

Enabling the Private Sector for Economic Well-being

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Introduction

A country's economic well-being is strongly tied to its private sector. It has an important role of creating jobs and providing income security to families and individuals, bringing new and innovative solutions to the market and, most importantly, supplementing the national income.

Bhutan's young private sector -- significantly developed since it was first identified as being important for economic growth in the Sixth Five-Year Plan (1987-1992) -- has largely played a peripheral role. It has been overshadowed by the larger public sector and the State-owned enterprises (SOEs). In recent years, driven by economic challenges, there has been a renewed view that the private sector ought to play a more central role in economic development.

However, the private sector is impeded by an inadequate market, and a lack of finance and sub-optimal capabilities, which will require major investments and initiatives from the government and private sector players to correct the course.

In this paper, I share some observations on Bhutan's private sector -- its current standing, key challenges, and areas of interventions required to make it a cornerstone of Bhutan's economy.

The Current State of Bhutan's Private Sector

The development of Bhutan's private sector can be traced back to the Sixth Plan, from 1987 to 1992, when it was identified as a key partner for economic growth. The Plan envisaged that the sector will play an increasingly important role in fostering economic growth, and become a major source of employment. By 1999, the private sector was able to create around 7,000 jobs (of which 50% was filled by expatriates)¹ in industries concentrated in the south-west corner of Bhutan.

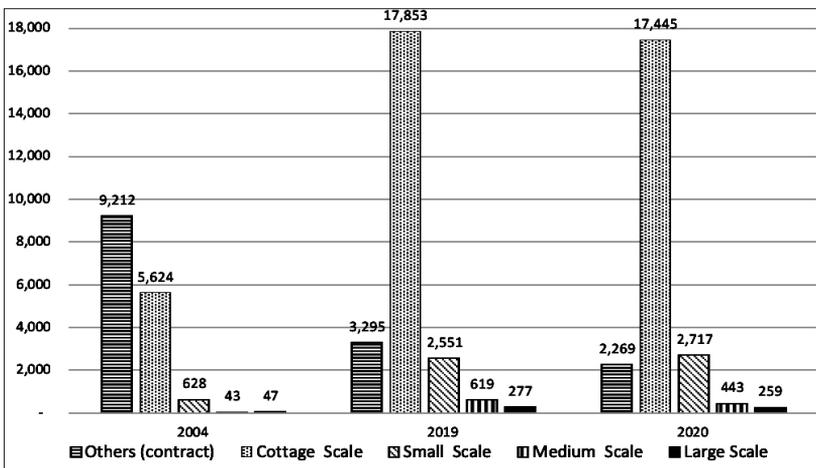
¹ Bhutan 2020: A Vision for Peace, Prosperity and Happiness, Planning Commission, Royal Government of Bhutan, 1999

“Bhutan 2020: A Vision for Peace, Prosperity and Happiness” published in 1999 by the Planning Commission, stressed the importance of the private sector. The vision acknowledged that response from the private sector to the goal of liberalisation from the government has been sluggish, and the growth and contribution have been inadequate. The vision recognised ambiguities in the legal and licensing frameworks needed to be clarified, infrastructure needed to be built, and programmes for developing institutional capacities scaled.

Since then, the private sector in Bhutan has evolved in lockstep with the economy. According to the latest information from the National Statistics Bureau² of Bhutan, the private sector in Bhutan has over 24,500 establishments. As figure 1 shows, the number of establishments/companies in Bhutan has increased by 50% since 2004, from 15,500 entities.³ The bulk of the growth has been in the small and cottage scale industries.

Figures on licence issuance and enterprises show that the number of companies in the private sector has increased gradually. However, the latest figures as of June 2020 show that, as a result of the pandemic, Bhutan has seen a significant number of company closures, with only 23,100 companies in operation.

Figure 1: Number of companies in Bhutan by size -- 2004, 2019 and 2020



² Statistical Yearbook of Bhutan 2020, National Statistics Bureau, October 2020.

³ Statistical Yearbook of Bhutan 2005, National Statistics Bureau, December 2005.

From 2004 to 2019, the private sector also expanded into multiple sectors -- including education, health, financial services, communications and technology -- from a concentration on agro, forest, and mineral-based industries. The private sector now employs around ~90,000 people (excluding those in farming), and the proportion of individuals employed, at 29%, is similar to that of 2004.

There are no formal studies on competition within the private sector in Bhutan. From my observations and discussions with market participants, competition in the retail/wholesale trade, construction and tourism is intense, where the barriers to entry are fairly low. There are only a few large business houses/conglomerates which operate in multiple sectors. The other main source of competition for the private sector are the SOEs.

Over the last two decades, the Royal Government of Bhutan has worked hard to improve the environment for doing business, by simplifying regulations and registration processes for starting businesses, and providing fiscal incentives to encourage local investors and FDIs to start companies in Bhutan. The World Bank's Ease of Doing Business Index ranks Bhutan at 89, up from 126 a decade ago.

Is the Private Sector Doing Enough?

Looking at the trends between 2004 and 2019, one is likely to conclude that the private sector in Bhutan is thriving. It is true that these numbers directionally indicate that the private sector has grown, but it is also true that the pace of growth and the contribution of the private sector could have been significantly better.

Bhutan's GDP growth is driven by the public sector and SOEs. This is reflected in the four-fold increase in government expenditure, from Nu. 12.8bn to Nu. 44bn, and the growth in employment from 16,000 to around 30,000⁴ in public and related agencies. In the last decade, there has been a proliferation of government-controlled entities and SOEs, which further employ around 13,000 employees.⁵

⁴ Civil Service Statistics, December 2019, Royal Civil Service Commission

⁵ State Enterprises Annual Report, 2018, Ministry of Finance

The share of Bhutan's private sector of the GDP is estimated to be ~40%,⁶ much lower than the 60-70% expected of a dynamic emerging economy. The private sector lacks companies that can be called market leading, with a major presence in any of the external markets. Over 97% of private sector establishments are shed vendors, single proprietors or partnerships.

The formal private sector, excluding farming, contributes around 29% of the total employment in Bhutan. This is low compared with other countries, and indicates that there is enough room for the private sector in Bhutan to generate employment. More than 50% of our firms employ a single individual, 30% employ only two or three individuals and fewer than 80 firms employ more than 100 individuals. As the unemployment problem becomes more critical in Bhutan, the private sector will have to be the major source of employment opportunities.

While the private sector has seen diversification into multiple sectors, the focus is still narrow, with over 80% of the entities plying their trade in retail and wholesale, repair of vehicles and hospitality. These sectors rely on imported goods and materials, which further impacts on Bhutan's unfavourable balance of trade. The private sector has opportunities to become more innovative, and move into more value-adding export-oriented industries.

A draft of the recent 21st Century Economic Roadmap has proposed a very ambitious target of quadrupling Bhutan's per capita Gross National Income from US\$3,000 to over US\$12,000 by 2030. There is an urgent need for the economy to find new sources of growth beyond the public sector and farming, both of which have now reached their limits of growth.

The public sector in Bhutan employs around 12% of economically active individuals, with a wage bill of 20% of government spending, and a government spending of ~35% of the GDP. These are close to thresholds beyond which the public sector becomes unwieldy, and less efficient and effective in deploying resources and delivering programmes. Farming -- employing around 160,000 people -- despite all the investments and initiatives, is fundamentally difficult to scale, due to smaller farm holdings and topography.

⁶ Analysis by author based on information in the Statistical Yearbook of Bhutan 2020, National Statistics Bureau, October 2020.

It is evident that, going forward, the private sector has to play a critical role in driving Bhutan's economic growth. An aspiration and ambition for Bhutan's private sector in the short to medium term (7 to 10 years) should encompass some or all of the following attributes:

- The private sector's share of Gross Domestic Product is at least 60%, with a deep presence and expertise across all the different sectors of the economy. The private sector will be seen as an equal partner in development supporting inclusive growth and will have supplemented the public sector in the delivery of services and goods.
- The private sector will employ at least 60% of Bhutan's economically active population. University graduates and high-performing individuals will see the private sector providing them the platform for growth and professional fulfilment, and entities in the private sector will be the preferred choice of employment.
- Bhutan's private sector will be seen as a thriving centre for business opportunities in the region, supported by business-friendly legislation and transparent regulations. It will attract investments and talent from all over the world.
- The private sector has organically built at least 25 large and hugely competitive companies with a major foothold in regional and key global markets, establishing and promoting "Brand Bhutan". The private sector will have helped Bhutan diversify the economy and improve the balance of trade with major trade partners.
- The private sector is working on solving critical challenges, and is known for its innovation and creativity. Through the private sector, Bhutan will have established itself as a leader in a number of fields, such as environmental solutions, technology and agriculture.

Achieving some or all of the aspirations above will require the government and the private sector to acknowledge challenges that the sector faces.

What Ails Bhutan's Private Sector?

The private sector in Bhutan faces issues that have been thoroughly documented by a number of studies by the government, the NGOs that operate in the market, and various observers of economic development in Bhutan. The major challenges, as I see them, are listed below:

Lack of Market/Market Access

Lack of a sizeable internal market for goods and services and access to external markets are major handicaps for the development of Bhutan's private sector. Bhutan's major trade partners are India and Bangladesh, which make up over 70% and around 20% of our export markets respectively. While these markets are well developed for products manufactured by the SOEs and a few larger private sector entities (e.g. cement manufacturing, export of minerals, etc), both markets are fairly less developed and less accessible for the majority of private sector entities.

Access to Finance

The financial services sector, including the two insurance companies in Bhutan, provide finances to the private sector. The outstanding credit to the private sector has gradually increased in recent years, from Nu. 72.6bn (57% of GDP) in 2015 to about Nu. 137bn (77% of GDP)⁷ in 2019, indicating that finance is available to the private sector.

However, access to finance continues to be cited as a hindrance, in regular surveys of the private sector and reviews by organisations outside Bhutan. There can be a number of reasons, and a reasonable hypothesis is that credit is available to more established businesses in more mature sectors, while smaller and new businesses require collateral to access finance from the financial institutions.

Recently, Bhutan has seen the emergence of new platforms for crowd-sourcing and organising financing for start-ups and entrepreneurs, which will address some of these problems.

Competition from the Public Sector and SOEs

The private sector in Bhutan is subject to a unique challenge, where a major source of competition is the government and its SOEs (there were 38 SOEs at the end of 2018). The SOEs operate across a range of sectors, such as importing and distributing products, agriculture, construction and real estate, wood craft, manufacturing, media and information technology, and the generation and distribution of electricity.

⁷ Author analysis based on figures from National Statistical Bureau. The equivalent World Bank figures for domestic credit available to the private sector are significantly lower.

The SOEs -- with easy access to finance, and having developed capabilities over a number of years as government departments or agencies -- crowd out the private sector, thus hindering any investments or capability development. In addition, the civil service and the SOEs compete with the private sector for talent in the market.

Lack of Talent and Skilled Resources

Bhutan has an unusual unemployment problem. Many private sector roles go unfilled because the market lacks skilled and experienced individuals.

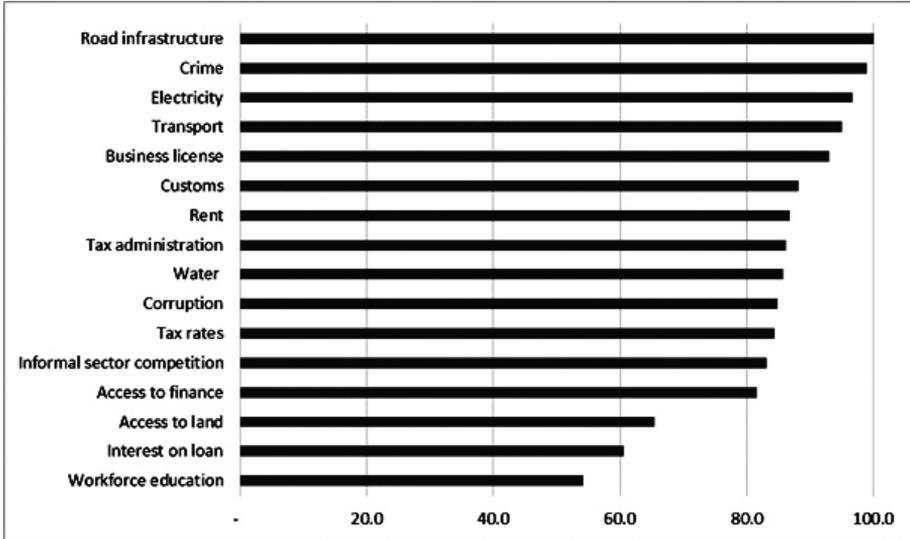
Bhutan's education strategy and investments into higher education and training institutes have created a generation of graduates without the skills to be employed by the private sector. This is likely an unfair expectation of graduates, but this is also symptomatic of the lack of managerial capabilities and training opportunities within the private sector.

There has been little to no recognition that our training and education curriculum do not align with the needs of the economy. However, this is beginning to change. Bhutan's private sector will also significantly benefit from individuals who bring more current technical, financial and commercial capabilities.

Regression in Enabling Conditions for Private Sector Development

There are many common obstacles the private sector faces. Processes for registration and setting up of businesses can be further simplified (or completely removed for small businesses). Taxes for smaller companies can be reduced so that they can re-invest and grow their businesses, and access to basic amenities such as electricity, transport and water can be improved. Figure 2 shows the major obstacles reported by over 50% of the 13,997 establishments enumerated during the Economic Census of Bhutan, 2018-2019 conducted by the National Statistics Bureau and the World Bank.

Figure 2: Obstacles reported as potentially affecting business operations, 2017 (%)⁸



Bhutan has seen its rank in the World Bank’s Ease of Doing Business Ranking reverse from a high of 71 in 2016 to 89 in 2019. The 2021 index of economic freedom, from the Heritage Foundation, identifies Bhutan as “Mostly Unfree” with the rank of 109th freest in the world.⁹ We lag behind the regional score (Asia Pacific) and the world average, and are moving downwards from being in the “moderately free category” in previous years.

The challenges indicated above are not insurmountable and will require a well thought out strategy, commitment of resources, and concerted efforts from the government and key players in the private sector.

Considerations for the Government and Key Players

It is inevitable that Bhutan will have to turn towards the private sector as it recovers from the impact of the COVID-19 pandemic, facing sustained unemployment, and uncertainty around aid and grants from our development partners while, at the same time, aspiring to become a high-income country by 2030.

⁸ Economic Census of Bhutan, 2018-2019 conducted by the National Statistics Bureau and The World Bank

⁹ 2021 Index of Economic Freedom, The Heritage Foundation

The Royal Government will have to work in partnership with the Bhutan Chamber of Commerce and Industry (BCCI) and the wider private sector, in implementing some major initiatives. It is clear that the government will need to show leadership by providing the private sector with the right opportunities, technical support and budgetary assistance. Most countries with a thriving private sector have often been enabled in their initial stages through government and public sector support.

Bhutan will also have to make strategic bets on specific sectors and boldly define where it wants to play. We have been successful with tourism. Can Bhutan replicate this success in any other sector? Can Bhutan position itself as a world class producer of organic food, a hub for biosciences and forestry, a leader in environmental services and products, or a manufacturing powerhouse for specific goods, using the abundant and supposedly cheap electricity? Accordingly, Bhutan will have to develop plans and strategies for investments into education, training, infrastructure and related capabilities to pursue specific bets via the private sector.

A critical first step is to develop markets for the private sector, both within and outside Bhutan. This means identification of products and services that the private sector can develop, or helping companies develop markets for their products and services. Exports (apart from tourism) are significantly skewed towards products, and opportunities exist for identifying services that can become a part of our offering to external markets.

Market development will require working with other countries to agree on standards, trade procedures, tariffs, and financial and institutional frameworks to allow access to their markets. Market development reduces risks and demonstrates commitment of the government to the private sector, thus encouraging entrepreneurs and owners, often with limited resources, to invest in, start, or grow their businesses.

To allow the private sector to develop technical and management capabilities, the government could commit to securing and delivering as many services as possible from the private sector. Over time, the government could exit certain sectors which are not deemed strategic (e.g. housing and agro) and allow sole private sector participation. The SOEs, having matured over more than a decade, should use their capabilities and expertise in crafting a path for Bhutanese companies to access markets outside and build “Brand Bhutan”.

To improve access to credit and finance, the government and the BCCI will need to work with financial institutions to simplify procedures for securing credit for medium-sized and smaller businesses. Despite Bhutan's domestic credit to the private sector increasing in the last few years, total credit still lags behind economies which have more robust and dynamic private sectors. It is clear that domestic credit needs to increase, and work is required to make it available to a wider pool of private sector participants.

Like many other countries, the government should also consider establishing alternative sources of credit, such as sector-specific funds (e.g. financial technology, environmental, societal and governance funds) to support new start-ups and innovative businesses, and introduce tax holidays and incentives for entrepreneurs and investors in the private sector.

Bhutan urgently needs to review its plan for developing talent in the private sector. A country that does not invest in its human capital over a long period of time stagnates as a low-skilled economy, and loses its more capable and enterprising people to underemployment, or to other economies. Bhutan will need to look again at its education and training curriculum and transform it to deliver talent ready for the future economy. Without this, Bhutan also risks missing out on the demographic dividend resulting from a youthful population. His Majesty the King has, repeatedly, and most recently in a Royal *Kasho*, highlighted the importance of education to the economy and the country.

Last but not least, the government will need to continue removing obstacles facing our private sector. The government will need to continuously work with the private sector and regularly re-visit our policies (e.g. existing economic development plans, fiscal incentives, taxations and rules) that relate to businesses, review their effectiveness, and continuously improve the business environment.

Further, the government will need to identify how it can accelerate development of innovative solutions, or help private sector participants access the market. These could manifest itself in initiatives such as setting up incubation/innovation hubs, product testing laboratories which require significant investments, or a network of regional or global market experts that private sector players in Bhutan can tap into.

There are immense opportunities for the private sector in Bhutan. The time for “muddling through” is over, and Bhutan has to recognise that the private sector can be the cornerstone of economic prosperity and self-sufficiency, and accord it its rightful status and the support it deserves.

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