and a tax rebate of up to 15% of up-gradation expenses.

Business Licenses

Entity Type	Entity Size	Investment/Share Capital (Nu.)	Unincorporated Salary Ceiling (Nu./month)	License Fee (Nu.)	Incorporation Registration Fee (Nu.)
Cottage/Micro	1-4	< 1 million	20,000	1,600	1,000
Small	5-19	1-2 million	30,000	3,100	1,500
Small	5-19	2-10 million	30,000	3,100	2,000
Medium	20-99	10-100 million	40,000	6,100	2,000
Large	100+	>100 million	50,000	12,100	2,000

Tax Rates

Entity Type	5 Year	10 Year	Other
CSO	Exempt	Exempt	Exempt
Cooperative	Holiday	Holiday	Additional 10 years if in "interior areas"
Cottage/Micro	Holiday	Holiday	Additional 10 years if in "interior areas"
Small	Holiday	Holiday	Additional 10 years if in "interior areas"
Medium	30%	30%	Depending on specific sector as defined in Fiscal Incentives Act
Large	30%	30%	Depending on specific sector as defined in Fiscal Incentives Act