

# Bhutan: Trade Brief\*

## Trade Policy

As of 2007, Bhutan's MFN applied simple tariff average at 21.9 percent is the highest in South Asia and much higher than the low-income country group mean (12.6 percent); the tariff also has increased since the early 1990s average (15.3 percent). The import-weighted tariff average of 14.8 percent is comparable to the regional mean (12.9 percent). MFN zero-duty tariffs were 15.9 percent of imports in the early 2000s. The cornerstone of the country's trade policy, however, is the free trade agreement (FTA) with India (since 1949), covering almost 90 percent of its trade, and a FTA with Bangladesh covering certain product lines and amounting to a further 5–8 percent of total trade. Combined with other exemptions, such as procurement associated with donor-financed projects, import duties accounted for less than 1 percent of imports (in the early 2000s) as opposed to the most recently available regional and low-income comparator group means of about 6.2 percent. With a frequency ratio of 3.9 percent (1999), nontariff barriers appear to be less common compared with the regional average of 9.83 percent. Bhutan's 2006 International Telecommunication Union (ITU) competition index in telecoms is 1.0 (0–2, higher score is greater competition), largely because the country has only one telecom provider and thus no competition due to the small size of the market

## Market Access

As reflected in the 2006 rest-of-the-world applied tariff weighted average of just 0.6 percent, Bhutan's exports face much lower barriers than the average South Asian (4.7 percent) or lower-income country (3.7 percent). In fact, its share of MFN zero-duty exports as a percentage of total exports (94 percent in 2006) is also much higher than the regional (26.4 percent) and low-income group (44.6 percent) means, suggesting that current preferential arrangements do not add much to its already favorable MFN market access. Bhutan nonetheless is a Generalized System of Preferences (GSP) beneficiary with a number of industrialized countries and is also eligible for duty-free market access under the European Union's "Everything But Arms" initiative for least-developed countries. Bhutan's utilization of EU and U.S. preferences, however, is very low (33.2 percent) as is their value at less than 1 percent of bilateral exports. Bhutan is a member of the South Asian Association for Regional Cooperation (SAARC) and as of 2004 is a party to the South Asian Free Trade Agreement (SAFTA), whose members have committed to a gradual phase-out of tariffs beginning in 2006.<sup>1</sup> Bonded shipments through India are possible, and a dry-port on the border is being developed. In addition, Bhutan is currently pursuing membership in the WTO. The historic trade routes from India to Tibet have been closed since 1959, which, combined with the absence of any road links, means that trade with China is nearly nonexistent. The Bhutanese currency, the ngultrum, is pegged at par to the Indian rupee and the Indian rupee is accepted as legal tender across most Bhutanese establishments.

## Behind the Border Constraints

Bhutan's development policy emphasizes environmental sustainability and promotion and preservation of cultural heritage (which, in addition to economic growth and development and

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\*As of April 2008. See the World Trade Indicators 2008 database at <http://www.worldbank.org/wti2008>.

<sup>1</sup> Along with Bangladesh, India, Myanmar, Sri Lanka, Thailand, and Nepal, Bhutan is also a member of the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC).

good governance, are the pillars of the Gross National Happiness concept). Mindful of these concerns, certain industries such as tourism are heavily regulated. With the lowest rank in the subcategory Closing a Business (178<sup>th</sup>), Bhutan's Doing Business overall rank is 119<sup>th</sup> (out of 178), and reflects the generally poor business environment in the region. Thanks to its political stability and recent peaceful transition from absolute monarchy to democracy, it noticeably outperforms the South Asian region and low-income group averages in all aspects of governance (regulatory quality, rule of law, and control of corruption). Despite major improvements in road access in recent years, difficult geography (mountainous terrain and landlocked) is a key factor raising transactions costs and hampering connectivity. This is reflected in Bhutan's rank of 128<sup>th</sup> (out of 150) on the 2006 Logistics Performance Index, and 149<sup>th</sup> (out of 178) on the Doing Business—Trading Across Borders subcategory.

### **Trade Outcomes**

Real growth of trade in 2006 was 30.4 percent, the highest in South Asia. This was partly due to the increasing demand for Bhutan's hydroelectricity exports in India and continues a trend of robust growth of trade since the late 1990s. Imports, however, have grown faster than exports at 35.6 percent in 2006, while export growth was 22.9 percent. The country's export product concentration of 38.4 is one of the highest in South Asia, next only to Bangladesh, although this is common in small economies and concentration is lower than the low-income group mean. The largest source of hard-currency, after aid flows, is tourism; albeit small, this sector has been growing very rapidly in recent years. Foreign direct investment (FDI) inflows as a share of GDP were less than 0.1 percent but new FDI is being attracted into tourism and energy-intensive enterprises.

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