

South Asia

Occasional Paper Series 3



COUNTRIES IN TRANSITION

A Brief Review of the Emerging Political Economy of
Bangladesh, Bhutan, the Maldives, and Nepal

Asian Development Bank



South Asia

Occasional Paper Series No. 3

COUNTRIES IN TRANSITION

A Brief Review of the Emerging Political Economy of
Bangladesh, Bhutan, the Maldives, and Nepal

Asian Development Bank

© 2009 Asian Development Bank

All rights reserved. Published in 2009.
Printed in the Philippines.

ISBN 978-971-561-830-4
Publication Stock Number RPS090817

Cataloging-In-Publication Data

Asian Development Bank.
South Asia occasional paper series no. 3.
Mandaluyong City, Philippines: Asian Development Bank, 2009.

1. Political economy. 2. Governance. 3. Bangladesh. 4. Bhutan. 5. Maldives. 6. Nepal.
I. Asian Development Bank.

The views expressed in this report are those of the author and do not necessarily reflect the views and policies of the Asian Development Bank (ADB), its Board of Governors, or the governments they represent.

ADB does not guarantee the accuracy of the data included in this publication and accepts no responsibility for any consequence of their use.

By making any designation of or reference to a particular territory or geographic area, or by using the term "country" in this document, ADB does not intend to make any judgments as to the legal or other status of any territory or area.

ADB encourages printing or copying information exclusively for personal and noncommercial use with proper acknowledgment of ADB. Users are restricted from reselling, redistributing, or creating derivative works for commercial purposes without the express, written consent of ADB.

Note: In this report, "\$" refers to US dollars.

Asian Development Bank
6 ADB Avenue, Mandaluyong City
1550 Metro Manila, Philippines
Tel +63 2 632 4444
Fax +63 2 636 2444
www.adb.org

For orders, contact
Department of External Relations
Fax +63 2 636 2648
adbpub@adb.org

Foreword

I am pleased to present to you the third issue in the South Asia Occasional Paper Series (SAOPS), which is designed to share research on development issues in the region with a wide audience, including policy makers, academics, and the general public. This edition, *Countries in Transition: A Brief Review of the Emerging Political Economy of Bangladesh, Bhutan, the Maldives, and Nepal*, presents emerging issues in governance and political economy in these four countries, each of which held elections in 2008, with far-reaching implications.

Development needs to be analyzed not merely as an economic phenomenon but in multi-dimensional aspects as well, such as the restructuring and reorientation of the whole economic and social system. Political economy considerations have a strong impact on economic development, particularly in developing countries. As countries develop, there are fundamental changes in the political economy; in the social, institutional, and administrative structures; and in attitudes, which allow more effective and efficient allocation of domestic resources, improving the economic system.

This SAOPS is very timely: (i) Bangladesh held national elections in late 2008 after a hiatus of two years; (ii) Bhutan held multiparty elections in 2008 for the first time; (iii) the Maldives held its first freely contested presidential elections late last year, resulting in the end of the 30-year rule of President Gayoom; and (iv) Nepal's elections in 2008 for the Constituent Assembly heralded not only the end of the two-and-a-half century monarchical rule but also the transition to a federal democratic republic. This report provides perspective on the main issues and recent trends in governance and political economy and highlights the main issues each of the four governments will need to be mindful of in 2009 and beyond. It analyzes variables such as gross domestic product growth, inflation, corruption, business environment, and public management to discuss the recent trends in governance and political economy.

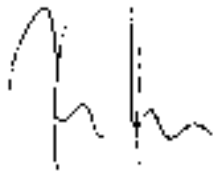
The immediate years ahead will pose substantial challenges to the governments unless concerted action is taken to mainstream development, further reform their economies, make the political process more inclusive, and ensure the proper accountability of public institutions. The review also highlights the specific areas of governance these governments will need to focus on: (i) the visioning exercise, (ii) continued political reforms (including decentralization/devolution and accountability of public institutions), and (iii) proper management of the economy.

This brief review shows some striking similarities in the four countries' context and reform agenda. They are as follows: (i) the global economic slowdown is surely an area of concern for these countries as the impact on remittances, tourist arrivals, and other developments begin to hurt national economies; (ii) given the reform agenda to date in these countries, second-generation reforms in their political economies are needed; (iii) political consolidation and/or political pluralism and reforms will continue to be the need of the day; (iv) the notion of devolution is taking center stage; and (v) at least in Nepal, inclusiveness will be the primary demand as the government begins to concentrate even more on reversing the policy lapses of previous years.

The management of public expectations will also take center stage. As new political parties (and/or parties that have been out of power for some years) take the reins of power, public expectations of swift, prompt, and effective development actions will rise. If not managed properly, these expectations could prove to be the bane of current governments. This is a key issue that governments of the four countries are well aware of. How they manage public expectations will prove to be just as important as instituting policy reforms themselves in governance and political economy.

We would like to thank South Asia Department staff and consultants of the Asian Development Bank for preparing this SAOPS. The work was conducted under the overall guidance of Bruno Carrasco. The report was authored by Gambhir Bhatta. Sally Mabaquiao, Aileen Pangilinan, and Jane de Ocampo provided administrative support. The publication was made possible by the cooperation of the Department of External Relations and the printing unit. Eric Van Zant edited and designed the report.

Finally, we would like to thank these and other colleagues who provided inputs and comments: Carl R. Mats Elerud, Firoz Ahmed, Tadateru Hayashi, Paul J. Heytens, Barry J. Hitchcock, Abid M. Hussain, Shikha Jha, Golam Md. Mortaza, Shamsur Rahman, Peter Robertson, Kyung-Nam Shin, and Meriaty Subroto.



Kunio Senga
Director General
South Asia Department

Contents

Chapter 1. Introduction	1
A. Context.....	1
B. Methodology	1
C. Definition of Key Terms.....	3
Chapter 2. Regional Picture	4
A. Economy	4
B. Business Climate.....	5
C. Corruption and Good Governance.....	5
D. Human Development Index Trends	6
Chapter 3. Bangladesh	8
A. Background	8
B. Recent Political Developments.....	8
C. Recent Economic Performance.....	9
D. ADB's Operational Strategy in Bangladesh.....	12
E. Emerging Issues in Governance and Political Economy.....	12
1. Political Party Reforms.....	13
2. Reforms in Public Sector Management.....	13
3. Anticorruption Efforts.....	16
F. Conclusions.....	17
Chapter 4. Bhutan	19
A. Background	19
B. Recent Political Developments.....	20
C. Recent Economic Performance.....	21
D. ADB's Operational Strategy in Bhutan	23
E. Emerging Issues in Governance and Political Economy.....	23
1. Public Management.....	23
2. Political Issues.....	26
3. Economic Issues	29
F. Conclusions.....	31
Chapter 5. The Maldives	32
A. Background	32
B. Recent Political Developments.....	32
1. Constitutional and Legal Changes.....	32
2. Elections and the New Vision.....	33
C. Recent Economic Performance.....	33
D. ADB's Operational Strategy in the Maldives	35
E. Emerging Issues in Governance and Political Economy.....	36
1. Public Management.....	36
2. Political Issues.....	38
3. Economic Issues	39
F. Conclusions.....	41

Chapter 6. Nepal	42
A. Background	42
B. Recent Political Developments.....	42
C. Recent Economic Performance.....	43
D. ADB's Operational Strategy in Nepal.....	45
E. Emerging Issues in Governance and Political Economy.....	46
1. Public Management.....	46
2. Political Issues.....	48
3. Economic Issues	48
F. Conclusions.....	51
Chapter 7. Summary	52
A. Major Trends.....	52
B. Major Risks.....	53
C. Key Lessons	53

Abbreviations

ACB	–	Anticorruption Board
ACC	–	Anticorruption Commission
ADB	–	Asian Development Bank
BPC	–	Bangladesh Petroleum Corporation
BNP	–	Bangladesh Nationalist Party
CAG	–	Comptroller and Auditor General
CPI	–	corruption perceptions index
CPN(M)	–	Communist Party of Nepal (Maoist)
CTG	–	caretaker government
DHI	–	Druk Holdings and Investment
FDI	–	foreign direct investment
FY	–	fiscal year
FYP	–	five-year plan
GDP	–	gross domestic product
HDI	–	human development index
IMF	–	International Monetary Fund
MYRB	–	multiyear rolling budget
PAC	–	Public Accounts Committee
PCS	–	position classification system
PPP	–	public–private partnership
PSC	–	Public Service Commission
RAA	–	Royal Audit Authority
SAOP	–	South Asia Occasional Paper
SOE	–	state-owned enterprise
STELCO	–	State Electricity Corporation
UNDP	–	United Nations Development Programme
WTO	–	World Trade Organization

Explanatory Notes

In this issue of the South Asia Occasional Paper, the following analytical or geographical groupings apply:

- South Asia comprises Afghanistan, Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan, and Sri Lanka.
- Developing Asia refers to the 44 developing member countries of the Asian Development Bank.

The issue incorporates data available as of February 2009.

1. Introduction

A. Context

1. This report focuses on emerging issues in the governance and political economy of the four countries in South Asia that held elections in 2008, with far-reaching implications: (i) Bangladesh (where national elections ended a two-year hiatus), (ii) Bhutan (where multiparty elections were held for the first time), (iii) the Maldives (where the first freely contested presidential elections resulted in the end of the 30-year rule of President Gayoom), and (iv) Nepal (where elections for the Constituent Assembly heralded not only the end of the two-and-a-half century monarchical rule but also the transition to a federal democratic republic). These are momentous changes.

2. The governance and political economy of these countries in transition is important because a lack of understanding of the political economy of reform is increasingly considered a risk to development effectiveness, which requires appropriate management.¹ The report seeks to put into perspective and highlight the main issues emerging in these four countries that their governments will need to be mindful of in 2009 and beyond.

B. Methodology

3. The report consists of country cases in which a broad sweep of developments in the political and economic arenas, and their implications, are assessed. This is meant neither as a rigorous academic study nor as an economic analysis per se; rather, the aim is to tease out the trends that will help development practitioners. The evidence comes from various sources, including in-country and desk-based review and research, discussions with senior government officials and

policy makers in all four countries, and reports of bilateral and multilateral agencies (such as the Asian Development Bank, the United Nations (UN), the World Bank, and others). Substantial reliance is placed on evidence collected from the daily news in the four countries to tap more current and topical evidence.

4. In keeping with the subject matter, and because several countries are covered, depth of analysis is compromised for breadth of coverage. The governance and political economy variables covered include

- i. gross domestic product (GDP) growth, because it is the one overriding and universally accepted indicator that measures growth in the economy;²
- ii. inflation, because it directly impacts the livelihoods of the poor and vulnerable populations (given that it signifies a decline in the value of money) and, therefore, serves as an indicator for governments to keep a close eye on to preempt dissatisfaction among the population;
- iii. corruption, because it is considered the primary indicator of malgovernance in each country;³
- iv. business environment, because it reflects the impact of government policies on how the private sector views the favorability of doing, and expanding, business in the country (this includes a brief discussion of the scope of public private partnerships in these countries);

¹ World Bank. 2008. *The Political Economy of Policy Reform: Issues and Implications for Policy Dialogue and Development Operations*. Report No. 44288-GLB. Washington, DC. November.

² The inclusion of this variable is also partly on the assumption that governments normally consider that the higher the growth rate, the greater their credibility.

³ See para. 6 for an explanation of the term "malgovernance."

- v. foreign direct investment (FDI), because it can be taken as a unique proxy measure of the confidence foreign investors have in the country's economy and economic policies;
- vi. public management, because it contains within it the policy making and policy implementation functions of government (including, for example, how state-owned enterprises [SOEs] limit the scope for private sector involvement in the economy and can also create losses to the state exchequer, not only in subsidies provided but also the opportunity costs of revenues lost); and
- vii. human development index (HDI), because it encapsulates the various variables that measure the progress made in channeling economic growth into human and social development.

5. Some of these variables merit further discussion:

- i. **Inflation.** The causes and effects of inflation need to be analyzed to assess its significance in understanding the political economy. The causes of inflation are numerous; for example, rising costs of imports of raw materials, rising labor costs, higher indirect taxes, and monetary policies, all of which have the effect of raising costs. While these are causes of inflation related to costs, inflation can also result from a greater demand for goods and services relative to supply; as shortages develop, sellers raise prices. Inflation can also be a direct outcome of poor economic and, in particular, monetary policy decisions, distorting the entire vector of relative prices in an economy. As mentioned earlier, inflation impacts society's

poor and vulnerable more severely, and is thus a key determinant of how governments view public policies that have significant cost implications.

- ii. **Corruption.** The term is used in varied senses, although the consensus is that this refers to a range of illegal activities, and that the focus is on abuse of public power for personal gain;⁴ it also includes public and private sector officials misusing their positions to illegally enrich themselves. In that regard, the term is not confined to merely one type of corruption, such as financial. Some types of corruption are also internal to an agency (for example, on inefficient use of resources) while others are external (that is, involving the agency's clients and customers). This is an important variable in the study of political economy since it not only directly addresses any "leakage" in the economy (for example, revenues lost because collection of taxes is compromised) but also a government's weak political mandate to continue to govern.

- iii. **Business environment.** Earlier, the term was presented in terms of how government policies affect private sector views of the favorability of doing, and expanding, business in a country. Private sector confidence in the enforcement of contracts is crucial to this given that much of business is predicated on the effective fulfillment of contracts. Also related to business environment is the ease and cost of doing business: the higher such costs are, the less appealing the business environment in the country is.

- iv. **Public management.** Given that the scope of the concept of public management inherently contains

⁴ This notion of abuse of power is contained in the definition used by Transparency International (TI) as well. TI operationally defines corruption as the "misuse of entrusted power for private gain" (source: www.transparency.org/news_room/faq/corruption_faq). TI further differentiates between corruption that is "according to rule" (such as facilitation payments to receive preferential treatment) and corruption that is "against the rule" (such as bribes to obtain services that are prohibited from being provided).

within it the policy making and policy implementation functions of government, a corollary issue for consideration has to be the extent of the government's role in the economy. Public management includes functions such as civil service, budgeting, and financial management, all of which feature in how governments try to manage and manipulate the economy. There is also a political aspect to this manipulation given that public management helps governments attain higher-level public policy and/or political goals.

C. Definitions of Key Terms

6. Governance. This term has been defined in numerous ways, but as used here means simply, "the exercise of political power to manage a nation's affairs."⁵ An associated term, "malgovernance," is also used to denote the absence of good governance in the country. Good governance has several benefits: (i) Economically, it directly contributes to an enhancement of GDP; (ii) Politically, it allows service providers to be made more accountable for their actions, and these actions are much more transparent;

(iii) Morally, it fulfills a bargain between service users and providers in that the relationship is one based on trust and openness, and a virtuous value system is possible in the relationship.

7. Political economy. This term refers basically to the interactions—and relationships—between politics and the economy, that is, in the context of how governments make policies (as well as the policies themselves) and how economic considerations determine the nature of politics. In other words, political economy refers to how politics is constrained by economic factors and vice versa.

8. Risks. Risks are simply the uncertainty of outcomes, their severity determined by the combined likelihood of occurrence and the degree of possible impact. Determination of risk severity thus tends to be subjective since likelihood and impact are a function of the perception of the risk assessor. The questions for government in dealing with risks in policies become the following: Given a particular vector of risks in the program—with x level of severity of the risks, and y level of risk appetite of the government—should it proceed with a policy or program? If so, how should the risks be mitigated?

⁵ Landell-Mills, P., and I. Serageldin. 1991. Governance and the Development Process. *Finance & Development*, 28 (3). pp. 14–17. For its part, ADB identifies four elements that constitute the core of governance: accountability, participation, predictability, and transparency (for a brief review of the various definitions, and how there is some confusion in this regard, see, for example, Landman, T., J. Bewsher, and E. Carvalho. 2007. *Preliminary Survey on Donor Use of Governance Assessments*. University of Essex/UNDP). Unbundling the notion of governance points to these components: (i) structure of government; (ii) political accountability; (iii) active and independent civil society; (iv) public sector management, including civil service, budgeting, and financial management; and (v) competitive private sector. (For a discussion of these components, see Gray, C. 2002. *Reforming Governance: World Bank Experience to Date*. World. March).

2. Regional Picture

9. It is instructive to see the performance of the four countries with respect to selected variables. The paper concentrates on (i) GDP per capita; (ii) FDI; (iii) business climate; (iv) corruption; and (v) the HDI.⁶

A. Economy

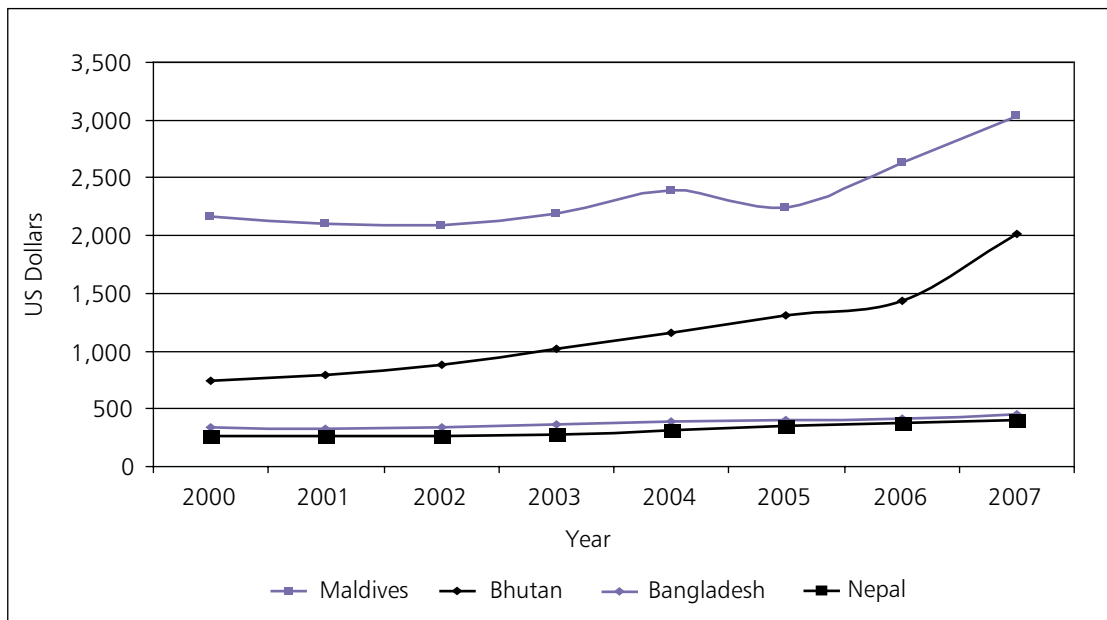
10. **Gross domestic product per capita.** Figure 1 shows two specific trends:

- i. The Maldives has always had the highest GDP per capita in South Asia and, as with Bhutan, the level is increasing faster than for Nepal and Bangladesh.

- ii. Nepal and Bangladesh continue to lag, with low GDP per capita and low growth.

11. **FDI.**⁷ Table 1 shows data related to FDI in the four countries. While only Bangladesh has managed to attract significant FDI, the level has tended to decline in recent years, a trend that could continue given the current global economic slowdown. In the other three countries, even though levels are increasing, they remain very low and insignificant. In Bhutan, FDI is low because opportunities for private investment are themselves low, although the situation has begun to improve in recent times. The numbers for Nepal are rather

Figure 1: Gross Domestic Product Per Capita of Bangladesh, Bhutan, the Maldives, and Nepal



Sources: Economic reports from ministries of finance in each of the four countries.

⁶ The other variables specified in para. 4, but not included here, are discussed with reference to specific country situations later in the report.

⁷ This is included here as a proxy for the degree of stability and economic opportunities that countries present to investors, that is, the degree to which investors see the political economy and governance as conducive to investment.

Table 1: Net Foreign Direct Investment Inflows FY 2005–2008 (\$ million)

Country	FY2005		FY2006		FY2007		FY2008	
	Net	% of GDP	Net	% of GDP	Net	% of GDP	Net	% of GDP
Bangladesh	800	1.3	743	1.2	793	1.2	650	0.8
Bhutan	9	1.2	6	0.7	73	7.0	30	2.2
Maldives	10	1.3	14	1.5	15	1.4	16	1.3
Nepal	2	0.0	(6)	(0.1)	5	0.0	5	0.0

() = negative, FY = fiscal year, GDP = gross domestic product.

Source: ADB. 2009. *Asian Development Outlook 2009*. Manila.

tentative, but reports from the central bank confirm the reversal of the negative FDI trends. Projected FDI increases in Nepal are based on the assumption that the constitution-making process will proceed smoothly and that political stability will continue.

B. Business Climate

12. The World Bank reports that South Asia is the second-least business-friendly region in the world, after Sub-Saharan Africa, based on its Doing Business 2008 survey of the perceptions of foreign investors in 178 countries.⁸ As shown in Table 2, all four countries slipped in the rankings (albeit only marginally but still not a very promising indicator to encourage the private sector to participate in the economy). These deteriorating rankings are derived from foreign investor perceptions of poor infrastructure, restrictive labor policy and labor unrest, political uncertainties and civil conflicts, weak regulatory systems, and corruption.

13. Perceptions of the ease of doing business are also associated with the total tax rate as

Table 2: Global Ranking of the Ease of Doing Business (2007–2009)

Country	2007	2008	2009
Bangladesh	102	104	110
Bhutan	122	122	124
Maldives	58	68	69
Nepal	104	111	121

Source: World Bank, Washington, DC (for 2007, www.doingbusiness.org/documents/DB-2008-overview.pdf; for 2008 and 2009: www.doingbusiness.org/CustomQuery/ViewCustomReport.aspx)

a percentage of profit. Table 3 breaks down this total tax rate for the four countries into three subsets: (i) profit tax, (ii) labor tax and contributions, and (iii) other taxes.

C. Corruption and Good Governance

14. Table 4 shows the level of corruption (as measured by Transparency International on a corruption perceptions index [CPI])⁹ in the four

⁸ The Doing Business Survey defines several key terms under the broad heading of “ease of doing business” as follows: (i) starting a business (“procedures, time, cost, and paid-in minimum capital to open a new business”), (ii) dealing with construction permits (“procedures, time and cost to obtain construction permits, inspections and utility connections”), (iii) employing workers (“difficulty of hiring index, rigidity of hours index, difficulty of firing index, firing costs”), (iv) registering property (“procedures, time and cost to transfer commercial real estate”), (v) getting credit (“strength of legal rights index, depth of credit information index), (vi) protecting investors (“strength of investor protection index, extent of disclosure index, extent of director liability index, and ease of shareholder suits index), (vii) paying taxes (“number of tax payments, time to prepare and file tax returns and to pay taxes, total taxes as a share of profit before all taxes borne”), (viii) trading across borders (“documents, time and cost to export and import”), (ix) enforcing contracts (“procedures, time and cost to resolve a commercial dispute”), and (x) closing a business (“recovery rate in bankruptcy”).

Source: www.doingbusiness.org/documents/DB09Easeofdoingbusinessrankmethod.pdf

⁹ The CPI—a poll of polls based on several international surveys—assesses the degree to which public officials and politicians in particular countries are perceived to be involved in corrupt practices. Countries perceived to be the least corrupt are given the highest scores out of 10, such that the CPI score ranges from 10 (highly clean) to 0 (highly corrupt).

Table 3: Total Tax Rates

Country	Profit Tax (%)	Labor Tax and Contributions (%)	Other Taxes (%)	Total Tax Rate (% of profit)
Bangladesh	30.3	0.0	9.2	39.5
Bhutan	34.2	1.1	4.4	39.8
Maldives	0.0	0.0	9.1	9.1
Nepal	20.0	11.3	1.3	32.5

Source: World Bank. 2008. *Doing Business Survey, 2008*. Washington, DC.

Table 4: Corruption Perceptions Index, 2006–2008

Country	2006		2007		2008	
	CPI score	CPI ranking	CPI score	CPI ranking	CPI score	CPI ranking
Bangladesh	2.0	156	2.0	162	2.1	147
Bhutan	6.0	32	5.0	46	5.2	45
Maldives	—	—	3.3	84	2.8	115
Nepal	2.5	121	2.5	131	2.7	121

— = not available or applicable.

Source: Transparency International, Berlin, CPI surveys for 2006, 2007, and 2008.

countries. Only the Maldives failed to raise its ranking in 2008.¹⁰

D. Human Development Index Trends

15. Table 5 shows that the Maldives continues to have the highest ranking in the HDI among the four countries. However, Bhutan has

managed to substantially increase its score over the years.

16. Paras. 17–61 look at governance and political economy in Bangladesh. Paras. 62–106 discuss these issues in Bhutan. Paras. 107–146 look at the case of the Maldives, while paras. 147–182 take a look at Nepal.

¹⁰ By way of comparison, the scores of the top three countries in 2006 were 9.6 for Finland, Iceland, and New Zealand; in 2007, 9.4 for Denmark, Finland, and New Zealand; and in 2008, 9.3 for Denmark, New Zealand, and Sweden. As for the bottom three, in 2006, Sudan scored 2.0, Guinea 1.9, and Iraq 1.9; in 2007, Tonga scored 1.7, Haiti 1.6, and Iraq 1.5; and in 2008, Afghanistan scored 1.5, Haiti 1.4, and Iraq 1.3. The scores for the other countries of South Asia not included in this report are as follows:

Table 5: Human Development Index Trends

Country	Year							Rank in 2005 (out of 177 countries)
	1975	1980	1985	1990	1995	2000	2005	
Bangladesh	0.347	0.365	0.392	0.422	0.453	0.511	0.547	140th
Bhutan ^a	—	—	0.325	0.427	0.521	0.550	0.579	133rd
Maldives ^b	—	—	—	—	0.612	0.683	0.741	100th
Nepal	0.301	0.338	0.380	0.427	0.469	0.502	0.534	142nd

— = not available or applicable.

^a Data for Bhutan is for 1984, 1991, 1994, 1998, and 2005 respectively; the data for 2005 is from the United Nations Development Programme (UNDP).

^b Data for the Maldives is for 1997, 1998, and 2005 respectively; the data for the first two years is from UNDP. 1998. *Human Development Report, 1998*. New York.

Sources: UNDP. 2007. *Human Development Report 2007*. New York; data for Bhutan from Planning Commission Secretariat. 2000. *Bhutan National Human Development Report, 2000*. Thimphu.

Top and Bottom 5	Years, Countries, and CPI Scores					
	2006		2007		2008	
Other South Asian countries – [rank in ()]	India (70th)	3.3	India (72nd)	3.5	India (85th)	3.4
	Sri Lanka (84th)	3.1	Sri Lanka (94th)	3.2	Sri Lanka (92nd)	3.2
	Pakistan (142nd)	2.2	Pakistan (138th)	2.4	Pakistan (134th)	2.5
	Afghanistan	—	Afghanistan (172nd)	1.8	Afghanistan (176th)	1.5

— = not available or applicable.

Source: Transparency International, various years.

3. Bangladesh

A. Background

17. Though prone to costly natural disasters,¹¹ and despite the naysayers, it has been said that Bangladesh can be a middle-income country by 2016 if it sustains high single-digit gross domestic product (GDP) growth until then.¹² This is not necessarily a tall order if the political process can be geared toward this objective. It is this impact of politics and of politicization of the social and economic life in Bangladesh that most characterizes its development trend.

18. For all its recent rather impressive economic performance, the country continues to be defined by an absence of good governance, and economic growth and poverty reduction are still frustrated by a lack of accountability, transparency, and predictability in the way government operates (that is, by poor governance). Indeed, in the public sector, personal greed has often been tended to be placed above public interests, which, at times, has led the country to the edge of failed statehood.¹³

B. Recent Political Developments

19. Parliamentary democracy was reinstated in Bangladesh in 1991 following the ouster of the autocratic military government by a mass

movement. Parliamentary government was established and all powers previously vested in the president were transferred to the prime minister; the president is the head of state, and the prime minister is the head of the government. Legislative powers are vested in Parliament.¹⁴

20. Four successive parliamentary elections have been held since 1991. These elections have ensured the emergence of parliamentary democracy and provided for a process of peaceful transfer of power, as witnessed by the formation of government by the two major political parties—the Bangladesh Nationalist Party (BNP) and Bangladesh Awami League—in 1991, 1996, and 2001. Parliamentary elections were scheduled for January 2007 but were deferred until December 2008 because of problems such as huge errors in the voters' list (the new voter list exposed about 15 million fake and duplicate voters in the old one), sparking mass protests by the opposition parties. The country came to a standstill, resulting in the imposition of a state of emergency under the constitution and the establishment of a caretaker government (CTG) in early 2007.

21. A large part of the problem in political governance relates to low internal accountability and transparency: the government apparatus

¹¹ For example, cyclone Sidr that hit southern Bangladesh in 2007 cost the country \$1.4 billion (or 2% of GDP) in damages and more than a thousand lives. Bangladesh also has to contend with devastating annual floods.

¹² Indeed, Goldman Sachs several years ago listed Bangladesh as one of the 11 developing countries that could rival the Group of 7 (G7) countries over time (Goldman Sachs. 2007. Global Economics Paper. No. 153. New York. 28 March). The other countries mentioned in the "Next 11" (or the N-11) were Egypt, Indonesia, Iran, Korea, Mexico, Nigeria, Pakistan, the Philippines, Turkey, and Viet Nam. JPMorgan Chase have also named Bangladesh one of the "Frontier Five" markets worth investigating for investments, along with Kazakhstan, Kenya, Nigeria, and Viet Nam (JP Morgan Chase. *From Ho Chi Minh Trail to Mexico*. New York. April 2007). Indeed, some have looked at Bangladesh as it is now and said it is "probably the best reform story in Asia" (*International Herald Tribune*. 2007. Around the Markets. 9 October).

¹³ For example, in 2006, Bangladesh was rated one of 20 states most at risk of failure (*Foreign Policy*. 2006. The Failed States Index. May/June). The situation since then, particularly after the December 2008 elections, has been a strong positive response to this adverse assessment.

¹⁴ Parliament has 48 committees, but during the last administration these were not formed in time, interfering with their oversight functions. For example, in the last seven parliaments, the Public Accounts Committee has been formed only five times, resulting in a backlog of audit reports to be reviewed and debated.

is often politicized as a result, leading to inadequate appreciation of differing points of view. And in the absence of adequate checks and balances, decisions are often taken without adequate consensus.

22. After the CTG made substantial political reforms—such as separating the judiciary, promulgating a Right to Information Ordinance, giving greater autonomy to the Anticorruption Commission, setting up a national election architecture with a new photo-attached voter list, national identification for all registered voters, and setting new regulations requiring mandatory registration of all political parties to participate in the election—national elections for Parliament were held in December 2008 after a hiatus of two years. Voter turnout in the peaceful and credible elections was 87%, while thousands of local and international election observers representing the United States of America (USA), the European Union, and Commonwealth countries attested to its fair and impartial conduct and that the verdict reflected the will of the people. Although the BNP alleged that the CTG allowed widespread rigging and “election engineering” to help the Awami League win, it has joined Parliament and given necessary support to the government as a responsible opposition. These are signs that the CTG’s governance and electoral reforms will bring political stability. But the onus is now on the Awami League leadership to allow the parliamentary and outside opposition to play their due role and not follow the “winner-takes-all” policy as the pre-CTG regime did.

C. Recent Economic Performance

23. **Gross domestic product growth.** Growth has averaged above 6% in the last several

years, hitting 6.6% in 2006, 6.4% in 2007, and 6.2% in 2008, but is forecast to ease to 5.6% in FY2009.¹⁵ Lower growth in 2007 and 2008 are due to (i) more moderate agricultural growth following the post-flood high growth of FY2006,¹⁵ (ii) extensive flooding during July–September 2007 and a devastating cyclone in mid-November 2007, and (iii) a slowdown in external demand for ready-made garments (RMGs). Impressive economic growth since the mid-1990s, nonetheless, saw the poverty rate fall to 40% by 2005 from 50% in 1995.

24. **Inflation.** This has accelerated in recent years, reaching 7.2% in FY2007 and 10.0% on a 12-month moving average basis in March 2008, with rises in food and nonfood prices.¹⁶ Inflationary pressures have been fueled by (i) rising domestic demand aided by steady GDP expansion and continued high monetary growth, (ii) higher food and commodity prices, and (iii) shortfalls in crop production due to natural disasters. In recent months, however, inflation seems to be tapering off and the projection for FY2009 is 7.0%. Basic food prices have been more or less stable and nonfood inflation (point-to-point) was less than 3.4% in the second half of 2008.

25. The earlier rise in food prices, nonetheless, tested the political will of the CTG. Rice prices (a country staple) rose in 2007 and part of 2008,¹⁷ and the situation had been dire indeed. By early 2008, steep increases in food prices hurt millions of poor people,¹⁸ and food price inflation (termed “agflation”)¹⁹ was considered “arguably the greatest problem facing the country today”. Food prices have since come down (and the CTG weathered the storm), but there are political implications and the new government will have to tackle the structural

¹⁵ ADB. 2009a. *Asian Development Outlook 2009*. Manila.

¹⁶ Footnote 15.

¹⁷ The president of the United Garment Workers Federation at the time summed up the situation thus: “If it weren’t for emergency rule, there would be revolution right now.” (Food Prices Leave Bangladesh at Risk. 24 May 2008. www.islamonline.net/servlet/Satellite?c=Article_C&pagename=Zone-English-News/NWELayout&cid=1209357868912). Observers have called this the worst food shortage since the major famine of 1974. From 2007 to 2008, prices nearly doubled, and the poor were spending almost four fifths of their budget on food (*The Daily Star*. 2008. WFP Fears Political, Social Unrest for Price Hike. 19 March).

¹⁸ Rahman, J. 2008. Of Food and Fuel. *The Daily Star*. 3 (2). February.

¹⁹ *The Economist*. 2007. Agflation: Food Prices – the End of Cheap Food. 6 December.

issues of agflation head-on if the adverse impacts of such price rises are to be contained on a sustained basis.²⁰

26. **Fiscal issues.** Although Bangladesh has carried out fiscal reforms in recent years, revenues have tended to remain weak. Its total revenue base was 10.3% of GDP in FY2007 and the recent trend remains on the low side. In FY2008, revenue collection jumped to 11.2% of GDP, but because expenditure is also expected to increase (for development spending primarily but also for subsidies for food, fuel, and others), the fiscal deficit is expected to reach 5% of GDP in FY2008. This raises the pressure for a significant increase in revenue collection to allow higher development spending without creating unsustainably high fiscal deficits.

27. A bright spot for Bangladesh in recent years has been remittances from overseas workers (Table 6).²¹ Nonetheless, boosting revenues requires major reforms in the tax system and tax laws.

28. Remittances rose as record numbers of Bangladeshis went abroad (981,102 in FY2007, about 74% higher than the previous fiscal year). Also, nonresident Bangladeshis sent about \$2.35 billion to Bangladesh from July to

September 2008, compared to \$1.63 billion in the same period of the previous fiscal year. Remittances remain high despite the global economic slowdown, mainly in the USA and European countries, but if the crisis continues it would have a negative impact.

29. Ready-made garments exports are another substantial source of revenue,²² and the sector has managed to do well even as the cost of doing business in Bangladesh, particularly in the garment sector, has risen by 15% in the past 2–3 years.²³ Manufacturers have been able to increase earnings in ready-made garment exports largely by raising export volume. Other favorable factors have included better negotiations with international buyers, and production of high value-added items. In the long term, however, unless structural issues in the sector are addressed in a sustainable manner, the costs of doing business are likely to increase disproportionately. Structural issues that need immediate attention include better infrastructure and plant machinery, and labor issues.

30. Revenue increases in specific sectors notwithstanding, expenditure levels are also increasing, largely in response to natural disasters, but also because of public sector undertakings. As such, in terms of constraining

Table 6: Level of Remittances to Bangladesh

Item	FY2006	FY2007	FY2008
\$ value of remittances (in millions)	4,801.88	5,978.47	7,914.78
% change	—	24.50	32.38
% of GDP	6.89	8.83	10.02
% of exports	45.62	49.09	56.09

— = not available or applicable.

Source: Ministry of Finance, Government of Bangladesh. www.mof.gov.bd/mof2/budget/mfmu/mfmu_july_08.pdf

²⁰ In keeping with its election manifesto, the Awami League government, upon assuming office, immediately expressed its intention to strengthen the price monitoring cell in the Commerce Ministry as a way to address the issue of rising prices for essentials. The government has said it will do all it can to ensure that the prices are kept steady, including, if necessary, by considering the profit margin.

²¹ While remittances do not go into the treasury, they have associative implications for the availability of credit in the economy (and, therefore, availability of funds for investment) given that the level of bank deposits will undergo an upward shift.

²² According to the Export Promotion Bureau, out of total exports worth \$14.110 billion in FY2007, woven and knitwear alone (the two ready-made garment subsectors) fetched \$10.699 billion in the previous fiscal year.

²³ Among the main reasons for this increase are erratic gas and power supplies, higher freight charges, the yarn price hike, implementation of the minimum wage for workers, higher transport costs, and higher prices of machinery (Export Price Index Edges Up 5.28 pc, Bangladesh. 12 October 2008. www.tg-supply.com/article/view.html?id=27866).

expenditures, the government needs to be mindful of the losses of state-owned enterprises (SOEs) and associated quasi-fiscal obligations that pose a significant fiscal risk. For example, the losses of Bangladesh Petroleum Corporation (BPC) in FY2007 were estimated at \$460 million, and unless relevant price adjustment mechanisms are put in place, the situation is expected to worsen. The same is true of the nonperforming loans of nationalized commercial banks (despite improvement, gross nonperforming loans of the banks remain high at 13% as of June 2008).

31. Natural disasters too have raised spending. Presenting the annual budget for 2008–2009, the finance advisor pointed out that, in the budget, there was a 48% increase in the costs of the safety net program (in the form of transfer payments and subsidies) and a 60% increase in the number of people being supported as a result of the calamities (Figure 2).

32. **Business environment.** The work of the CTG notwithstanding, the general perception of the business environment in Bangladesh is that it has worsened in recent years. While the CTG emphasized the work of the Bangladesh Better Business Forum²⁴ and the Regulatory Reform Commission, the business sector feels that considerable red tape remains and

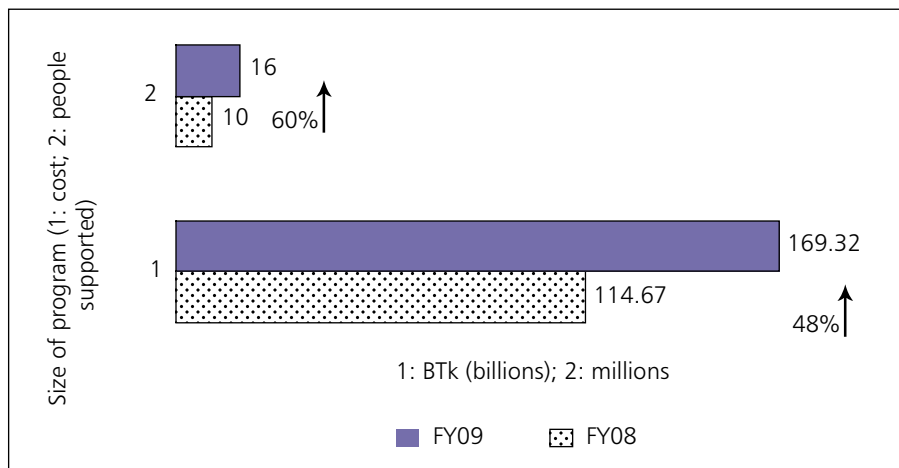
that quick decision making on business and investment is difficult. Still, given the election manifesto of the Awami League, there is hope that the business climate will be more open, political space will be opened up considerably, and internal democracy in political parties will continue to be strengthened.

33. The World Economic Forum’s Global Competitiveness Report for 2008–2009 reflects a declining trend in the competitiveness of Bangladesh in the global economy (Table 7).

34. The picture is reinforced from the rankings inherent in the World Bank’s *Doing Business Report* and the global investment indices of the United Nations Conference on Trade and Development (UNCTAD). In both, Bangladesh ranks fairly in the middle rung among South Asian countries when it comes to many of the indicators used. Interestingly, however, Bangladesh is ranked highest in the region for protecting investors, although it also has the least impressive processes in South Asia related to starting a business, registering property, and enforcing contracts.

35. Largely in response to this, the Bangladesh Better Business Forum has been active recently, and the government has proposed that it be strengthened by bringing it under

Figure 2: Increase in Safety Net Program



Source: 2008–2009 budget, Government of Bangladesh.

²⁴ Government and the private sector created the forum in November 2007 to strengthen processes and policies on investment and trade. Its secretariat is attached to the Board of Investments. It is not clear yet, however, what specific role the forum will have under the new government.

Table 7: Bangladesh Rank in Competition

	2006–2007	2007–2008	2008–2009
Rank	92nd	107th	111th
Number of countries surveyed	122	131	134

Source: World Economic Forum, *Global Competitiveness Report*. Geneva. Various years.

a permanent administrative structure (most likely the Board of Investment). However, this may not necessarily be the right measure as a bureaucratic arrangement may well stifle the independent and out-of-the-box thinking that would ensure innovative recommendations. To date, five Bangladesh Better Business Forum's working committees have recommended 290 measures to improve business in the country, of which 94 have already been implemented. Those that have been implemented include simplification of import-export forms, creation of an endowment fund for the agriculture sector, rationalization of letters of credit charges of local and foreign banks, and others.

D. ADB's Operational Strategy in Bangladesh

36. The operational strategy of the Asian Development Bank (ADB) in its development efforts in Bangladesh has revolved around three key outcomes:²⁵ (i) sustainable economic growth, (ii) social development, and (iii) good governance. Its interventions to achieve these outcomes focus on private sector development, capacity building, regional cooperation, and gender and environment considerations. Current operations take into account the potential risks identified in the country strategy, and are generally in the areas of supporting investments and establishing policy and institutional reforms in energy, transport, education, and integrated urban infrastructure (including urban health, water supply, and transport).

37. ADB also still supports the small and medium-sized enterprises and financial sectors,

while it is scaling up support for agriculture, rural infrastructure, and irrigation to help boost agricultural productivity and domestic food production. ADB has also implemented a strategy of mainstreaming concerns about disaster induced by climate change into all development projects through mitigation and cost-effective adaptation measures. Finally, ADB is assisting the private sector to play an increasingly important role in infrastructure.

38. In the area of governance and finance, ADB's operational strategy supports government efforts to improve core governance (such as by combating corruption and improving access to justice). Technical support to strengthen the institutional capacity of the Anticorruption Commission (ACC), implement a national integrity strategy, and enhance governance management capacity is also a key feature of its operations. To a logical extent, this has also meant integrating governance concerns into its sector operations and intensifying assistance for improving urban and rural local governance by building local government capacities for planning and delivering local services and infrastructure development.

E. Emerging Issues in Governance and Political Economy

39. In considering these emerging issues, it is useful to highlight three specific areas that will determine the macro context of how Bangladesh weathers internal systemic weaknesses: (i) political party reforms, (ii) reforms in public sector management, and (iii) the continued fight against corruption and malgovernance.²⁶

²⁵ ADB. 2005. *Country Strategy and Program: Bangladesh (2006-2010)*. Manila. October.

²⁶ Two particular proxies for measuring malgovernance in the country can be seen in the terms *hartals* (strikes) and *hairani* (harassment). Until early 2007, when the CTG took over, UNDP estimated that 3%–4% of GDP/year was lost as a result of hartals. A Power and Participation Research Center report gives a discussion of how *hairani* is used as a measure of malgovernance (Power and Participation Research Center. 2007. *Unbundling Governance: Bangladesh Governance Report*. Dhaka).

1. Political Party Reforms

40. Since 2007, there has been a concerted move to get the major political parties to reform internally, with the lack of democracy and transparency within party machinery considered a root cause of the political problems. But of late, there are encouraging signs that at least the two biggest political parties are beginning to rethink internal governance. The Awami League, for example, has come up with a plan to pick candidates from panels elected by grassroots-level committees, and will devolve authority for nominating the candidates from the top leadership to the field level. Its political manifesto also speaks of the disclosure of wealth records of its legislators and their family members.²⁷ In October 2008, the BNP prepared a provisional charter clipping the absolute authority of the BNP chairperson to form the party's standing and executive committees. Henceforth, members of the two crucial bodies will be elected at national councils.²⁸ Also trimmed was the power of the party chief to unilaterally expel anyone from the party and to dissolve or reconstitute any committee he or she chose.

41. The Election Commission implemented significant electoral reforms in 2008, including amendments to the "Representation of the People's Order, 1972" (as amended in 2008), and promulgation of "Political Party Registration Rules 2008", and the "Code of Conduct for Parliament Election, 2008". These laws and regulations brought about major changes in the electoral process, which include (i) the oversight of rules governing party funding, (ii) publicizing the level of donations and sources of party revenue, (iii) public disclosures on eight important information components regarding educational qualifications and antecedents by political candidates both before and after elections, and (iv) imposing a ban on the use of state resources for political purposes. Proposals have also been made to disassociate professional and student bodies from political

parties as a requirement for registration. Parliamentary elections held in December 2008 saw an impressive outcome of the electoral reforms, which were largely observed and implemented by all the political parties and others. But unless such reforms are carried out on an institutional basis across all political parties, they will be incomplete.²⁹

2. Reforms in Public Sector Management

42. The reforms undertaken so far to improve public sector management need to be continued and enhanced if Bangladesh is to better manage its economy in the years to come. Three aspects of public sector management merit mention here: (i) corporatization or privatization, (ii) civil service reforms, and (iii) local government.

a. Corporatization and Privatization

43. Bangladesh has seen some significant progress in this area. For example, privatization of port operations at the Chittagong container terminal and related measures had, by the end of 2007, substantially eased container congestion by reducing the vessel turnaround time from 12.0 to 2.4 days, and the port dwell time for containers from 25.0 to 16.5 days, thereby reducing the cost of container handling by 30%. Chittagong Port Authority revenues consequently increased from \$105 million in FY2006 to \$119 million in FY2007 (not necessarily a substantial increase but a significant one nonetheless). The government also made the Public Procurement Act 2006 and Public Procurement Rules 2008 effective from 31 January 2008.

44. The government also transformed the state-owned telecom giant—Bangladesh Telegraph and Telephone Board—into a public limited company, renaming it the Bangladesh Telecommunications Company Limited. The aviation industry, which was once dominated by a state-owned monopoly, has had participation

²⁷ However, its appetite for reforms has yet to go further. Its refusal to delink its student, labor, and professional fronts minimizes the impact of the reform process.

²⁸ In what can only be seen as a telling twist to this, a day later it was announced that only three people in the BNP were privy to these changes that were recommended and shared with the Election Commission. (*The Daily Star*. 2008. Only 3 in BNP Saw Revised Charter. 22 October).

²⁹ This point was brought home very poignantly immediately prior to the national elections in December 2008. Even as political party reforms were continuing, it was reported that more than a third of those who filed nomination papers for the elections had neither paid income tax nor had any tax identification number (*The Daily News*. 2008. 35 pc Aspirants Pay No Tax or Lack TIN. 8 December).

and investment from private operators. Finally, the government restructured Biman Bangladesh Airlines into a public limited company by selling shares through the capital market, which eased a significant portion of the government's budgetary burden.

45. Despite this, losses of SOEs continue to be a drag on the economy (reaching 3% of GDP in FY2008). In FY2008, the net losses of all 44 nonfinancial SOEs more than doubled to an estimated \$769.2 million (or about 1% of GDP), primarily reflecting administered prices of products and services, especially fuel, power, and fertilizer.³⁰ Losses were concentrated in four main SOEs: the BPC,³¹ the Bangladesh Chemical Industries Corporation, the Power Development Board, and Biman Bangladesh Airlines. Budgetary transfers covered around three fifths of these losses, while bank credit and arrears covered the rest (see Table 8).

46. The regulatory environment has now improved in various sectors, as demonstrated by the fact that three nationalized commercial banks have been transformed into public limited companies and four state-owned power and oil companies are listed on the stock exchanges. To streamline and upgrade the business regulatory framework, the government constituted a regulatory reforms commission. It also streamlined procedures for

land registration and labor export, and set up the Small and Medium Enterprise Foundation to pay greater attention to the needs of small and medium-sized enterprises.

47. Despite these measures, the private sector in Bangladesh still sees considerable scope for improving the enabling conditions that can enhance the ease of doing business. From Table 2, the country's rank in recent years has decreased. And even though it did perform better than the other countries in carrying out key reforms—such as reducing the time it takes to pay taxes or concentrate on legal rights—the private sector would also like to see the government focus on specific areas, including starting a business, securing necessary permits, registering property, improving labor employment, and enforcing contracts.

b. Civil Service

48. While the CTG emphasized other areas, core civil service reforms did not appear to be high on its agenda. In addition, despite sporadic public sector reform efforts, the civil service remains politicized,³² relatively ineffective and unaccountable, and lacks proper motivation due to a weak incentive system. The highly centralized political and administrative system weakens the government's capacity to deliver and monitor services effectively. The Public Service Commission

Table 8: Losses of Key SOEs in FY2008 (% of GDP)

	Total Losses	Budget Transfer
Bangladesh Petroleum Corporation	1.3	0.9
Bangladesh Chemical Industries Corporation	0.5	0.2
Power Development Board	0.8	0.7
Biman Bangladesh Airlines	0.4	0.1
Total	3.0	2.0

Source: International Monetary Fund. 2008. *Bangladesh: Staff Report for the 2008 Article IV Consultation*. Washington, DC. October. p. 13.

³⁰ ADB. 2008. *Asian Development Outlook 2008 Update*. Manila.

³¹ The BPC, however, has reaped huge benefits from the government's decision not to roll back fuel price hikes instituted when oil prices were \$147 a barrel in July 2008. BPC is currently making a huge profit selling its existing stock of imported oil procured in late November 2008 at \$55 (crude) and \$70 (refined) per barrel (Bangladesh Petroleum Corporation [BPC] Nets Staggering Profit as Fuel Price Not Adjusted. 12 January 2009. <http://blog.bauani.org/2009/01/bangladesh-petroleum-corporation-bpc.html>).

³² See, for example, *The Daily Star*. 2007. TI Global Corruption Report, 2007: Politicization Major Reason for Judicial Graft in Bangladesh. 5 (1059). 25 May.

(PSC)—the body responsible for recruitment into the Bangladesh civil service—itself has been accused of a lack of transparency.³³

49. One thorny governance issue the new government needs to tackle head-on is a review of the quota system in the civil service. At present, the quota system for both cadre and noncadre posts has merit posts weighted at a mere 45%, while district-based quotas include freedom fighter's children at 30%, females at 10%, tribal at 5%, and general at 10%. The PSC working paper shows a need for urgent review of this situation, suggesting the merit quota should be a minimum of 50% and a maximum of 70%. According to PSC sources, the quota for freedom fighters has largely remained unfilled in past decades due to a lack of qualified candidates. Given this, the proposal is to reduce this to a maximum of 10%. The same report also recommends increasing the quota for women from 10% to 15%. Making the changes, however, will require considerable political commitment, which no government to date has managed to exhibit.

50. As far as government processes themselves are concerned, implementation processes remain slow, suggesting an urgent need to rethink government business processes throughout. Only 13% of the Annual Development Program has been implemented in the first four months of FY2008, about the same as in the same period of the previous fiscal year (11%).³⁴ The new government has optimistically stated that it would manage to implement 90% of the Annual Development Program by the end of the fiscal year. This seems to be a tall order; the current figure in the first seven months of the fiscal year is a

mere 31%. Revenue expenditure, on the other hand, is faster, signifying that nondevelopment expenditures (for example, interest payments, wage bills, and others) remain biased.³⁵

c. Local Government

51. Before the end of its tenure, the CTG had established a Local Government Commission by ordinance in October 2008. The functioning of all local government institutions, which were under the direct control of the Ministry of Local Government and Rural Development and Cooperatives, were to now come under the commission. The commission was also given authority to investigate any alleged financial and administrative irregularities in local government bodies and thus support the Anticorruption Commission in its work. This was significant since it introduced in Bangladesh, for the first time, an effort to devolve governance.

52. However, the incoming Awami League government did not submit the relevant ordinance for ratification by Parliament,³⁶ thus technically making the Local Government Commission defunct and signaling a need for more debate about how local governments can be made more effective. The core of the debate is that local governments need to be given greater authority for development work; how exactly this should be done is still far from certain.

53. In this respect, one of the first moves by the new government to ensure that control over local development will be in the hands of the elected members of Parliament rather than elected local government functionaries has generated some concern.³⁷ The proposal means members of Parliament will have an advisory

³³ See, for example, *The Daily News*. 2007. Probe Corruption in PSC, Bring Culprits to Book: Speakers Tell TIB Roundtable. Dhaka. 23 March. There were also charges in the past against the PSC of tampering with recruitment processes for entry into the civil service.

³⁴ Worryingly, fully half of the 48 ministries and divisions had spent zero to a mere 6% of their allocations.

³⁵ A large part of this has been explained by observers in Bangladesh as a case of a "wait and see" attitude of the bureaucracy to the shape of the incoming government, and the fact that there is rather little political pressure from the CTG, occupied as it was with conducting the elections.

³⁶ The CTG had come up with three ordinances with respect to local governments: (i) Local Government (City Corporation) Ordinance, (ii) Local Government (Municipality) Ordinance, and (iii) Local Government (Upazila Parishad) Ordinance. The new government had expressed its intention to put up for parliamentary ratification only the first two. The relevant ministry is currently drafting a fresh bill on upazila parishads without the requirement to have the chairman- and vice-chairmen-elect of upazila parishads to resign from their party posts before taking the oath of office in the upazila parishad.

³⁷ See, for example, *The Daily News*. 2009. Editorial: Effective local government still a far cry? 19 February.

role in local development, raising the fear that they will interfere with the functions of the *upazila* (subdistrict) chairman and perpetuate their hold over local development.

3. Anticorruption Efforts

54. Corruption is the single most telling indicator of malgovernance in Bangladesh, and for the first five years of the 2000s, the country ranked at the bottom of the Transparency International index (Figure 3). The CTG tried to address this problem in a concerted manner, and while some success was achieved, there is still much to be done.³⁸ As of early October 2008, 267 people (including 229 government officials) had applied to the Truth and Accountability Commission (TAC) to confess to graft, 40 of them depositing Tk87.3 million with the state exchequer. That said, only lower-ranking government employees voluntarily disclosed their ill-gotten wealth.³⁹

55. However, the CTG was not very successful in strengthening accountability processes, especially in establishing an ombudsman's

office—even though the constitution provides for one, and for precedent purposes, an ombudsman for tax purposes already does exist—and getting an ad hoc Public Accounts Committee (PAC) functioning outside of Parliament (which also has a precedence in Bangladesh political history)⁴⁰ to review the reports of the auditor general. In the last seven Parliaments, the PAC has been formed only five times, significantly reducing the scope for legislative review of government accounts.

56. However, the CTG should be given credit for other reforms that have a bearing on future anticorruption drives, including strengthening the ACC (both organizationally and financially), effectuating judicial independence (the subordinate courts are now under the judiciary rather than the executive),⁴¹ and finalizing the Right to Information ordinance. The new government has so far sent positive signals that it will continue all three reform efforts (although the Right to Information ordinance was allowed to lapse without being considered by Parliament for ratification as law before the government tabled a bill of its own on this).

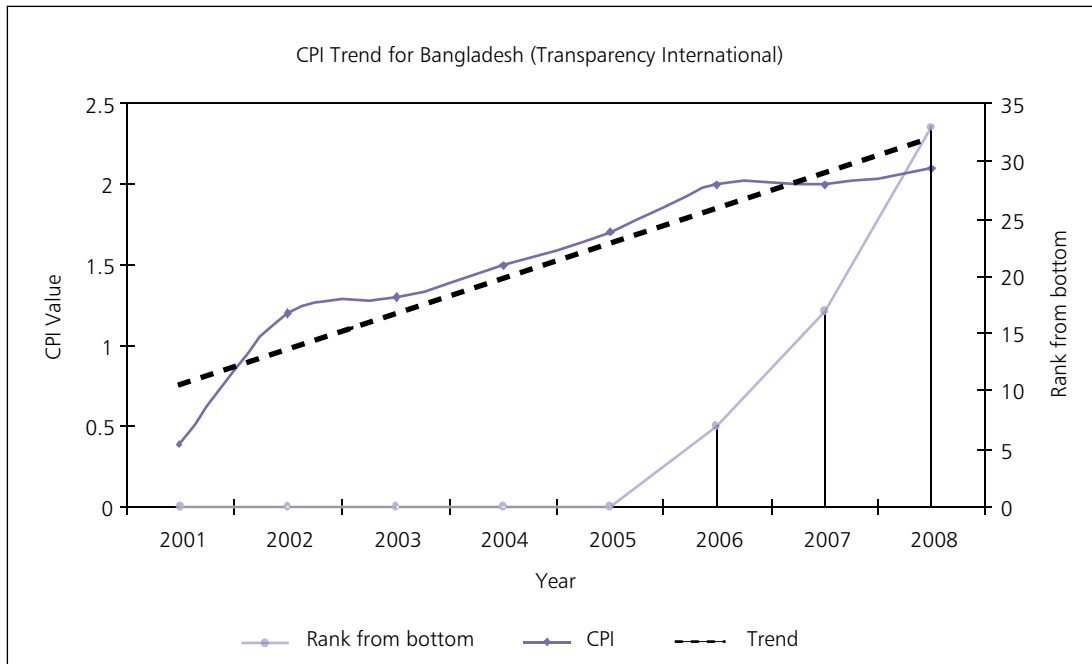
³⁸ At the beginning, what the strong anticorruption drive served to do was to shake business confidence because banking rules were made more stringent and antihoarding and consumer protection moves were strengthened. A unique feature of the anticorruption drive was the targeting of notable individuals rather than institutional corruption.

³⁹ What has taken many observers by surprise is the decision by the High Court of Bangladesh to declare the legal basis of the TAC invalid. The High Court in mid-November 2008 declared illegal and unconstitutional the Voluntary Disclosure of Information Ordinance (2008) through which the TAC was established. It argued that, by establishing the commission, an alternative system bypassing the judiciary had been set up which was against the constitution. It further said that promulgating such an ordinance is a policy decision and that the caretaker government could not make any policy decision as per Article 58(D) of the Constitution of Bangladesh. It is not yet clear what will happen to the hundreds of cases the TAC was considering.

⁴⁰ Indeed, the office of the Comptroller and Auditor General (CAG) in late July 2007 asked the CTG to immediately constitute a PAC on an ad hoc basis to scrutinize government accounts and reports of the CAG in the absence of Parliament (and in line with a recommendation made to the government by the World Bank in June 2007 which highlighted that, given the schedule of submission of reports by CAG, there was a danger that the CAG reports starting from FY2005 would not have been acted upon for at least three years until a Parliament was in place). In asking for the formation of a PAC on an ad hoc basis, the CAG had drawn the government's attention to the fact that, already in mid-2007, the increase in the number of unresolved audit reports involved millions of dollars and the cases of retired government officials who were not getting their pensions due to unsettled objections remained high. The need for an ad hoc PAC is not new in Bangladesh; one had been formed before in 1983 (*The Daily Star*. 2007. Govt Accounts Pile Up as Parliament Missing. Dhaka. 26 July).

⁴¹ This is an exceedingly important development in the minimization of malgovernance in Bangladesh. Judiciary independence took effect in late 2007, and with only 77 Supreme Court judges and 750 other judges for 150 million people, the health of this institution is critical for the ongoing anticorruption drive of the government. In the first quarter of 2009, however, because of pressure from administrative magistrates, the new government diluted some of the powers of the judicial magistrates.

Figure 3: Corruption Perceptions Index Trend



Source: Adapted from data sources of various years from Transparency International.

The new government has also said that, as per the party's election pledges, Awami League ministers and lawmakers will make their wealth statements public.⁴²

F. Conclusions

57. Bangladesh presents a conundrum with respect to governance and economic growth: a report on governance in the country shows that its impressive record of economic growth and social change has been achieved despite weak governance (particularly the high levels of corruption).⁴³ That said, positive governance developments—of which there are many, including greater space for the private sector and nongovernment organizations, and wise public expenditure policies in general, such as capping the growth in the military budget—provide ample evidence that, with

improvements in governance, the country will better institutionalize economic growth and social development.

58. As a result, in 2009 and beyond, the new government has already placed focus on several areas that relate directly not only to sustaining the reforms already underway but also to building on them to ensure a strong basis for continued economic growth, inclusive development, and an inclusive political process. The Awami League's vision for 2021 ("a liberal, progressive, and democratic welfare state") concentrates on five key priorities:

- i. maintenance of economic stability and control over commodity price hikes;
- ii. effective (multipronged) action against corruption;

⁴² The new government, which has vowed to expand the social safety net, will also need to be mindful of recent reports of malgovernance in the system. Local media reported in mid-February that about 12% of social safety net benefits was lost on bribes and other flaws. A report of the Food and Agriculture Organization (FAO) says that 1% of the benefits is leaked out as bribes, 7% due to poor targeting, and 3%–4% for receiving less than the prescribed amounts (*The Daily Star*. www.thedailystar.net/newDesign/news-details.php?nid=76542).

⁴³ World Bank. 2007. *Bangladesh: Strategy for Sustained Growth*. Washington, DC. July.

- iii. reforms in the power and energy sector;
- iv. elimination of poverty and inequity; and
- v. establishment of good governance.

59. One issue not specified in the vision, but that is intricately related to the government's promise to establish good governance, has to do with the current work in the country (initiated during the CTG tenure) on a national integrity strategy to focus on how to institute integrity in governance. This is necessarily related not only to more efficient public sector management (such as through civil service reforms, improved service delivery, devolution, and others) but also to anticorruption measures. If there is one lesson that has emerged relevant to governance work in the past several years, it is that the development process now needs to be underpinned by a vision of how national integrity is to be sustained. The national integrity strategy⁴⁴ presents a unique opportunity to the new government to put in place a framework under which public sector integrity can be restored. One of the most tangible impacts

of this strategy will be to give confidence to investors that the government is serious about taking a holistic perspective on improving governance.

60. While the new government appears very committed to the reform process, there could well be a few exogenous factors that jeopardize reforms. Observers caution that Bangladesh faces significant risks in its political economy in the coming months. These include (i) an uncertain external environment resulting from the global economic slowdown,⁴⁵ with an impact on many fronts, primarily a reduction in remittances; and (ii) contingent liabilities arising from SOEs and low revenue collections.⁴⁶ Furthermore, the country is always susceptible to the significant risks posed by natural calamities, as demonstrated by floods and cyclones in recent years.

61. As the new government takes the reins of power in Bangladesh, reasons to have cautious optimism that the reforms will not be reversed appear to be sound. Among other things, public expectations for a continuation of many of the reforms are intense.

⁴⁴ The national integrity strategy framework, which the CTG approved, sits at the core of the good governance agenda for the country. Its articulation of the NIS is based on the premise that good governance is fostered by encouraging and facilitating a dialogue among key participants—including civil society, academia, government, and politicians—to build a broad national consensus on how to deal with corruption and poor governance. Its components could include (i) strengthening of the relevant legislative and institutional mechanisms; (ii) making effective use of NGOs to provide external measures of control; (iii) further strengthening of current internal control measures in selected ministries; (iv) developing an ethics- and values-based public service to complement the existing rules-based measures; (v) mobilizing resources outside the government to encourage the private sector, the media, and others to scrutinize every aspect of government expenditure; and (vi) determining strategic measures against all forms of corruption at all levels (that is, ensuring that, to the extent practicable, all types of corruption are addressed).

⁴⁵ One of the more immediate impacts of the global economic slowdown is that the budget estimates of foreign aid in the previous fiscal year had to be revised (showing a decline of 5.6% [or \$0.12 billion] of aid projected in the original budget).

⁴⁶ International Monetary Fund. 2008. *Bangladesh: Joint Fund-World Bank Debt Sustainability Analysis (DSA) 2008*. Washington, DC. September; International Monetary Fund. 2008. *Bangladesh: Staff Report for the 2008 Article IV Consultation*. Washington, DC. October. p. 7.

4. Bhutan

A. Background

62. By all accounts, Bhutan—which discarded its closed-door policy in the 1960s—has been a success story to date. In 1961, gross domestic product (GDP) per capita was \$51, the lowest in the world. Yet, by 2006, GDP per capita had reached \$1,200, while real GDP grew almost matching the pace of the world’s fastest-growing economies. Socially, too, Bhutan has attained much: its Human Development Index (HDI) rose from 0.550 in 1998 to 0.579 in 2005 to 0.600 in 2006,⁴⁷ while just a few decades ago, it showed extremely low levels of human and social development. Indeed, the country has managed “significant and sustained progress in meeting the millennium development goals and is potentially on track to achieve them all”.⁴⁸ It has also been successful in significantly reducing the number of people below the poverty line (from 36.3% in 2000 to 23.2% in 2007). However, the country still faces the challenges of unequal development in rural and urban sectors, youth unemployment, rural poverty, and others.⁴⁹

63. Development takes place within a unique context in Bhutan. Its characteristics include the following:

- i. It is land-locked. With the nearest port 800 kms away, the ease of access to, and cost-effective trade with, global markets is severely constrained.
- ii. It has harsh mountainous topography and scattered populations. Therefore, large parts of the country are inaccessible to markets and services, and per capita costs of providing public services are high.
- iii. Its problems are unique to those of small states.⁵⁰
- iv. It is subject to the governance-poverty nexus,⁵¹ which frames how the dynamics between governance and poverty may be better understood and poverty reduction better targeted.

⁴⁷ Bhutan, starting from a very disadvantaged position in 1990, in one decade overtook Nepal and Bangladesh in the UNDP-prepared Human Development ranking.

⁴⁸ See, for example, *Kuensel*. 2008. MDGs – Bhutan’s Progress report is good but Thimphu. 30 September.

⁴⁹ According to the 2007 Poverty Analysis Report, less than 1.7% of the urban population is poor, compared to 30.9% in rural areas. Poverty is also unevenly distributed, generally with a low percentage in the west, and higher poverty rates in the east and some of the southern districts. The Gini index at the national level is 0.416 (which is among the highest in Asia and demonstrates the degree of inequality existing in Bhutan).

⁵⁰ Small states are generally characterized by, among others, (i) a less diversified production structure and export base, with one or two dominant products or industries (in Bhutan, hydroelectricity exports account for the bulk of total exports); (ii) lack of integration into the global economy but very strong ties with a neighboring big economy (Bhutan, for example, is yet to join the World Trade Organization [WTO], and an average of greater than 90% of its exports in the past decade have gone to India); and (iii) absence of an independent monetary policy (Bhutan’s currency, the ngultrum, is pegged to the Indian rupee at par, and the Royal Monetary Authority [RMA] does not serve as a true central bank yet). This means Bhutan, as a small state, is vulnerable to exogenous shocks particularly impacting its largest market, India. As in a “small economy case”, Bhutan also has a system whereby the central bank is responsible for supervision of financial institutions (this role in big economies is normally carried out by a separate regulatory institution).

⁵¹ The nexus between governance and poverty is usually analyzed at two levels: (i) that poor governance disproportionately impacts the poor since they rely much more on public goods, and poor governance means the costs of those goods will be higher; and (ii) that poor governance contributes to poverty by accentuating the inequalities in society (this is premised on the assertion that poverty is due not only to a lack of resources but also to their distribution). For both (i) and (ii), the implication is clear that good governance contributes significantly to poverty reduction.

- v. It has its own development philosophy that is rooted in the unique country context.

64. **Gross National Happiness.** One such conceptualization of human and social development that Bhutan is eager to apply on its own (and that has been in currency since 1972) is that of Gross National Happiness (GNH), the maximization of which it considers its all-encompassing goal of development.⁵² This remains the principal guiding philosophy of the country's long-term development vision and is now increasingly being mainstreamed in the planning and business processes in the public sector.⁵³

B. Recent Political Developments

65. Governance in Bhutan, until shortly before the 2008 elections, was led by the monarchy, which has been in place since 1907 and is widely credited with the country's development path to date. Yet it was the king who initiated the constitutional changes that transformed his role to that of a constitutional monarch. Recent governance reforms in Bhutan have focused on creating greater political space, emphasizing devolution and decentralization, judicial reforms, stricter adherence to accountability, and strategic visioning, including taking a strategic perspective to development as well as ensuring that national goals of self-reliance and sovereignty are mainstreamed in all development work.

66. As part of the gradual opening up of political space, Bhutan undertook its first

democratic elections in 2007 and 2008, with National Council elections—the upper house of the new Parliament—in December 2007 and January 2008, and National Assembly elections in March 2008. In the March elections, two major parties, Druk Phuensum Tshokpa (DPT) and the People's Democratic Party, competed against each other. Contrary to expectations, the DPT was the overwhelming winner, taking 95.7% of the votes, and 45 of 47 parliamentary seats in a thorough rout of the People's Democratic Party.⁵⁴ The significance of this, however, is limited as most existing policies across the development spectrum are expected to remain in place.

67. The government's vision contains goals for an ideal Bhutan and one that is more specific with respect to development policy goals. DPT's vision of an ideal Bhutan, as included in its manifesto, is of the country as a regional hub, a data center, a destination for quality health service, and an attractive place of leisure promising spiritual and physical well-being. More practical development goals include connecting every *gewog* (county or group of villages) with roads, providing every family with safe drinking water, electricity for all, telephones for every village, three doctors in every district hospital, and others.

68. As the first key steps toward implementing governance and institutional reforms as enshrined in the 2008 constitution, three independent constitutional bodies were established: the Office of the Auditor General, the Anticorruption Commission (ACC), and the Election Commission. The heads of these

⁵² GNH is based on notions of material as well as spiritual well-being and is based on four pillars: (i) equitable and sustainable socioeconomic development, (ii) preservation and promotion of cultural values, (iii) conservation of natural environment, and (iv) good governance.

⁵³ This mainstreaming process can be termed the "GNH-ization" of plans and policies. This process is evident in the establishment of the GNH Commission (from the previous Planning Commission). All ministries, districts, and *gewogs* (a *gewog* is a county or a group of villages) will have a GNH Committee, and applies to plans and policies. This latter element concentrates on (i) investing in people, (ii) living with tradition and nature, (iii) bringing about good governance, and (iv) developing a dynamic economy (as the foundation for a vibrant democracy). The idea of GNH has generated some debate outside Bhutan as well, particularly in its measurement and application. But its merits are rather obvious. Indeed, in the Subjective Well-Being index, in 2007, Bhutan ranked 8th out of 178 countries (the only country in the top 20 "happiest" countries that has a very low GDP) (White, A. 2007. *A Global Projection of Subjective Well-being: A Challenge to Positive Psychology?*) UK: University of Leicester.

⁵⁴ However, it appears there is still some skepticism among the average citizens in Bhutan about just why such a democratic system is needed; after all, these reforms came about—unlike in neighboring Nepal—through the expressed wishes and vision of the king. A quotation from the daily press around the time of the elections sums this up: "When pot is not broken, why it is mended?" (Dorji Rinchen, citizen, commenting on the elections) (<http://edition.cnn.com/2008/WORLD/asiapcf/03/24/bhutan.elections/>).

institutions are independent of the executive and report directly to the National Assembly. These and other recent political developments have led one researcher to label Bhutan as “an anachronism in a world dominated by economic globalization”,⁵⁵ referring to Bhutan’s unique approach to modernity (not only in economic development but also governance) that is tied to a deep sense of retaining traditional values and mores. By all accounts, it has managed the process remarkably well so far.

69. One particular political development that does not get much press internationally, but which will invariably impact how Bhutan manages the development process, particularly at the local level, is the continued focus on devolution and decentralization. The design of local governments is structured around 20 *dzongkhags* (districts), 204 *gewogs*, and 2 urban areas (Thimphu and Phuntsholing). The Local Government Act of 2007 provides the updated legal basis for the work of the local governments. Specific rules and regulations will still need revision in order to align them with the 2007 act, particularly given the administrative and political setup and changes put in place in 2008.

70. In terms of decentralization, the size of the budget outlay for local government has been increasing over the years (from Nu18 billion in 2006–2007 to Nu24 billion a year later). Discretionary grants to local bodies have also increased and now stand at about Nu1 million per *gewog*.⁵⁶ The government has decided for the 10th Five-Year Plan (FYP), 2008–2012, to institutionalize capital grants to all *gewogs*,

which means corresponding transparent locative formulas have to be in place.⁵⁷ While decentralization has always been a cherished government goal, more fundamental constraints of organizational turf could have some impact on effective implementation of the 10th FYP.⁵⁸

71. Finally, a particular political issue the government has not yet been fully able to manage is that of the fate of 100,000 or so Bhutanese of Nepali ethnicity who are currently in refugee camps in Nepal waiting for a political agreement between Nepal and Bhutan that will enable them to return to their homes. This so-called southern problem of Bhutan could be significant since there have been reports of Maoist influence in the refugee camps, and greater potential to stir disturbances inside Bhutan.⁵⁹ It is largely in response to this that the government has recently worked very closely with India to more effectively patrol the country’s southern border.

C. Recent Economic Performance

72. **Gross domestic product growth.** Bhutan has grown impressively over the years. GDP growth averaged 7.5% from 2003 to 2005, and was 6.4% in 2006. Growth increased substantially to 14.1% in 2007 (although falling slightly to 11.5% in 2008), which was largely associated with returns from investments in hydropower. While for 2009 the rate is expected to fall to 5.5%⁶⁰ as a result of the global slowdown and declines in tourist inflows, it is expected to return soon to its long-term average. This is phenomenal for a remote country with access to few natural resources

⁵⁵ Lustig, R. 2006. Will Bhutan Be “Happy” as a Democracy? BBC News. 23 May. news.bbc.co.uk/1/hi/world/south_asia/5001222.stm

⁵⁶ To access funds from this resource envelope, *gewogs* will be invited to apply for funding against any outstanding works or schemes identified in the five-year plan. The Ministry of Finance has said it wishes to finance block grants to all *gewogs* for capital investments initially at the level of Nu2 million per *gewog* for 2008 and 2009.

⁵⁷ The GNH Commission has drafted the Guidelines for Annual Grants for Local Governments under which the allocation formula has the following parameters: population (70%), poverty (15%), environment (10%), and size of territory (5%).

⁵⁸ The matter of which agency is responsible for local government (the GNHC or the home ministry) has for now been resolved. In any event, the matter will surely be revisited when the Royal Civil Service Commission begins to review the entire government structure in the near future.

⁵⁹ The problem is so named because the Nepali refugees are predominantly from the south of the country. As part of an international effort to resolve the problem, a third country resettlement plan is being implemented under which about 60,000 of the refugees are to be resettled in the USA. The rest who opt to be resettled will go to other countries.

⁶⁰ ADB. 2009. *Asian Development Outlook 2009*. Manila.

and limited options for international trade. As stated earlier, the hydropower sector fuels a substantial portion of growth.

73. **Inflation.** The rate of inflation in the country mirrors India's, given the close ties of these two economies, including the currency peg between the Indian rupee and the Bhutanese ngultrum. At the beginning of 2008, the inflation rate stood at 8.85%, compared to the estimated 5.2% for 2007.⁶¹ In general, according to the Royal Monetary Authority, inflation in Bhutan tends to be higher on locally available goods and services like red rice or rent (house rent constitutes around 25%–30% of any income and will most likely rise 15% to 20% in the periods after 2008).

74. **Fiscal issues.** While the government has, over the years, prudently balanced its expenditure commitments with revenue availability, the aggressive development agenda of the recently drafted 10th FYP looks set to severely test this balance.⁶² One particular expenditure commitment that looked set to test the government was how to meet even the minimum threshold of the recommended pay hike of 40%–77% to civil servants (which would cost the government nearly Nu2 billion). In the 2008–2009 budget, pay and allowances for the 18,000 civil servants would have come to about Nu2.8 billion (the recommended pay hikes also include increases for benefits).⁶³ In late January 2009, however, the National

Assembly endorsed only a 35% uniform pay hike for civil servants⁶⁴ (deciding also to consider another hike toward the end of the 10th FYP if the situation improved).⁶⁵ Salaries were last raised in January 2005, by 45%. A different pay structure for holders of constitutional posts was also established.

75. Pay hikes and other expenditure commitments are always issues of consideration by government. This is because it prepares a multiyear rolling budget (MYRB) which allows it to make projections for more than one financial year (indeed, besides the budget year, projections are made for two more years under the MYRB system). At the moment, MYRB is being piloted in the ministries of health and education. The government has a plan to replicate this to other budgetary agencies, and by FY2009, MYRB is expected to be fully implemented. Training, however, is required to ensure that the MYRB system is used effectively.

76. To solidify the MYRB, the government strengthened its medium-term fiscal framework, wherein it has been projecting key economic variables as part of a 5-year planning process. By strengthening the medium-term fiscal framework, the government has managed to adhere more closely to liaising between the FYPs and the annual budgets. The 3-year rolling budgets allow this link.

⁶¹ The latest IMF Article IV consultation report for Bhutan (International Monetary Fund. 2007. *Bhutan: Staff Report for the 2008 Article IV Consultation*. Washington, DC. October) had estimated the rate of inflation to be 5.2% for 2007–2008; this turned out to be too optimistic (see www.bhutan.gov.bt/government/newsDetail.php?id=1042).

⁶² Still, during the 9th FYP (2003–2007), the domestic revenue mobilized met the recurrent expenditures of the government. With the commissioning of the Tala hydropower plant, and with increasing economic activities, it is expected that internal revenue will not only finance recurrent expenditure but will also finance part of the capital expenditure during the 10th FYP. The final approved 10th FYP has an outlay of Nu148.074 billion, up by Nu7 billion from of the draft plan. The 10th FYP shows the following: (i) the GDP growth rate for the plan period was projected at 7.7%, down from its earlier projection of 8.8%; (ii) the resource gap increased to 4.15%, up from the earlier 3.40%; and (iii) fiscal deficit doubled to 6.76% of GDP, from the 3.40% projected earlier. It is interesting to note that of the budget allocated for all ministries (67.56% of the total budget), the budget for the Ministry of Finance (at 20.74%) is more than the allocation for the ministries of agriculture (5.55%), education (7.09%), and health (5.86%) combined.

⁶³ The Pay Commission's recommendations had also originally proposed taxes on cars and luxury items to raise revenue apart from cost cutting. The government later decided to drop the tax proposal.

⁶⁴ Part of the difficulty for the government in this regard has to do with the fact that, according to the constitution, it cannot use grants from other countries to finance salaries or any pay hikes. There is a commitment of grant assistance of Nu35 billion from India, but this money cannot be used for the purposes stated here. The constitution and financial rules also state that no capital expenditure money can be diverted for pay or allowances.

⁶⁵ Interestingly, there are reports that rents in urban areas have begun to rise significantly as a result of the pay hikes. These rent increases have been in the general area of 10%–20% (*Kuensel*. 2009. Rents go through the roof. Thimphu. 5 February). The situation was considered dire enough by government that the prime minister himself in January 2009 made a public appeal to landlords not to raise rents as a result of the civil service pay hikes.

77. However, the MYRB presumes that spending agencies have resource projection capabilities and accurate information. This includes information on projected aid levels and a functioning aid harmonization system. The government often sees significant delays in receiving expenditure reports from districts and gewogs, and there is still rather limited in-house capacity for carrying out the economic and financial analyses needed for preparing the 3-year rolling budgets.⁶⁶

D. ADB's Operational Strategy in Bhutan

78. ADB's country partnership strategy for Bhutan has taken as its overarching goal poverty reduction through economic diversification, in keeping with the stated goals of the government. As for operational strategy, two key areas have emerged: (i) assistance for programs and projects in core sectors (which include transport, power [including rural electrification and renewable energy], urban infrastructure development, and financial and private sector development), and (ii) capacity development, both in the operation sectors and in the overall management of the development process.

79. The country partnership strategy targets three strategic pillars for assistance:⁶⁷

- i. **Broad-based economic growth.** Under this, the focus has been on (a) reducing isolation by increasing road connectivity, (b) enhancing access to electricity on a sustainable basis in

rural areas, (c) expanding the access of civic services to well-designed and well-developed urban centers, (d) improving the reach and competitiveness of the financial sector, and (e) enhancing the enabling environment for the private sector, particularly small and medium-sized enterprises.

- ii. **Inclusive social development.** Under this, while no direct investments are sought to be made in social areas, the focus will be on supporting urban municipal infrastructure, and improving transport access for rural areas.
- iii. **Good governance.** Under this, several government reform efforts will be supported, including (a) second-generation reforms in the governance of the power sector, (b) capacity building in urban planning and municipal governance, (c) labor laws and the legal framework in the finance sector, and (iv) the policy and regulatory regime to enable private sector activity.

E. Emerging Issues in Governance and Political Economy

1. Public management

80. Economic growth is still led by the public sector, which provides the most scope for employment.⁶⁸ But because opportunities do not abound in the private sector⁶⁹—and

⁶⁶ A critical point to note is that MYRB is possible when resource availability can be more or less ascertained in the future. Given that a significant portion of the government outlay (anywhere in the range of 16%–20%) comes as grants from the Government of India (which is not easily confirmed on time), the capability to do MYRB tends to be a bit constrained.

⁶⁷ ADB. 2005. *Country Strategy and Program: Bhutan (2006-2010)*. Manila. September.

⁶⁸ Public and state-owned enterprises account for nearly 60% of GDP and only about 100 or so medium-sized companies dominate the private sector. On average, about two-thirds of all employment vacancies are made up by the public sector, a quarter by the corporate sector, and the rest by nongovernment organizations (see, for example, *Kuensel*. 2008. Coming to grips with the real world: Government job still first choice but other options being explored. Thimphu. 8 October).

⁶⁹ Constraints on private sector development include (i) lack of infrastructure for establishment of industries (such as industrial estates); (ii) low mechanization and lack of technical capacity and relevant work experience in major projects of private firms; (iii) competition from external firms for big construction project works; (iv) lack of ready access to capital for private sector development (the financial systems in Bhutan are still rudimentary) and given the homogeneity in the operations of the financial institutions (such as in interest rates and collateral requirements), there is little scope for a more ready avenue for capital acquisition); (v) transaction costs stemming from, for example, a rather lengthy and cumbersome process to obtain a license; and (vi) other causes, such as the practice of business fronting, which serves to deter genuine business entrepreneurs.

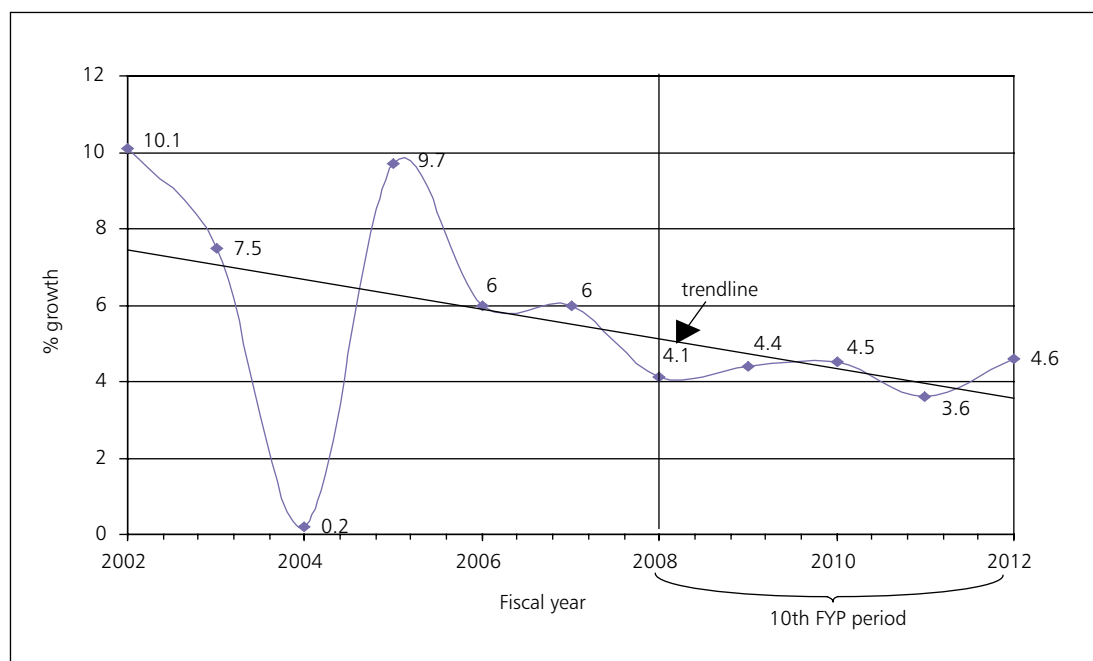
the government does not necessarily permit rapid expansion in public employment—youth unemployment has been a particular risk.⁷⁰ An important consideration is that the development model based on hydropower development is not particularly employment intensive other than during the construction phase and provides few spillovers to the rest of the economy.

81. It is interesting to note that sector growth rates for public administration and social services show a declining trend from 2003 to 2007, while 10th FYP estimates suggest levels will stay low during the 10th FYP period (Figure 4). Yet this growth is 1.5 percentage points faster than was envisaged for this sector in the 9th FYP projections. In the 10th FYP development budget allocation (in millions of ngultrums), this is slated to go up to 26.12% of public

expenditures. This is the largest share, more than for social services (health and education) at 23.61%, transport communications and public works at 20.54%, and agriculture at 9.98%. This is in large part because, at least for public administration, the strength of civil service has increased at 5.62% over the last several years. There are several observations on this growth trend: (i) In general, and over the years since 2002, the growth rate has been on the decline (more pronounced in the 9th FYP period).⁷¹ (ii) The growth rate in 2004 is clearly an anomaly, the reasons for which are not yet clear. (iii) The rate of growth in this sector is projected to have less variance in the 10th FYP.

82. Owing to its rapid development, Bhutan in 2007 formed a holding company for state-owned enterprises (SOEs). Druk Holdings and Investment (DHI), a holding company

Figure 4: Trend in Gross Domestic Product Sector Growth Rates—Public Administration and Social Services



Source: Gross National Happiness Commission. 2008. Draft 10th Five Year Plan (2008–2013). February. Thimphu.

⁷⁰ Given successes in the education sector and an increasingly high number of educated youths (but few employment opportunities in the public or private sectors), the attendant consequences of youth unemployment are natural. This unemployment rate had quadrupled from 2.2% in 1998 to almost 10% a decade later.

⁷¹ While public administration and social services are different sectors, they have not been unbundled in the plan. This means that it is difficult to ascertain the share and growth rate for public administration alone. In any event, it is assumed here that the growth trend for the entire sector applies to the public administration subsector as well.

with 14 SOEs (out of 22), including some on hydropower, has a mandate to transform the SOEs into competitive, high-performing organizations.⁷² Good corporate governance is an essential part of this transformation and new boards have been formed or existing ones changed significantly. In general, however, managing directors of SOEs in Bhutan tend to be civil servants, and were until recently chosen by the Royal Civil Service Commission; compensation too was set by civil service rules.

83. The Royal Civil Service Commission is a central player in Bhutan's public management system. The reform of the civil service has centered on the position classification system (PCS), introduced in January 2006. It rewards meritocracy and efficiency, and is based on open competitive selections, transparency, accountability, and equal pay for equal value of work. The PCS has succeeded in decentralizing some powers to ministries, agencies, and district administrations. Most government agencies have also started setting up performance targets and annual individual performance ratings. The PCS also allows organizational development exercises in these agencies, which looks at their mandates and the corresponding capacity gaps to meet them. But difficulties in implementation have meant the PCS still has not been institutionalized and mainstreamed in the civil service. The government maintains that the PCS has not been entirely successful because the Bhutanese work culture tends to reward seniority rather than merit, and that it is hard to change the mindset so early on.

84. Three aspects of public management merit further mention here:

- i. The government has undertaken a fairly comprehensive machinery-of-

government review and civil service restructuring in recent years. This is evident in the reallocation of government portfolio (which also has made the GNH Commission the focus of development work at the central government level),⁷³ review of procurement processes throughout the public sector, and implementation of the position classification and organizational development exercises throughout the civil service. In the near future, these exercises will also be carried out at the local level.

- ii. Questions have been raised about the extent to which the civil service has increasing control over service delivery.⁷⁴ The Royal Civil Service Commission has a completely free hand in the termination, staff movement, and promotion of all civil servants. By and large, there is a clear perception in Thimphu that the RCSC has concentrated significant powers in itself.
- iii. The government has stated clearly in the 10th FYP that it wishes to emphasize human capital formation and expenditures on it as essential long-term investments rather than expenses. Related investments in human capital formation are among the highest in the world, calculated either on the basis of expenditures as a ratio of GDP or as a percentage of the national budget.⁷⁵ It will be interesting to see how the need for human capital enhancement will play out at the local level in line with the focus on decentralization. This will

⁷² The "blue ribbon panel" of DHI has been recently reconstituted, allowing more civil servants in the panel. There is now a change in the panel—from the two constitutional postholders and DHI CEO to the secretary of the Ministry of Economic Affairs and the governor of the Royal Monetary Authority. Even in the DHI board, the government from now on will have a minimum of two directors from the civil service, including a representative of the Ministry of Finance (MOF), who will be appointed by the finance minister. There is no ceiling on the maximum number of civil servants on the board, but DHI would set the criteria required for board members. DHI will now also have to submit periodic reports on its performance to the MOF (earlier, it was to be done once a year at the annual general meeting).

⁷³ Indeed, the public sector will also be incorporating the concept of GNH. Several GNH indicators have been prepared, and progress in the 10th FYP will be measured against them.

⁷⁴ See, for example, *Kuensef*. 2008. Minister-Bureaucrat balance of power: Which is the real power centre? Thimphu. 29 September.

require a fundamentally larger share of the resource envelope.

85. The 10th FYP has a well-laid-out policy on human resource development in the public sector. The guiding principle for resource allocation will be to concentrate on priority sectors which support programs in the 10th FYP and which contribute to long-term development. Accordingly, it has focused on building HRD in the social sectors as a priority investment (given this, about 40% of total HRD allocation in the FYP has been placed in education and health sectors). In line with its decentralization policy, the government is also keen to employ a strategy where all short-term training programs will be decentralized, to be run by the various ministries, agencies, and district administrations themselves.

2. Political Issues

86. **Bifurcation of roles.** With the parliamentary system now in place, one particular issue needs to be resolved, one with deep political connotations: the clear bifurcation of the roles of politicians and the bureaucracy (that is, a clearer demarcation of the roles and responsibilities of ministers and top-level bureaucrats).⁷⁶ Parliament is now debating this matter under the draft Civil Service Bill; the main point to keep in mind in the bill is that

there should be no negative political influence in the civil service. In this regard, the National Council has raised its voice on the matter of the independence of the civil service from the political establishment.⁷⁷

87. The National Council and the National Assembly (the two chambers of Parliament) have also argued in the past over the role each will play in approving the annual budget. The National Council contends it has a right to participate in the procedure for passing an annual budget. A compromise agreement sees the budget being broken up into an “annual budget” and the “budget bill”. The former will be presented to, and approved by, the National Assembly alone, while the latter will follow the normal process of any bill, which allows the National Council to play its legislative role.⁷⁸

88. Bhutan is also set to establish a Civil Society Organization Authority soon, with responsibility to ensure transparency and accountability in the functioning of nongovernment organizations and hopefully, in the process, serve as a stronger check on the political establishment and the bureaucracy.

89. **Local governance.** The draft Local Government Bill 2009, now under debate in Parliament, defines the autonomy, position, powers, and functions of local governments

⁷⁵ The allocation for the education, health, and human resource department sectors under the 10th FYP comprises more than a quarter of the total planned budget; this figure will be higher if the various training and capacity-building programs of each of the ministries, district, and block administrations and local governments are also included.

⁷⁶ In reality, this is also evident at the local level. There have been reports of local elected representatives not cooperating with the bureaucrats posted from Thimphu (see, for example, *Kuensel*. 2008. The Ongoing GAO versus Gup Wrangle. Thimphu. 19 August). At the core of the problem lies the overlapping terms of reference of these local officials, as evident in two documents—the terms of reference that the GNH Commission has for the gewog administrative officers and the rules regarding the powers of the *gups*. This matter, however, is expected to be resolved as a result of suitable amendments in the Local Government Act endorsed by the Cabinet and which will be taken up in the coming parliamentary session. At another level, the government has also told senior civil servants that anyone going against the political and policy directions of the government may face reprimand or even termination of employment. This demonstrates the unclear and uneasy relationship between the two in the new democratic Bhutan.

⁷⁷ Recently, when four DPT party workers were recruited in the Cabinet Secretariat, the National Council decried the move, saying it violated civil service rules because the appointments were made based on party affiliations. This debate on the separation of powers also extended at one time to the Police Bill. The National Assembly had asked for some key changes in the bill, which MPs felt were vital to ensuring some checks and balances on the force, while the Royal Bhutan Police wanted to avoid undue political influence and did not provide for any membership for the home ministry in the bill.

⁷⁸ The annual budget is to be considered the plan of intended revenues and expenditures of the government, reflecting the priorities of the country, and also is to include a budget policy on matters of GDP, fiscal deficit, external debt, balance of payments, foreign exchange, reserves, and inflation, among others. The purpose of the budget bill, on the other hand, is to look into budget policy, overall budget estimates of the year, the resource allocation framework, the total expenditure budget for central agencies, *dzongkhags* and gewogs, and reports on trust funds and SOEs, among others.

within the new democratic framework. According to the bill, the *gup* (that is, the local elected leader) will be chief executive officer in the gewog instead of the Gewog Administrative Officer, who is deputed from the center and who will now be only the administrative head. A major change in the draft bill is that it outlines the specific regulatory, administrative, and financial powers of each of the local governments, which were absent in the 2007 Local Government Act.

90. As in other countries of the region, there is a strong debate ongoing in Bhutan about the extent to which elected representatives should be able to control the development process in the constituency they represent. The National Council has, so far, opposed the idea of a constituency development grant, first brought before the National Assembly, which would allow each Member of Parliament to spend up to Nu2 million for development activities. Council members have argued, drawing on experience elsewhere including India and the Philippines, that it would erode the separation of powers between the executive and the legislature, and dilute the ownership of local governments in the local development process. They have also argued that as the Public Accounts Committee (PAC) of the Parliament scrutinizes the expenditures of the executive, any development activity initiated under the constituency development grant could fall under the purview of the PAC, thus leading to a conflict of interest.

91. **Anticorruption efforts.** As demands for transparency mount, the problem of corruption will also feature more strongly in the public domain. Already the problem is being discussed more openly in Bhutan, with an active role

being played by the Anticorruption Commission (ACC). The ACC, in collaboration with other relevant government agencies, has also begun to put in place a systemic basis for development of relevant indicators to measure corruption and its incidence, not only in the public sector but also in the private. There is a general public perception that corruption exists in the public sector,⁷⁹ although, in general, development partners and others concur that no system-wide and institutionalized corruption exists in the sector, other than the usual inefficiencies and ineffectiveness of a young bureaucracy.

92. Yet the government is taking a strong stand on this problem. For example, the ACC is seriously considering a task force recommendation that there be a substantial review of the licensing regime.⁸⁰ The Royal Audit Authority (RAA) has stepped up efforts to conduct audits,⁸¹ particularly at the district level, where inefficiencies and possible malfeasance are caused generally by lack of knowledge of government business processes. Finally, even the fledgling PAC in Parliament is taking a deeper interest in its role to scrutinize government accounts for arrears due to malfeasance and corruption in government agencies.

93. The government's policy actions against corruption (under the rubric of the "zero tolerance approach") are numerous (Table 9).

94. In addition, the Ministry of Finance is reviewing the procurement manual in the wake of strong RAA evidence that the construction sector has inherent structural deficiencies in procurement.⁸² While the review started in 2005, several rounds of stakeholder discussions

⁷⁹ The 2007 Annual Report of the Royal Audit Authority states that "2007 saw the highest cases of strong indicators of fraud and corruption".

⁸⁰ See "Loosening the stranglehold of a license regime." *Kuensel*, Thimphu, 2 October 2008. The task force found that the administrative burden arising from licensing regulations of trade, industries, and commercial ventures costs the government almost \$2.5 million a year.

⁸¹ RAA audits have been described in contradictory terms: bureaucrats consider them aggressive and impinging on their ability to be more innovative and flexible in service delivery, while the RAA insists they are robust and serve to enhance trust in the public sector.

⁸² The manual itself consists of provisions including (i) a legal framework, (ii) creation of the Public Procurement Policy Division, (iii) institutional and individual capacity building in the area of procurement, (iv) an independent review mechanism, and (v) adoption of electronic government procurement.

Table 9: Bhutan's Specific Measures against Corruption

Domain	Specific Measure
Institutional	<ul style="list-style-type: none"> • Setting up the Anticorruption Commission • Encouraging incorporation of legal units in every public body to address legal issues • Strengthening the internal audit function in departments • Building anticorruption institutional and human capacity in relevant agencies • Creating anticorruption committees in specific ministries, such as agriculture
Procedural	<ul style="list-style-type: none"> • Revising the procedures of procurement goods, awarding of contracts, bidding, and licensing • Instituting a system for an Audit Clearance Certificate which has been accepted as a prerequisite for a staff member's promotion, training, and contract extension • Using information technology more smartly and widely • Creating a draft Asset Declaration Rule and draft Gift Rule^a • Moving the Royal Audit Authority from procedural audits to performance audits
Policy based	<ul style="list-style-type: none"> • Instituting a zero-tolerance approach in auditing such that the probability of arresting corruption is high • Building coalition and partnership with key allies and stakeholders • Creating a culture and climate of anticorruption behaviour
Moral and ethical	<ul style="list-style-type: none"> • Instilling a moral and legal obligation to fight corruption • Promoting anticorruption values and moral standards in the youth • Promoting islands of integrity

^a The Anticorruption Commission also has a provision for what it calls a "lifestyle audit system", which is helpful; but an asset declaration provides a stronger basis to prosecute (*Kuensel*. 2008. Plugging the Loopholes of Corruption. Thimphu. 20 October).

Source: Various government and media reports.

have warranted further reviews. According to the 2005 audit reports, the government spent about Nu26.92 billion on procurement of goods and services and on construction works in the 9th Plan. Of this, the RAA estimates that anywhere from Nu4.36 billion to Nu7.0 billion has been wasted because of manual shortcomings, and a further Nu35.6 million was misused in violation of procurement norms

by various government agencies.⁸³ The revised manual is expected to include better surveillance provisions and assurance of transparency in tender evaluation. The government also created the Public Procurement Policy Division in August 2008 to monitor the implementation of the manual once the revision is complete. Finally, there is an urgent need to complete the manual revision as considerable infrastructure

⁸³ Royal Audit Authority. 2005. *Annual Report, 2005*. Thimphu. The situation seems to have worsened given that the RAA's 2007 annual report cites that, in one year alone, the government lost over a billion ngultrums on procurement-related irregularities (RAA. 2007. *Annual Report, 2007*. Thimphu).

development is expected to take place in the 10th FYP.⁸⁴

3. Economic Issues

95. Private sector development. The government in the past has been remarkably open about its inability to jump-start the private sector.⁸⁵ Even with substantial spinoff from the construction of major hydropower projects across the country, the private sector has not been able to play a bigger—and desired—role in the economy. A holistic approach to private sector development (for example, combining financial support mechanisms, infrastructure support, enabling policies on investments, foreign exchange, partnership with external firms, flexible labor laws, and others) appears to provide the greatest leverage for bringing about this outcome.

96. To stimulate the private sector, the government is contemplating a new industrial policy that assumes that, for the private sector to grow, the government will need to extend its thinking beyond just hydropower projects and foreign aid. The policy is likely to focus on framing clearer rules and regulations for private sector participation in the economy, and for incentives to ensure and enforce compliance. Industry representatives have identified the following areas it would need to concentrate on: (i) employability of labor, (ii) need for infrastructure, both hard and soft (such as the right financial architecture), and (iii) policies on

relevant exemptions. It also needs to properly target the sector's reliance on foreign labor.

97. Ease of doing business. The ease of doing business in Bhutan is not considered to be on par with that of the other countries of the region. This provides one of the constraints for private sector growth. The 2009 Doing Business Survey showed that among the South Asian countries, Bhutan is better at enforcing contracts, employing workers, and registering property, but fares very poorly in ease of doing business and closing one, getting credit, and, most worryingly, protecting investors.⁸⁶

98. The global economic crisis, to some extent, constrains the government's ability to focus immediately on improving the business environment. Any depreciation of the ngultrum against the US dollar or the Indian rupee will impact the country's import bills, production costs, debt servicing, and balance of payments. Nonetheless, Bhutan is cushioned by its economic relationship with India, and its exposure to the global market is not as severe as that of other countries.

99. A more worrying area for the government (and in some ways more susceptible to the global crisis) is banks' nonperforming loans (NPLs). Data from the Royal Monetary Authority shows that bad loans with banks and nonbank financial institutions jumped significantly to Nu2.54 billion by June 2008,⁸⁷ from Nu1.79 billion in 2007,⁸⁸ or 13.35% of

⁸⁴ A significant area of concern with respect to corruption and mismanagement in Bhutan has to do with the construction sector. The construction industry has not been pleased with the provisions in place governing procurement. For example, a bone of contention has now appeared in the increase in the "defect liability period"—the time given in which contractors have to repair defects that appear in their work after completion—doubling it to 2 years. The Ministry of Finance worries that increasing the duration of this period would substantially increase costs for the government as contractors could factor the cost of maintenance into their bids.

⁸⁵ For example, in the 2003/04 Annual Report of the Royal Monetary Authority, an honest appraisal of government attempts to develop the private sector reads as follows: "In the last decade, however, liberalizing public sector enterprises, and government incentives in the form of tax and tariff exemptions, have not yet resulted in the desired effect of boosting growth of the private sector with regard to overall GDP, diversification of revenue, or employment generation" (Royal Monetary Authority. 2004. *Annual Report, 2003/04*. Thimphu.)

⁸⁶ See the definitions of these terms in footnote 8.

⁸⁷ These include the Bank of Bhutan, Bhutan National Bank, the Royal Insurance Corporation of Bhutan, Bhutan Development Finance Corporation, and the National Pension and Provident Fund.

⁸⁸ *Kuensel*. 2008. Banks Burdened by Bad Loans. Thimphu, 11 October. Both the Bhutan National Bank and the Bank of Bhutan, which together constitute around 88% of the financial assets in the banking sector in the country, have a ratings. There is also concern over the unequal sectorwise breakup of loans, with housing having the highest share at 29.79%. More worryingly, while NPLs in any sector should ideally be below 8%, in housing in Bhutan they currently stand at 21.5%.

total loans, and the highest in eight years. The highest portion of bad loans is in the housing sector (at 21.5%), where the banks have a predilection to lend given a high level of collateral, which provides them with some measure of security. The situation results from a weak credit policy and unsatisfactory monitoring and loan recovery.

100. **External shocks.** All economies, particularly small ones, are vulnerable to external shocks,⁸⁹ and Bhutan is no exception. Hydropower accounts for 32% of the economy and 50% of total revenues—jumping from 12% and 32% before the commissioning of the Tala Hydropower Project in mid-2006—and any shocks, natural or otherwise, could create major economic problems. The government takes into account natural shocks to hydropower (such as reduced water levels in project canals) when calculating its potential electricity generation in any given year. Yet the dependency on one market for its hydropower exports could pose a risk, even though this is not immediately evident. Still, there has been continuous effort to promote economic diversification (for example, in the tourism sector), which also serves to meet the employment-generation objectives of the government.

101. Bhutan will also soon join the World Trade Organization (WTO), a project in the works since 1999 and expected by 2010. The merits of joining the WTO have been a matter of some debate, with some arguing that because the WTO promotes “consumerism” it contradicts the GNH development philosophy.⁹⁰

102. The government contends, nonetheless, that WTO membership will help support GNH. There is awareness in government that accession carries costs. To formalize the accession, the country needs to undertake two important obligations: (i) trade liberalization (which is not

likely to be without costs), and (ii) harmonization of policies with the WTO agreement. But the advantages of acceding to the WTO mean that, among other things, (i) Bhutan will gain access to predictable markets, (ii) the domestic market will see more inexpensive external goods, and (iii) rules-based dispute mechanisms can be within easy access. On the negative side, however, the country will also, among other things, see a displacement of local production (toward the goods that are easily accessible from abroad). Increases in imports (facilitated by low or no import duties) mean short-term current account deficits will be greater. And if exports do not increase correspondingly, the economy could face imbalances.

103. Accession to the WTO will require the country to fundamentally alter its thinking on how to sustain its exports. In agriculture, for example, Bhutan has been encouraged to move to niche products, to launch more concentrated marketing campaigns for its products, and to force import substitution.⁹¹ When it is a member of the WTO, it will have to reduce, or completely abolish, tariffs issued on imports from other member countries. However, this is not expected to have direct dramatic impacts because the free-trade agreement with India already facilitates imports from that country, and the low import tariffs do not form a big barrier to imports from other countries. One particular impact of lower import tariffs is decreased government revenues. But because revenues from import duties are not currently a substantial budget item (less than 2% of the total national revenue on average in the past half decade or so), this effect is not likely to be very problematic.

104. Finally, the government feels the current global economic slowdown could affect the tourism industry and possibly industrial development since external investors are likely

⁸⁹ While Bhutan (like other small, rather closed economies) will be insulated from the first round of effects of the current global financial crisis (owing partly to its sound macroeconomic management and partly to the underdeveloped nature of the financial market, which has low exposure to international markets), the second round of effects is likely to kick in through adverse trends in, for example, tourism receipts, remittances, and external financing for infrastructure.

⁹⁰ *Kuensel*. 2008. WTO accession: A Question of If rather than When? Thimphu. 22 November.

⁹¹ T. Wissink. 2004. The Impact of Trade Liberalization on Agriculture in Bhutan. Paper for the 18th European Conference on Modern South Asian Studies, Lund, Sweden, 6–9 July; T. Wangyal. 2003. Reconciling Rhetoric and Reality: An Assessment of the Impact of WTO on Bhutan. In Center for Bhutanese Studies, *The Spider and the Piglet - Proceedings of the First International Seminar on Bhutan Studies*. Thimphu.

to be cautious. However, it does not feel at this stage that it would have any substantial direct impact on the implementation of the 10th FYP.

F. Conclusions

105. Bhutan is not interested merely in “good enough” governance; the government has stated in the 10th FYP that, in order to continue the pace of development, good and proactive governance will be crucial. This means

- i. engendering a truly representative, responsive, and meaningful democracy, the substantive steps for which have already been taken;
- ii. maintaining proper and effective checks and balances among various branches of the government, particularly now that a parliamentary system is in place with representatives directly elected;
- iii. ensuring the proper management and best use of public resources as well as broadening the economic base;
- iv. enhancing the political capabilities and participation of all Bhutanese;
- v. ensuring administrative and financial efficiency, transparency, and accountability, and improved public service management;⁹²
- vi. combating the spread of corruption;

- vii. promoting the role of the media and civil society;
- viii. enforcing the rule of law, wherein the law is applied impartially; and
- ix. strengthening local governments and decentralization processes.

106. The last issue (on local governance) takes on added significance given the government’s long-term interest in devolving power. There is a strong relationship between decentralized governance and the introduction of parliamentary democracy, which provides a special opportunity to fully consolidate the gains of decentralized local governance. The new political environment will facilitate a greater plurality of actors participating in national and local governance, which will help promote greater transparency, accountability, efficiency in public service delivery, and implementation of development activities at both the national and local levels. Additionally, there is a stronger likelihood of local-level interests and concerns being more effectively represented in national decision making, which could determine equitable development outcomes in regions and local communities. Moreover, the success or failure of local governments and decentralized governance processes, in turn, will considerably influence the course of democracy in Bhutan and how deeply it takes root in the years to come.

⁹² This includes strengthening of accountability and management institutions, such as the ACC, the Royal Civil Service Commission, the Public Accounts Committee, the Royal Institute of Management, and the Royal Audit Authority, as well as seeking second-generation reforms in many sectors, including governance and finance.

5. The Maldives

A. Background

107. The year 2008 was a remarkable one for the Maldives. The first democratic elections in the country yielded a change in government after 30 years of rule by President Gayoom. But there are other dimensions of change: (i) from tsunami relief and recovery to rehabilitation;⁹³ (ii) from an indirect election system to a multiparty and direct election of the president; (iii) movement from a least developed country to a middle-income country, and (iv) demographic transition characterized by falling population growth rates and a surge of young people entering the labor market.

108. These changes have to be viewed in the general context of a far-flung country—1,190 islands scattered among 20 atolls with a total land area of less than 300 km² spread over 900 km² around the equator—yet sparsely populated,⁹⁴ with more than a third of its people crowded into the tiny capital Malè (only 2 km²). This has meant not only high unit costs of public service provision but also that overcrowding in urban Malè has undermined social peace, with high youth unemployment and frequent and violent gang battles.

B. Recent Political Developments

1. Constitutional and Legal Changes

109. Significant political changes began with nascent dissident journalism in the 1990s, which by the early 2000s had blossomed into a bona fide political opposition. Continued disturbances in 2003 and 2004 led to the Roadmap to the Reform Agenda⁹⁵ prepared by then-President Gayoom and resulting from intense pressure from within and outside the country.⁹⁶ The Special Majlis (Parliament) in August 2008 finalized the new constitution and the then-President, after some deliberation, ratified it. This paved the way not only for direct election to the Office of the President and the Majlis but also the enactment of various laws on governance and the machinery of government.⁹⁷

110. Other political changes underway include the unanimous passage in October 2008 of the Bill on Maldives Media Council to create an independent institution to aid in press freedom, and the Bill on Freedom of Expression. Still, while political changes may have taken place at the center, the country remains in a transitional

⁹³ The tsunami of late 2004 did considerable damage to the Maldivian economy: it displaced 29,000 people and caused damage up to 62% of GDP (UNDP. 2005. *UNDP and the Tsunami Recovery in Maldives*. Malè).

⁹⁴ The country's population of about 321,000 people lives on 197 of the 1,190 islands; only 28 islands have a land area greater than 1 km², and only 4 islands have a population greater than 5,000 people. Seventy percent of the inhabited islands have a population of less than 1,000.

⁹⁵ The roadmap provided for independence of the judiciary, development of a multiparty system, protection of human rights, and strengthening of key institutions for better and more transparent governance. To attain these goals, it specified three action tracks: (i) revising the constitution by the Special *Majlis* (Constituent Assembly), (ii) enactment of relevant laws by the *Majlis*, and (iii) implementation of measures by the executive.

⁹⁶ Civil unrest in 2004 gathered steam after a prisoner was murdered by prison guards, and countries such as the United Kingdom and international organizations highlighted the lack of political rights in the country. This in itself led to the British government-mediated talks between government and the opposition MDP, which culminated in the Westminster House Agreement in 2006.

⁹⁷ The constitution provides for, among other things, equality, economic and social rights, privacy, right to vote and run for public office, and the following freedoms: of expression, of media, of assembly, to form political parties, and others.

phase; legislative elections took place in May 2009, and local government elections are still to take place.

2. Elections and the New Vision

111. For the first time in 30 years, the country has a new Constitution and a new President elected through universal adult suffrage in a free and fair election. Mohamed Nasheed, a former political prisoner and an opposition leader, defeated President Maumoon Abdul Gayoom in runoff elections in October 2008 to be only the second President of Maldives in more than 30 years (and the fourth in the country's history). President Nasheed's Maldivian Democratic Party (MDP) teamed up with four other opposition parties to defeat President Gayoom.

112. The new President has said the primary aim of his government is to develop the country in a sustainable manner and provide basic services equally to all citizens. Other priorities include the following:

- i. **Decentralization of the administrative apparatus.** While there are proposals to decentralize powers to the atolls, there is at the moment some confusion about the nature of the reconfiguration and composition of provinces and other administrative bodies at the local level. Parliament is at the moment debating the government's proposed policies in this regard.
- ii. **Small and medium-sized enterprise development.** This is a key focus of the new government and, in this respect, there is awareness that much needs to be done relating to better access to finance and technical assistance, including, for example, a credit

guarantee scheme, to enhance access to finance for SME development.

- iii. **Focus on the youth.** There is a recognition that, while this is a long-term issue, it needs to be tackled urgently. The youth need to be engaged in productive activities since unemployment invariably leads to engagement in socially harmful activities.

C. Recent Economic Performance

113. **Gross domestic product (GDP) growth.** This averaged 4.5% in 2003–2005, but rose substantially to 18.0% in 2006 as a result of the massive tsunami-related expenditures and negative growth rate in the previous year. Growth eased to 7.2% in 2007 and 5.7% in 2008, and is expected to be –1.5% in 2009 given the global economic slowdown. Still, and despite the neglect of long-standing structural issues, the country has done well over the years in economic development; indeed, it is on target to be taken off the list of least developed countries of the United Nations (UN).⁹⁸

114. **Inflation.** Worryingly, inflation almost doubled from 7.4% in 2007 to 12.3% year-on-year in 2008,⁹⁹ a staggering increase from 3.5% in 2006, in large part due to higher food and oil prices. Skyrocketing construction costs are of particular concern (for example, the price of cement more than trebled in less than three years from \$4.08 per bag in 2006 to \$10.20 in 2008), and in an economy where resort leasing is critical, the rising costs of constructing new resorts is a worry. All 64 resorts currently under construction are behind schedule. Given its spatial characteristics and economy, the Maldives is import dependent, importing everything from staple foods to resort supplies, and price variations elsewhere have a substantial impact.

⁹⁸ However, in order to continue to benefit from special economic privileges (such as waiver of tariffs for export of fish products), the Maldives will soon ask the UN to postpone removing the country from its list of least developed countries, the second time it will have done so.

⁹⁹ Data from the Maldives Monetary Authority in September 2008 showed that, as of August 2008, the rate of inflation was around 12.4%. This edged down to 12.3% by the end of 2008 (remarks by the Maldives delegation at the South Asia Forum on the Impact of Global Economic and Financial Crisis, Manila, 9–10 March 2009).

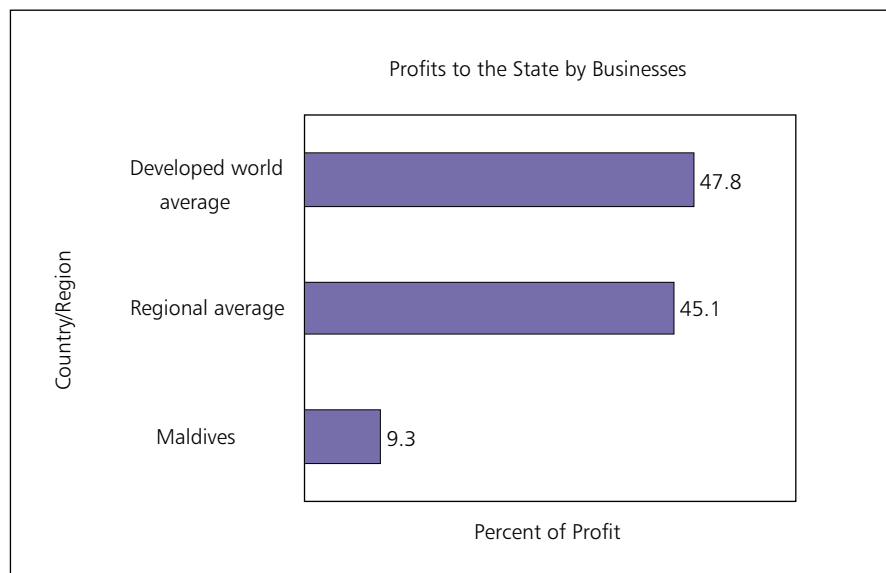
115. **Fiscal issues.** The country is in a very difficult economic situation with large deficits in budget, balance of payments, and current accounts. Revenue enhancement has been hampered by the fact that the government has given up the idea of leasing 31 new resorts (its main revenue base), although it is still proceeding with the leases of 11 “reef resorts” on inhabited islands, and has also recently announced another three uninhabited islands put out to tender.¹⁰⁰ Multilateral agencies and others have cautioned that ad hoc revenues from the lease of additional island resorts may well prove uncertain, and that the government should not rely on them as revenue-enhancement measures. Maldivian businessmen are also the least taxed in the world—given that there is no corporate or personal income tax—further constraining revenues. Figure 5 shows that the treasury only receives about 9.3% of profits by businesses as opposed to the average of almost 48% in the developed world.

116. While the government had hoped to secure greater revenues through advance

lease rent by leasing an additional 31 resorts as an emergency measure to meet the budget shortfall, this was not included in the Third Tourism Master Plan, and many in government were against the idea. The governor of the Maldives Monetary Authority himself had warned that the authority could take little action until government expenditure came in line with revenue. The crisis occurred when \$180 million of projected revenue from a planned transshipment port could not be realized in 2008. In June 2008, the International Monetary Fund (IMF) also cautioned the government to rein in the “extraordinarily high” rate of expenditure in the state budget, amounting to nearly 70% of GDP.

117. The government needs to pay particular attention to reining in expenditures, including substantial electricity and water subsidies, primarily in Malè. State electricity subsidies in the Maldives¹⁰¹ have kept prices artificially low, despite high global oil prices for much of 2008. This is one reason why the state-owned State Electricity Corporation (STELCO) faced

Figure 5: Business Profits to the State



Source: Truck and Barter: Discussing Doing Business. truckandbarter.com/mt/archives/2006/09/discussing_doin.html

¹⁰⁰ Putting reef resorts to tender may not generate much interest. In mid-2008, of the two reef resorts put to tender, one secured no bids and the other received only two bids. Reef resorts are planned on inhabited islands with the aim of bringing resorts closer to local communities and reducing the commute time for workers.

¹⁰¹ In late 2008, the auditor general revealed that STELCO had received over Rf200 million worth of government subsidies that year alone (*Minivan News Online*. 2008. STELCO Incurs Losses of Rf 1.4 Million A Day. 8 December. www.minivannews.com/news_detail.php?id=5642). Both the World Bank and ADB in July 2008 pointed out to the government that the STELCO subsidy is an area of expenditure that should be contained.

a \$72.5 million deficit by the end of 2008, including over \$18 million in outstanding fuel charges. A report by the independent auditor general¹⁰² says this is because of politicization in the affairs of STELCO through government appointment of staff and the board of directors. STELCO has also, on the request of the government, paid out a large portion of its profits (prior to 2005) as dividend, rather than building its equity. The World Bank, the Asian Development Bank (ADB), and the IMF have all asked the government to contain the large electricity subsidy to STELCO. While the government has not revealed the size of the subsidy, power tariffs have remained unchanged since 2002, despite steep hikes in global oil prices.

118. The performance of some state-owned enterprises (SOEs) has also not been satisfactory, and there are many enterprises whose performance has deteriorated over time.¹⁰³ The government has had to provide financial support in the form of grants, subsidized loans, guarantees, rental subsidies, and others to ensure the continuity of their operations. But their returns have not justified such subsidies (dividends from 21 SOEs to the government went down by almost 40% from 2004 to 2005). Only five enterprises accounted for more than 90% of dividends in 2005,¹⁰⁴ while the others pay marginal dividends or none at all.

119. The SOEs are a drag on the economy not only because of the subsidies they get, but also because of lost revenues and inability to

obtain adequate returns on the investments made in them.¹⁰⁵ The new government in its electioneering also made commitments of fresh rounds of expenditures (such as wage hikes to civil servants) and salary increases for elected government officials.

D. ADB's Operational Strategy in the Maldives

120. ADB's operational strategy for development in the Maldives and its strategic focus concentrates on four themes:¹⁰⁶

- i. capacity development (in phase I of the country strategy), wherein the focus is on
 - strengthening economic and financial management (through project management capacity, multiyear fiscal framework, debt management, tax administration, and internal audit capacity);
 - strengthening the private sector by creating public-private partnerships (PPPs), marketing links and business development services, privatizing SOEs, and others;
 - strengthening priority-sector institutions, including the development of a transport sector master plan, power sector institutional reforms, etc.;

¹⁰² Thanks to the political reforms in place, an independent auditor general was appointed who has been one of the main drivers of the exposure of poor practices in government. Indeed, the new auditor general has issued eight dramatic reports that have, for the first time, brought out the extent of corruption and mismanagement in the government. In his first report in July 2008, the auditor general pointed out that even though the government had said the FY2009 budget was "balanced", it really faced a deficit of \$342 million and violated basic accounting principles. In light of that report, and in the face of a revenue crisis, the government decided to cut expenditure by 20%.

¹⁰³ A large part of this is because the Maldives currently does not have any stated policies or regulations in place for enabling SOE reforms, such as a common framework for identifying SOEs to be reformed or a basis for categorization of enterprises for restructure, privatization, or closure. SOE boards of directors are predominantly staffed by government representatives, and contemporary human resource practices, such as linking compensation and promotion to performance through an objective performance management system, are by and large absent. See also the discussion in paras. 121–144.

¹⁰⁴ These are Dhiraagu, Maldives Airport Company, State Trading Organization, Malé Water & Sewerage Company, and Maldives Port Authority.

¹⁰⁵ The larger issue here is obviously whether the government should be involved in running businesses at all. While some level of involvement could be deemed acceptable (particularly if specific social outcomes are sought), the primary question is how SOEs fit into the broader development agenda. For a cogent analysis of the link between government, SOEs, and SOE reforms, see, for example, *Bureaucrats in Business* by the World Bank (World Bank, 1995). *Bureaucrats in Business: The Economics and Politics of Government Ownership*. Oxford University Press).

¹⁰⁶ ADB. 2007. *Maldives: Country Partnership Strategy (2007-2011)*. Manila. October.

- ii. integrated project assistance for SMEs, and energy and transport sector projects;
- iii. investment in sector operations, including energy, private sector development, transport, public financial management, a regulatory framework, and others; and
- iv. coordination with other partners to enhance development effectiveness.

E. Emerging Issues in Governance and Political Economy

1. Public Management

121. Institutional changes subsequent to the promulgation of the new constitution have included the establishment of an Anticorruption Commission (ACC), replacing the largely ineffectual Anticorruption Board (ACB), and of statutory bodies such as the Auditor General's Office, the Election Commission, the Civil Service Commission, and the Human Rights Commission. There have been some teething problems in these new institutions but reforms in public management appear to be on track.

122. However, politicization of the bureaucracy remains a risk,¹⁰⁷ its extent evident during the national elections, for example, in the transfers and appointments of atoll chiefs. The then-President used a clause in the new constitution to remove up to 500 employees from the jurisdiction of the Civil Service Commission, which, among other things, bans employees from political activity. Those removed from the civil service jurisdiction included atoll chiefs and their deputies, ministers, deputy ambassadors, secretaries to ministers, and others. This was done despite the fact that, according to the new constitution ratified in early August 2008, island chiefs are to be chosen through local elections. Atoll chiefs had been made a part of the civil service after the Civil Service Act became law in May 2008, meaning that they were prohibited

from political activity. Observers have said that, in the past, atoll chiefs have played a significant part in elections.

123. The new government is already contemplating reshaping the public sector. For example, the Nasheed Government has reduced the number of ministries from 21 to 14 and the new President has pledged a business-friendly government with an intention to carry out center-right policies and to trim the public sector. In the months to come, there will be a substantial debate in the Majlis about the structure of the machinery of government in the new Maldives, but the debate is expected to be long. One particular area where the move to privatization will be rather evident will be the planned reduction in public sector employment. The new Civil Service Commission has already hinted at such cuts, and is working on severance packages that will incentivize such reductions.

124. **Privatization and the private sector.** While in many areas (such as tourism), the private sector is already the engine of economic growth, there is room for it to grow even more. The government has talked much about privatization in its political manifesto, and has pledged to reduce its role in the economy. Still, SOEs continue to remain dominant largely in banking, transport, international shipping, communications, electricity, fisheries, and water supply. This has narrowed the scope for the private sector. A primary manifestation of the special attention government pays to SOEs has been their being shielded from private competition and provision with special benefits (such as below-market land-rental rates and additional financial benefits).

125. A core plank of the new government's economic reform agenda centers on privatizing SOEs. To this end, it has established an independent Privatization Committee to oversee the implementation of its privatization policy. The government envisages a greater role for the private sector in the country's economic

¹⁰⁷ A matter very much at the core of the independence of the civil service has recently taken center stage in the Maldives. The high court in early December 2008 ruled as unconstitutional Article 53 of the Civil Service Act, which prohibits civil servants from participating in any political activity. The state is currently appealing the decision at the Supreme Court. The former ruling Dhivehi Rayyithunge Party had lodged the case in high court after party members, who were also public office holders, were penalized for political party activities during ex-President Gayoom's reelection campaign.

development and seeks to progressively privatize SOEs. As a first step in the new direction, it has invited expressions of interest for the privatization of nine SOEs. Invest Maldives (the former Foreign Investment Services Bureau, para. 127) is proactively leading the implementation of the privatization process in close consultation with the Public Enterprise Monitoring and Evaluation Board. Invest Maldives has posted on the government website the SOEs for privatization, including the following: Malé International Airport, MIFCO (the state-owned fisheries company), MNSL (the shipping company), and STELCO (the electricity company). However, a formal privatization policy is yet to be enunciated. A clear privatization policy is critical, particularly in the absence of a privatization law, to establish clear principles underlying the privatization process, including the necessary checks and balances.

126. The government is also planning to corporatize five major commercial functions—energy, waste management, water supply, sewerage, and broadcasting—in the hope that this will induce private investment in these areas. Despite the release of the government's SOE shares, however, a multifunction regulatory body will be needed to ensure public interests are well maintained.

127. The new government has renamed the Foreign Investment Services Bureau as the Invest Maldives Department. Invest Maldives, under the Ministry of Economic Development, will serve as the focal point for all foreign investment-related activities and will handle all marketing and promotion of investment and export opportunities.

128. Despite the reform efforts being contemplated for SOEs, the Maldives' private sector could still benefit from a better enabling environment for business and investment. The government is keen to aggressively pursue PPPs in various sectors. In public transport, for example, it is strongly committed to establishing an integrated and comprehensive public transport system that will connect all

inhabited islands and for which it is seeking initial expressions of interest from the private sector for working through PPPs.¹⁰⁸ Under an existing ADB Private Sector Development loan,¹⁰⁹ a PPP component assists the government in structuring and developing pilot PPP projects. One is aiding implementation of a domestic maritime transport project that aims to provide regular and reliable inter- and intra-atoll ferry transport services, and to involve and combine freight and resort transportation elements to bring economies of scale and reduce transport costs. This pilot PPP will also combine the development of a logistics supply chain involving warehousing, cold storage, harbors, and other distribution networks.

129. The government has also recently floated a PPP idea in the education sector. It is of the view that it no longer needs to control the means by which education is delivered, and has even hinted at international parties being invited to take over management of new and existing schools. Some educational services, however, such as libraries and computing facilities, will be outsourced.

130. **Ease of doing business.** But these PPPs will fail to materialize fully unless urgent steps are taken to improve the operating environment for the private sector. Access to credit is one area of concern: the country ranks 143rd worldwide on the comparative ease of getting credit, well below most other South Asian countries. In addition, bankruptcy laws are weak, discouraging the private sector, while the finance sector is narrow. There is only one locally owned commercial bank (Bank of Maldives), branches of three South Asian state-owned commercial banks, and a branch of the international bank HSBC. Banks seldom extend loans with maturities of more than 3–5 years and the spreads remain high. Lending rates vary from 8% to 13% for domestic currency and 7.75%–13% for foreign currency.

131. Nonetheless, despite the lack of adequate incentives for the private sector in Maldives, it is easier to do business there than in the other eight South Asian countries. In the 2009

¹⁰⁸ The archipelago has been divided into seven regions, each covering 20 to 50 interchange terminal nodes.

¹⁰⁹ ADB. 2008. *Private Sector Development Loan*. Manila (Loan IND-2427). This loan was approved on 20 June 2008 and is currently being implemented.

Doing Business Survey, the Maldives ranked top in ease of doing business, dealing with construction permits, employing workers, and paying taxes. Enforcing contracts is easy (albeit implementation of court decrees has tended to be problematic), but the country ranks last in registering property.

132. **Corruption.** The Maldives' performance in the Transparency International index has slipped to 115th in 2008 from 84th in 2007, with a score of 2.8. Only four or five other countries have similarly shifted downward. This is in large part due to weak institutions of accountability including the ineffectual ACB (replaced by the ACC) which reported to the President directly and whose reports were not publicly available. Government accounts also had not been audited for 27 years until 2008, when the new auditor general took an aggressive stand.

133. On a related note, the auditor general has also highlighted the matter of willful defaulters. For example, a new report shows that, by the end of 2008, the Bank of Maldives had granted Rf8.14 billion (\$633 million) in loans, of which 60% was granted to 12 groups,¹¹⁰ a number of which have not repaid their loans on a regular basis. Of greater concern is the fact that the largest loans released by the bank in 2008 were given on the basis of political influence through procedures that facilitate corruption. A significant portion has now been classified as a nonperforming asset.¹¹¹

2. Political Issues

134. ADB has cautioned that "perhaps the most fundamental challenge (in Maldives) is strengthening weak institutions and the

inadequate governance architecture".¹¹² Plans by the new government to proceed full steam ahead with decentralization fall under this governance architecture. This includes establishing regional development councils in the north and south,¹¹³ and is different from the previous system under which, while there were offices at atoll and island levels, the Ministry of Atolls Development in Malé remained influential in their workings.

135. According to government plans, a state minister will be responsible for the two regions, and the committees will be selected from a grassroots island development committee. The appointed atoll chiefs, currently administrative heads of the atolls, will also work under the state minister. The state ministers will be assisted by departments on social services, administration and budget, infrastructure, and economic development. To bring this about, the government intends to provide opportunities and incentives to central-level employees to return to the atolls.¹¹⁴ The new constitution itself calls for administrative divisions to be decentralized and elected councils to be established at the island and atoll levels.

136. The decentralization policy makes sense on many fronts: (i) one-third of the country's population live in Malé, given the city's essential services such as education and medical care; and (ii) costs of service delivery will be considerably lower, although the front-end costs of setting up the infrastructure in atolls will be high. However, the new government's decentralization plans¹¹⁵ have not gone very smoothly to date. Several island administrations have opposed them, fearing unequal representation of atolls in regional committees. Local governance experts

¹¹⁰ The incriminating report by the auditor general revealed defaults on bank loans by influential political persons (Minivan News. 2009. Bank of Maldives in Jeopardy: AG. 19 January. www.minivannews.com/news_detail.php?id=5869).

¹¹¹ Recently, the President also criticized the Maldives Monetary Authority for failing to monitor the activities of the Bank of Maldives more closely. In mid-January 2009, the auditor general published a report on the Bank of Maldives revealing financial fraud and defaults on bank loans due to corruption (Minivan News. 2009. MMA Responds to President's Criticism. 3 February. www.minivannews.com/news_detail.php?id=5948).

¹¹² Footnote 111, ADB. 2007.

¹¹³ These are two of seven pledged regions; the northern region is to consist of Haa Alif, Haa Dhaal, and Shaviyani atolls; and the southern region of Addu and Fuvahmulah atolls.

¹¹⁴ This has to be seen in the context of the government's Population Consolidation Policy, which aims to (i) establish physical links between islands to improve access to better economic and social services, and (ii) relocate the people from small and remote islands to larger and easily accessible ones to benefit from scale economies and increased mobility of people and goods.

¹¹⁵ The decentralization plan has yet to be formalized, however. The Majlis has yet to debate this measure.

have also assailed the new government for moving too hastily with decentralization and for not initiating a comprehensive stakeholder consultation process. As per the government's plans, decentralization will come in two phases: devolving administrative functions, followed by local government elections. There is as yet not much discussion on how the more important financial devolution will take place.

137. The government in October 2008 set up the country's first independent ACC to replace the ACB, although four of five members are former members of the ACB.¹¹⁶ As noted earlier, the Maldives fell 31 places in a year in Transparency International's ranking of perceived corruption internationally. The ACC's work is now being complemented by the recent spate of independent reports from the auditor general.¹¹⁷

138. On the institutional front, a substantial debate is brewing over the Judicial Service Commission (JSC), recently set up as per the new constitution. A constitutional question has been raised about whether the JSC can indeed have control over the judiciary's budget. The Supreme Court in December 2008 stated that existing provisions in the Constitution related to the JSC's administrative and financial control gave the commission undue influence over the judiciary and was, therefore, unconstitutional. Among the commission's responsibilities are the appointment and dismissal of all judges except the chief justice, the investigation of complaints about the judiciary, and the giving of advice to the President and Parliament on judicial matters.

139. Opponents of the JSC have said that the judiciary should be administered by the judiciary itself rather than by a commission in the executive branch of government. Their main contention has been that the current arrangements threaten the separation of powers among branches of government, a main pillar of the constitution. Those on the other side of the argument refer to Article 155 of the constitution, which states the "*Majlis* shall have authority to pass laws concerning the administration of the courts". The matter remains unresolved.

140. All these developments point to the fact that, while major political changes have taken place in the Maldives, the months ahead will continue to test the new political arrangements, which may not bode well.¹¹⁸

3. Economic Issues

141. The neglect of long-standing structural weaknesses in the economy has manifested itself in recent years in rising expenditures and a corresponding increase in budget deficits. The situation has been exacerbated by very optimistic assumptions about revenue streams. Since late 2008, the new Cabinet has recommended expenditure cuts of 20% in the latest budget¹¹⁹ and admitted that there are recessionary trends in the economy. To reduce the revenue–expenditure gap, government policy measures have contemplated (i) more rapid reductions in domestic expenditures, (ii) introduction of the business profit tax and other taxes, and (iii) additional lease payments related to the development of the

¹¹⁶ In that process, the ACC also became the first independent institution established under the new constitution, ratified in August 2008. The ACC was established as per the Anticorruption Act of 2008. More than 150 cases previously being investigated by the ACB have now been transferred to the ACC. The ACB itself was set up in 1991 but was not very effective as it had little independence and there was very little transparency in its work. For example, in November 2007, it refused to reveal details of cases investigated from 2000 to 2005, citing presidential immunity and powers of pardon (observers feel the real reason may be that this may give grounds to prosecute the then-President, or because the President had pardoned those at fault).

¹¹⁷ For example, less than two days before the first round of polls in September 2008, the auditor general released an audit report of the President's Office revealing Rf47.7 million (\$3.7 million) in outstanding loans. This was vehemently denied by the then-President.

¹¹⁸ Already, within a month of the formation of the new government, the coalition saw the resignation of the home minister over heavy criticism of his handling of a labor dispute at a five-star resort.

¹¹⁹ International Monetary Fund. 2008. *Maldives: Public Information Notice No. 08/115*. 10 September (as part of the discussion by the IMF Executive Board on the Maldives 2008 Article IV Consultation).

tourism industry. A bill on corporate profit tax was prepared by the Legal Reform Ministry in June 2006 and is now being debated in Parliament.¹²⁰

142. One measure to reduce domestic expenditures is to control the wage bill. Promises of a pay increase prior to local elections for atoll chiefs and members of Parliament were prohibitive: they were to get a 500% pay rise, plus a 400% rise in living allowance. Partly in response to this, the Ministry of Finance had announced in mid-2008 a series of budget cuts, most of them coming from the Public Sector Investment Program.¹²¹ This resulted from a budget shortfall because revenue from several proposed mega-infrastructure projects failed to come through. As a result, the government introduced a more austere budget for 2009, which seeks to align expenditure within the available resource envelope.¹²²

143. The room to manipulate the budget is also small. Up to three-fifths of the full-year budget is for recurrent expenditure, which poses risks to macroeconomic stability. Yet this is difficult to trim mid-stream. Levels of foreign reserves have also consistently dropped in recent years (down from 4.1 months' worth of imports in 2003 to 2.1 months' worth in 2008). The new government wishes to tackle this by not only increasing revenue sources but also constraining expenditures:

- i. by increasing revenue sources, for example, through
 - (a) introduction of the corporate profit tax, it expects to raise about \$250 million (although this figure has been debated),
 - (b) increase of resort lease periods by 15–20 years to yield a further \$100 million to \$125 million,¹²³ and
 - (c) other means, including raising revenues by selling off excessive presidential and state assets (as suggested by the new President during the election campaign)
- ii. by constraining expenditures, such as for administration,¹²⁴ this includes, largely as a symbolic measure (but significant nonetheless), expenditure cuts for the presidential palace (from Rf176 million to Rf40 million). The budget for the president's office was also cut from Rf127 million to Rf43.9 million in the amended budget.
- iii. 144. Yet the government has moved ahead aggressively with the planned seven regional centers, which will cost the state Rf140 million. There is

¹²⁰ The government has also realized the utility of introducing corporate profit tax and is discussing such a levy of around 15%. Since corporations have grown used to the absence of such a tax, the government must first educate businesses about the need for one. Indeed, the Maldives has never taxed income, capital gains, business profits (except bank profits), wealth, or real estate. About two-thirds of the government's tax revenue comes from import duties (which the new government has cut because it feels they merely widen the wealth gap) and 28% comprise tax through bed rents.

¹²¹ However, the cuts were settled upon only after the government first tried to lease 31 new resorts in order to make up for the shortfall in the budget. But the plan was eventually scrapped. The revenue shortage that necessitated the cuts was serious—the then-finance minister was reported to have said the government would not be in a position to pay teachers the salary increase they were promised. The cuts the government has promised to make must not only be in the recurrent expenditure but also in capital expenditure.

¹²² Still, the projected fiscal deficit for 2009 stands at 7.4% of gross domestic product or GDP (which is better than the over 14% in 2008).

¹²³ This move has come under increasing fire in the *Majlis*. Those opposed say that standardizing rents would increase revenue more than the proposed measure. In some instances, there is a possibility of raising the bed rate from the current \$2,000 per bed to \$7,500, thus yielding significant revenue. Yet others have argued that the government should be more focused on increasing tourist arrivals, given that the country's tourism industry accounts for one-third of the economy.

¹²⁴ The IMF reports that the pay for nearly 30,000 civil servants cost the state nearly \$279 million in 2008. Unless the civil service is trimmed and a wage-freeze instituted for some period, it will be hard to contain expenditure.

a lack of credible information on how this is to be paid for at a time when measures to constrain expenditures are being strongly debated. Moreover, while some revenue sources have been trimmed (import duties on diesel, essential food stuffs, and others have been slashed),¹²⁵ expenditure items have also been added. In addition to decentralization, other cost items that have been included in the new budget include new policy initiatives on pensions for the elderly and medical insurance for one-third of the country's population. This is apt to pose greater strains on the economy at a time when the global economic slowdown is set to hit the Maldives hard, particularly given the presumed decline in tourist arrivals from those countries hit hardest.¹²⁶

F. Conclusions

145. There will be pressure on the new government to:

- i. focus on better fiscal management (including through privatization of SOEs) in light of the state of the economy as well as the global slowdown, which is expected to impact the Maldives through the tourism industry, and on global demand for its sea products;

- ii. diversify sources of growth, to the extent possible, from tuna and tourism;¹²⁷
- iii. focus on a sequenced approach to achieve better public resource management by paying greater attention to initially building capacity in the public sector prior to major investments;
- iv. be cautious in developing new investment projects, for which readiness filters have been proposed in the ADB Country Partnership Strategy,¹²⁸ and where strong PPP interest has been demonstrated by the private sector;
- v. focus on the establishment—and proper functioning—of independent accountability institutions, now that a more democratic governance system has been instituted; and
- vi. emphasize the devolution of authority from Malé to regional centers and then to atolls.

146. In many ways, the devolution of authority alone will truly signify the extent to which democratic changes at the center have been brought home to the citizens of the Maldives.

¹²⁵ There is opposition in the Majlis to the cutbacks in the import duties. By the finance minister's own reckoning, the Maldives stands to lose half a billion rufiyaas as a result of the cuts, but the new government had pledged to reduce the cost of living, hence the proposed measure.

¹²⁶ According to statistics from the Maldives Association of Tourism Industry, the total number of tourist arrivals recorded in January 2009 was down 5% from a year ago. It is interesting to note that 80% of the total tourist arrivals in January to November 2008 were made up of those from Europe, Japan, and North America, all regions or countries that are facing the brunt of the global economic slowdown.

¹²⁷ This is obviously easier said than done, particularly given that countries must diversify in their areas of comparative advantage. But the fact remains that, as long as the country continues to rely on these two sources of growth, it will continue to face limiting options for growth at times like the present. One long-term option the government has been considering is for the Maldives to capitalize on its sea-transit position.

¹²⁸ These filters include (i) a reduction in the government's ratio of external debt to GDP as evidence of progress towards fiscal consolidation and sound debt management; (ii) an increase in the ratio of disbursements to outstanding commitments of ADB assistance; and (iii) progress made in developing a medium-term fiscal framework, to ensure that new public investment is prioritized and can be realistically financed without undermining macroeconomic stability.

6. Nepal

A. Background

147. In the years before 2008, fundamental political changes had taken place in Nepal. A popular uprising—bolstered by the Maoist rebels—replaced the 250-year-old monarchical system with a federal democratic republic. Yet Nepal remains an impoverished country. Indeed, the UN reports that “1/3 of Nepal’s population live in some of the worst conditions to be found on the planet”.¹²⁹ For all the excitement about the new direction the country has taken, the political breakthroughs of 2006 have so far yielded no tangible peace dividend to the Nepali citizen.

B. Recent Political Developments

148. After multiparty democracy was introduced in 1990, the political situation displayed dual tendencies toward a lack of credibility among political parties (rendered ineffective by constant partisan bickering) and the marginalization of large segments of the population. In the mid-1990s, the Communist Party of Nepal (Maoist) or CPN(M) splintered from the core alliance of leftist parties and initiated a “people’s war” against what it termed the feudal state. In the decade-old conflict, 11,715 people were reported killed and 19,000 displaced.¹³⁰ Physical losses have been estimated at NRs5 billion (about \$68 million), not to mention the untold misery and agony of thousands of people affected by the conflict.

149. In February 2005, the king took the reins of power with a promise to steady the

political situation and resolve the matter of the insurgency, but failed. A mere 14 months after his takeover, all political parties—in alliance with CPN(M)—united to force the king to reinstate Parliament, and the conflict soon came to an end. Since then, political governance has been characterized by attempts to steer the country toward a different political landscape. At the core of this is the consensus among political parties to move the country toward a federal state based on a new constitution drafted by the constituent Assembly, the elections for which were held in April 2008 after two postponements.

150. The Constituent Assembly elections were generally peaceful and orderly, with a reasonably high voter turnout of 61%, reflecting the Nepali people’s aspiration for lasting peace and stability. In what came as a surprise to many, CPN(M) won the largest number of seats under both the first-past-the-post and the proportional representation electoral systems.¹³¹ In May 2008, the Constituent Assembly, in its first session, formally declared Nepal a federal democratic republic, thus ending the almost two-and-a-half-century reign of the Shah dynasty. The Constituent Assembly itself is more inclusive of historically marginalized groups than previous legislatures,¹³² and this augurs well for the process of preparing the constitution.

151. Probably the most substantive political development in Nepal that has not garnered much media attention has been the work that the current and the immediately preceding governments have done on recalibrating fiscal relationships between the central and local

¹²⁹ UNDP. 2008. *Least Developed Country Report*. New York.

¹³⁰ Ministry of Peace and Reconstruction. Cited in *The Himalayan Times*. 2008. *Miseries Continue to Dog Thousands of Conflict-Hit*. Kathmandu. 8 May.

¹³¹ CPN(M) won 220 seats in total, followed by Nepal Congress with 110, the Communist Party of Nepal (United Marxist-Leninist) with 103, Madhes People’s Right Forum with 52, and other smaller parties with 90. The remaining 26 seats for the 601-member Constituent Assembly were nominated by the interim government in June 2008.

¹³² The Constituent Assembly Member Electoral Act 2007 allocated special seats to women and disadvantaged groups (DAGs) as follows: Dalits 13%, indigenous groups 37.8%, backward regions 4%, Madhes 31.2%, and other groups 30.2%. Males and females equally shared each of these quotas.

governments.¹³³ This is relevant since it is a precursor to the transition to a federal state. While local governance, until 1990, was always dominated by a greater focus on administrative considerations than political or economic autonomy, and very little political space was given to local governments, this changed with the Constitution of 1990. Since then (and particularly after the legal framework provided by the Local Self-Governance Act in 1999 and the Interim Constitution of 2007 that provided priority to local self-governance and equity-based resource allocation), local governance reforms have been debated in the same breath as overarching national political reforms.

152. Nepal has not had elected local governments since July 2002, which means there are no local elected representatives. This has myriad consequences, the most significant of which is that local administrations run by bureaucrats deputed from the central government¹³⁴ have very little downward accountability, even though they are supported by an all-party mechanism at the local level. This has hindered local stakeholder ownership of the development process.

153. The CPN(M)-led government formed in May 2008 focused on three specific short-term priorities (that is, until a new constitution is in place): (i) completion of the peace process, and immediate relief of people affected by the conflict, (ii) accelerated economic growth, largely by focusing on public works and construction, and (iii) social security and inclusion.¹³⁵ All three priorities are integral parts of the vision for what has been termed a “New Nepal” (one where the political economy will be substantially different from that evident in 2008).

C. Recent Economic Performance

154. **Gross domestic product (GDP) growth.** Nepal’s average economic growth rate in 2006–2008 was a mere 3.9%, compared to the 7.6% average for other least developed countries. The Asian Development Bank (ADB) concludes that, despite the difficult political environment, GDP growth in FY2008 (ending mid-July 2008) was 5.3%, although it is likely to weaken to approximately 3.0% in FY2009 due to the poor winter crop caused by severe drought, continued power shortages, unresolved labor tensions, and frequent political strikes dampening agricultural and industrial growth.¹³⁶ The relatively low rates are a reflection of ongoing political instability impacting private sector development and other structural issues (such as infrastructure bottlenecks). The contribution to GDP growth by major sectors is shown in Figure 6.

155. **Inflation.** The consumer price index rose to 14.5% year-on-year in mid-November 2008 (from 6.3%) in the previous year, according to the central bank.¹³⁷ Food prices in 2008 also rose at an alarming rate. The rate of inflation in July 2008, for example, was 13.1% (more than double the rate in the same period in 2007) as food and nonfood commodity prices rose sharply. Inflation is likely to continue rising although the government’s monetary policy seeks to contain it at an average of 10.0% in FY2009 compared to 7.7% in FY2008 (still, ADB expects average annual inflation in FY2009 to be 11%–12%).¹³⁸ Rising inflation reflects still-high prices in India and depreciation of the Nepali rupee.¹³⁹ Food grains, edible oil, petroleum products, and transport remain the key contributors to rising prices. Although

¹³³ At the moment, local governments in Nepal constitute 75 district development committees, 58 municipalities, and 3,915 village development committees. The current intergovernmental fiscal transfer system relies on an annual performance assessment, and as local governments meet minimum conditions and graduate to fulfilling other performance measures, their level of unconditional grants from the center varies accordingly.

¹³⁴ This includes executive officers in municipalities, local development officers in district development committees, and secretaries in village development committees.

¹³⁵ Government of Nepal. 2008. *Budget Speech of Fiscal Year 2008-09*. Kathmandu.

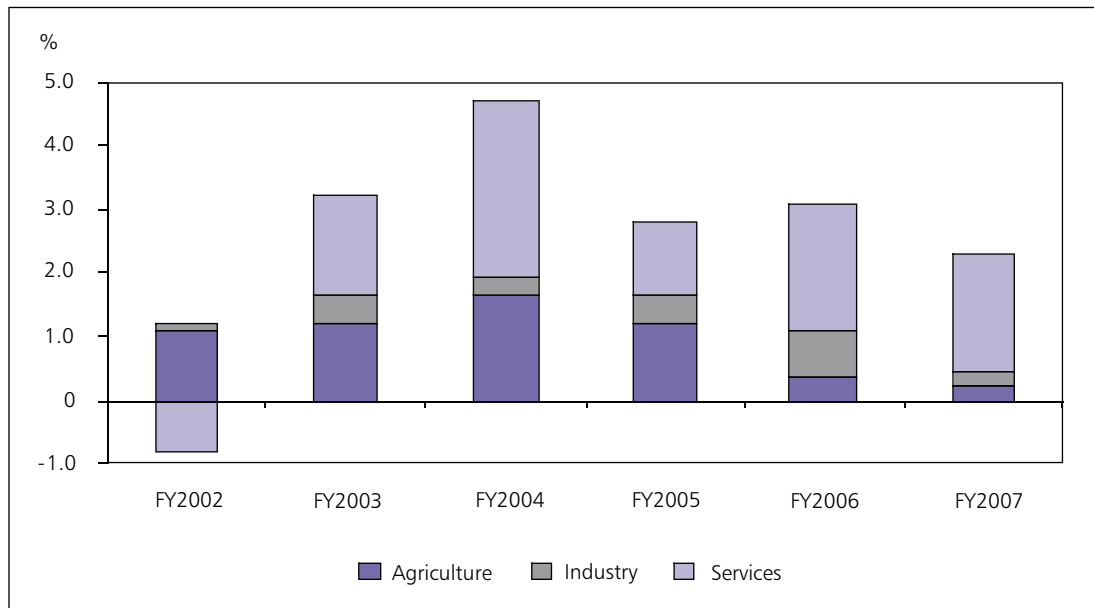
¹³⁶ ADB. 2009. *Nepal: Political and Economic Update—Board Information Paper*. 3 July. Manila; ADB. 2009. *Quarterly Economic Update – Nepal*. Manila.

¹³⁷ Nepal Rastra Bank. Current Macroeconomic Situation (Based on the First Four Months’ Data of 2008/09). Kathmandu. [www.nrb.org.np/ofg/recent_macroconomic/Recent_Macroeconomic_Situation_\(English\)--2009-01_Text_\(Based%20on%20first%20four%20month%20data%20of%202008-09\).pdf](http://www.nrb.org.np/ofg/recent_macroconomic/Recent_Macroeconomic_Situation_(English)--2009-01_Text_(Based%20on%20first%20four%20month%20data%20of%202008-09).pdf)

¹³⁸ ADB. 2009. *Nepal: Political and Economic Update—Board Information Paper*. 3 July. Manila.

¹³⁹ The IMF terms the Nepali inflation rate “imported” because there is a fixed exchange rate with the Indian rupee, and substantial trade with India.

Figure 6: Sector Contribution to Gross Domestic Product Growth in Nepal, Fiscal Years 2002–2007



FY = fiscal year.

Source: Ministry of Finance. www.mof.gov.np/publication/budget/2006/surveyeng.php

global oil prices have declined in recent months, inflationary pressure has not eased as administered domestic fuel prices have not been adjusted accordingly, while a 27% pay increase for civil servants in the FY2008 budget and pressures for upward adjustments in fuel prices could also increase inflationary pressures. The central bank asserts that rising prices are due to reasons beyond monetary control alone and that other nonmonetary problems (such as rigidities in the transportation syndicate, cartels, and hoarding) currently dominate.

156. Fiscal issues. The overall fiscal situation of the government remained robust in the

first 9 months of FY2009 with an overall budget surplus of NRs12.8 billion (compared to the deficit of NRs5.3 billion during the same period in FY2008). The unprecedented treasury surplus is mainly on account of strong revenue mobilization. Despite the political problems, revenue collection has increased measurably in recent periods¹⁴⁰—17.5% in 2008 compared to 15.4% in 2007—owing to a high rate of growth of income tax, customs duties, value-added tax, travel receipts from tourists, and workers' remittances.¹⁴¹ The government has also put in place specific policies to enhance internal revenue collection.¹⁴²

¹⁴⁰ In the first 9 months of FY2009, revenue collection showed an increase of 39.3% compared with the same period in the previous year.

¹⁴¹ Workers' remittances continue to dominate the revenue stream for the government. In 2008, an almost 75% increase in such remittances has meant a large current account surplus.

¹⁴² One specific effort is the Voluntary Disclosure Information Scheme (VDS) launched in October 2008 to give an opportunity to tax evaders to pay all outstanding dues and divulge earned assets and income to the proper authorities. Despite ongoing opposition from the private sector, the CPN(M)-led government had, through VDIS, collected Rs350 million as of mid-February 2009 (well below the targeted Rs1 billion, but nonetheless substantial). In addition, an extra 10,000 potential new taxpayers were identified as a result of the VDIS. More revenue collection is now possible largely by tightening the tax net and revising bureaucratic processes, including putting in place a performance-based incentive scheme for customs officials (*Nepali Times*. 2009. "I am not frustrated, and no one should be..." . Interview with Finance Minister Mr. Baburam Bhattarai. Issue 433. 9–15 January. www.nepalitimes.com.np/issue/2009/01/09/Interview/15544).

157. Workers' remittances have turned out to be a substantial cash cow for the country, rising from \$800 million in FY2005 to almost \$1.4 billion in FY2007.¹⁴³ The number of workers going abroad also jumped, from 107,000 in 2003–2004 to 240,000 in 2007–2008. Rising remittances have also seen consumption increase, which in turn has helped foreign trade expand, by 13% in FY2008 compared to FY2007. However, Nepal continues to trade heavily with India (growing by 16% in FY2008, while trade with third countries grew by less than half that).

158. Meanwhile, government expenditures have ballooned (of the recurrent rather than capital type). Recurrent expenditure has grown at 22.0% in the first 9 months of FY2009, compared to 21.4% during the same period in FY2008, on account of increased civil service salaries¹⁴⁴ and peace process–related expenditures (such as the operation of the People's Liberation Army cantonments and allowances to conflict-affected victims). The budget deficit (after grants) was 2% of GDP in FY2007 compared to 1.6% in FY2006. The widening deficit was largely due to a shortfall in foreign grants, despite the achievement of domestic revenue targets and development expenditures below budgetary targets.¹⁴⁵ In 2008, government revenues grew 19.2%, while expenditures rose 21.4%. Capital spending remained below target as many positions in local bodies remained vacant, hampering implementation of development programs at the grassroots level.

159. The current 3-year Interim Development Plan (FY2008–FY2010)—which looks set to be renewed for a further two years as the

political process to a federal state has yet to be complete—focuses on reconstruction, reintegration, rehabilitation, economic recovery, and social inclusion. The plan's approach paper aims to achieve average annual GDP growth of 5.5%, with targets placed at 3.6% for agricultural growth and 6.5% for nonagricultural growth. This outlook assumes that gains in the peace process will be consolidated, investor confidence restored, and foreign aid inflows increased.

D. ADB's Operational Strategy in Nepal

160. ADB's operations in Nepal are based on the underlying assumption that the decade-and-a-half-long conflict had as its root cause poverty and inequality.¹⁴⁶ Indeed, deeply rooted social exclusion underlies the continued unrest in many parts of the country, and so the manner of involvement in Nepal's development process that ADB has taken supports the following measures to foster a more inclusive development and results-oriented process:

- i. conflict assessment, in light of the recent history of the people's war;
- ii. a participatory process, to ensure that communities and others are directly participating in the development process, the lack of which was the underlying cause of the conflict in the first place;
- iii. mainstreaming inclusion, under which all ADB programs and projects will ensure, to the extent possible, opportunities to assist poor women,

¹⁴³ Nepal Rastra Bank. 2007. *Current Macroeconomic Situation*. Kathmandu. September.

¹⁴⁴ The overall salary index rose by 16.8% year-on-year in April 2009 relative to 10.9% in April 2008. In particular, the salary index of army and police officers increased sharply by over 30% year-on-year in April, relative to only 9.3% in the previous year. Similarly, the salary index of civil servants increased by 28.1% in April 2009, even after a 23.5% rise in April 2008 (ADB. 2009. *Quarterly Economic Update – Nepal*. Manila). The salary, allowances, and benefits of civil servants are to be reviewed every three years taking into consideration the rate of increase in revenue, total civil service positions, and the rate of dearness allowance paid over three years. A performance-based salary system was piloted in several offices in FY2007; its success will be critical for wider application of performance-based salary in the civil service, and consequently, for the civil service wage bill.

¹⁴⁵ In addition, Nepal is subject to global inflationary pressures which are fueled by an increase in money supply through an increase in the Net Foreign Assets. While this will assist in maintaining liquidity, financing the deficit will require an expanded public borrowing program which will put pressure on domestic interest rates.

¹⁴⁶ ADB. 2004. *Nepal: Country Strategy and Program (2005-2009)*. Manila.

disadvantaged ethnic and caste groups, and the rural population; and

- iv. transparency and accountability, such that decentralization, public participation, and measures to help reduce corruption will help the government better attain its development goals.

161. In line with the above, and in keeping with the emerging political economy of the country, ADB is also targeting assistance in the following broad areas meant to enhance economic growth accompanied by inclusive development:

- i. broad-based economic growth, along with providing access to economic opportunities with a special focus on the needs of the poor and the excluded in rural areas;¹⁴⁷
- ii. inclusive social development, under which ADB's support will be in human resource development, which aims to empower the poor and those excluded through social mobilization and awareness, and promote the skills needed for remunerative employment and for raising productivity; ADB is also keen to help the government address gender, ethnic, and caste discrimination by encouraging inclusive public policies, civil service reform initiatives, and others;
- iii. good governance, which, as in the other countries considered here, is central to the development process; focus in this area has included:
 - encouraging the participation of women and of disadvantaged

and excluded groups in the development process and in government,

- supporting the government's decentralization initiatives, including fiscal decentralization,
 - improving devolved service delivery at the grassroots level,
 - pursuing institutional strengthening and deregulation to minimize opportunities for corruption, and
 - supporting civil service reforms to enhance the accountability, transparency, and results orientation of public service delivery;
- iv. private sector development, under which ADB is helping promote private investment by fostering a more conducive policy and enabling environment (with special attention to enhancing enforcement of policies aimed at catalyzing private initiative).

E. Emerging Issues in Governance and Political Economy

1. Public Management

162. While there have been major political changes in Nepal in the late 2000s, the public management structure and system have vestiges of past poor practices. For example, there are still 139 prevailing laws considered discriminatory to women in the civil service even though the government has a policy of 33% reservation for women in all state mechanisms. In other issues related to public management, service delivery, and other areas, a strategy is now in place for service delivery as part of good governance that aims to:

¹⁴⁷ Areas ADB is targeting to bring about broad-based economic growth include developing the transport and communications network to support a more dynamic market economy; strengthening the farm-to-market link in underserved regions; supporting prudentially sound, market-oriented rural financial intermediation; restructuring the energy sector; improving access to rural communications; and encouraging private investment. The advantages of focusing on these areas of economic growth are clear: not only will they lead to greater wealth generation, but they will also create the fiscal space for more inclusive poverty-reduction programs.

- i. minimize corruption by strengthening institutions such as the National Vigilance Center (NVC) and the Commission for Investigation of Abuse of Authority;¹⁴⁸
- ii. transfer local services to local bodies;
- iii. continue to emphasize citizens' charters and public hearings and give civil society a greater monitoring role largely through a more comprehensive social mobilization policy;
- iv. disseminate information more effectively by, for example, computerizing all information in public agencies involved in service delivery and enhanced communication among service providers, and make available to the public all information on services delivered by the state;
- v. give greater authority to institutions that deliver services and equip them adequately; and
- vi. place greater emphasis on consumer rights.

163. This largely means promoting access to economic and social service delivery through public participation, transparency, accountability, and the creation of a corruption-free environment. One particular strategy in this respect has been to reiterate the fundamental rights of the client to receive effective and quality service by making service delivery from all government agencies inclusive. Another is to encourage a greater role for nongovernment organizations and community-based organizations in social mobilization.

164. **Civil service reforms.** Recent governments have concentrated their efforts on "rightsizing" the civil service, covering elimination of vacant positions, a freeze on recruitment, contracting

out of services, functional devolution to local bodies, and organizational restructuring. The new Civil Service Bill includes provisions for rightsizing the civil service under which vacant positions in the nongazetted classes 3 and 4 and the classless level¹⁴⁹ will be eliminated. This will correct the imbalance between professional and support staff, the former constituting only about 10% of the civil service. The 2003 Service Contract Directive also allows public institutions to contract out services (for example, security, mail delivery, transportation, surveys and design, and maintenance) to private individuals and firms. Activities in education, health, agriculture extension, and local infrastructure sectors have been devolved to local bodies as provisioned in the Local Self-Governance Act, 1999.

165. **Anticorruption efforts.** Anticorruption efforts by recent governments have focused on legislative and institutional matters. The Political Parties Act of September 2002 aims to develop political parties as organized bodies, systematize the process of their registration, promote the process of democratization in their internal workings, and ensure their development as responsible bodies by making their funds transparent. The act also requires an audit of accounts of political parties, and preparation of annual income and expenditure reports.

166. In addition, public officials are required to submit an annual updated statement of income and property according to Section 50 of the Prevention of Corruption Act of 2002. Anyone holding a "public responsibility post" has to submit an annual updated statement of property in his/her name or in the name of his/her family members along with evidence to an authority prescribed by the government. Under the act, the National Vigilance Center was established in February 2003 as an anticorruption unit under the prime minister. Its mandate is to prevent corruption-motivated actions in government and to promote

¹⁴⁸ Anticorruption efforts of specific agencies could still be strengthened, although some institutional steps have been taken, including giving greater mandates and resources to the Revenue Investigation Department (within the Ministry of Finance), strengthening the Public Accounts Committee in the legislature, strengthening the Special Court, and providing stronger support to civil society and nongovernment organizations to advocate greater awareness of corruption at the grassroots level.

¹⁴⁹ There are about 11,000 vacancies in the nongazetted classes 3 and 4 and the classless levels.

awareness of corruption. It works closely with civil society (for example, in putting together public awareness programs, workshops, and seminars on corruption control themes at the regional and district levels for government and nongovernment agencies).

167. The previous CPN(M)-led government took a firm stand against willful defaulters, an item high on its agenda. In February 2009, it publicized the names of 339 willful defaulters, each owing at least NRs10 million to the banks. Banks are owed about NRs16 billion (about 12 commercial banks bear the brunt of this offense), and double that when interest is calculated. Actions against the defaulters included seizure of passports and prohibition from taking company directorships.

168. **Public-private partnership (PPP).** There is currently, at least on paper and as stated intentions, considerable interest in the government to pursue public-private partnerships (PPP), with plans to encourage this partnership in sectors such as education, physical development, agriculture, and health (where it is believed there is a substantial basis to generate PPP interest). However, putting PPPs into practice will require considerable government investment (by some accounts, above \$60 billion in the next 10–15 years).¹⁵⁰ Clearly, this does not look very feasible given current economic trends and the size of the national economy.

169. Despite this, and in the larger context of a dampened business and industrial environment, work on a new draft industrial policy is continuing, which focuses on, among other things, developing female entrepreneurship, providing tax holidays, and providing capital availability. One of the more interesting proposals in the draft policy would give greater grants to local bodies that promote private enterprise.

2. Political Issues

170. **Move to a federal state.** This is a pressing problem that will need to be tackled

head-on in the emerging political economy. Where almost 85% of government revenue comes from seven districts due to differences in economic endowment,¹⁵¹ and where the center can collect only 18%–20% of revenue from local bodies, how to manage a federal economy where the resource base and stock are not uniform is a serious issue. To compound the problem, there is as yet no consensus on how the federal state should be constituted. Even within the CPN(M), which aggressively fought for this ideal, there are internal divisions on the nature of the republic to be formed. This is likely to mean a prolonged—and potentially ill configured—national debate.

171. The constitution-drafting process—a key step forward in the ongoing peace process—has only recently begun although the Constituent Assembly approved a schedule for this in mid-November 2008. At the moment, it appears unlikely the process will move ahead comprehensively until the former Maoist combatants—the People’s Liberation Army—are integrated into the Nepal Army or at least the controversy over it is amicably resolved.

172. **Army integration.** This is a thorny issue for now. Possible options for People’s Liberation Army combatants are (i) integration into the national army, (ii) decommissioning and demobilization, (iii) outright dismissal, (iv) joining an industrial security force, or (v) joining the police (including border security, regular police, and armed police). The Army Integration Special Committee has made some headway in its work, but the integration process itself has not yet commenced.

3. Economic Issues

173. Successive governments in Nepal have publicly stated their commitment to put in place relevant policies that will lead to rapid economic growth. However, it is also true that regardless of the political hue of the party leading the government, there has continued to be a focus on the predominance of the state in the economy. In the meantime, the mantra

¹⁵⁰ The *Himalayan Times*. 2008. PPP Concept Isn’t Maoists’ Brainchild. 9 December.

¹⁵¹ The Ministry of Local Development estimates that Kathmandu District alone collects 40% of all revenue in the country; Parsa District, which handles much of Nepal’s overland imports from India, collects another 20%; and 64 of the 75 districts in the country together collect only 14%. The remaining nine districts collect the residual 26%.

of fiscal discipline as a firm policy commitment has not waned over the years, even though in practice this was not always evident. This is a relevant point since development partners have cautioned that, generally, the budget in Nepal tends to be ambitious (and if it failed, macroeconomic stability would be jeopardized), the proliferation of deposit-taking institutions in the country at present is proving to be a tough challenge, and banks and other financial institutions have overexposed themselves to the real estate market¹⁵² and there is an urgent need to prevent the risks of this growing exposure.

174. Parallel to this, the capacity of the central bank (Nepal Rastra Bank [NRB]) to regulate them has also been questioned. Effective mid-October 2008, the central bank has enforced a Prompt Corrective Action in a bid to get sufficient capital reserves in registered banks and financial institutions and to ensure financial stability.¹⁵³

175. **Impact of global economic crisis.** While this is not likely to be very severe in the short term, a high-level monitoring mechanism has been established to analyze economic indices and other activities and recommend suitable action. Possible crisis impacts are mixed:

- i. Overall, the impact should be limited by the narrow exposure of the financial system to the global financial market and products. However, various

indirect adverse impacts are likely, and largely dependent on the extent to which India's economy is affected.¹⁵⁴

- ii. Tourist inflows will be hurt, particularly where the economic crisis is severe (such as in North America, Europe, and Japan).
- iii. Remittance inflows will also be affected if the global slowdown worsens.¹⁵⁵ Nonetheless, as with the situation in Bangladesh, given that the bulk of Nepal's foreign employment is in the Middle East, remittance inflows may remain relatively intact for the time being (although the significant growth rates seen in recent years may not be sustained in the medium term in view of the emerging crisis in other host countries such as the Republic of Korea and Malaysia).
- iv. Another key implication of the global crisis would be the likely difficulty in securing financing for a number of upcoming large-scale infrastructure projects, particularly for those being developed under PPP modalities with significant foreign direct investment.

176. Indeed, the global crisis has already had some impact on industry. According to the Confederation of Nepalese Industries, as of

¹⁵² For example, commercial banks' total outstanding loans in real estate doubled from September 2007 to September 2008 although they still account for just 13.9% of total outstanding loans (*The Himalayan Times*. 2008. Credit and real estate: the emerging financial crisis. 2 December). Indeed, the Nepal Bankers' Association has warned that Nepal is at present overbanked and unhealthy competition is growing. At the moment, there are three dozen commercial banks (soon to increase even more), five dozen development banks, over six dozen finance companies, and several hundred cooperatives. The fear is that should a crisis hit, the government will not be able to inject money to rescue them.

¹⁵³ For example, NRB has stated that any bank or financial institution under category A, B, or C will be immediately punished if it is found not to be maintaining the capita adequacy ratio fixed by the regulator. This punishment could include, for example, NRB preventing the concerned banks and financial institutions from declaring dividends and bonus shares if their minimum capital ratios are found to be up to 2 percentage points less than the required ratio. Likewise, NRB can bar the concerned institutions from increasing salaries and benefits of employees, recruiting additional workforce, and others.

¹⁵⁴ This is so given the close integration of Nepal's economy with India's (the Nepali rupee is pegged to the Indian rupee, India is its main trading partner, and the two countries share a long open border). Generally, any slowdown in the Indian economy will hurt Nepal.

¹⁵⁵ Towards late 2008, the NRB cautioned the government that the global slowdown would see remittances decline 40% by mid-November 2008 against an 80% increase in mid-October compared to the same months in the previous year.

the end of October 2008, industry had already lost NRs20 billion.¹⁵⁶ Particularly hard-hit have been businesses dealing in iron, edible oil, and metals. Other areas that could feel the pinch in time are tourism, foreign investment, real estate, financial services, and, most worryingly, remittance inflows.

177. **Business environment.** One of the most serious emerging issues in Nepal is the rising tide of business-unfriendly developments. The list of companies and businesses impacted by shutdowns due to labor disputes (or other pretexts) is long. Trade unions affiliated with political parties often close down factories and businesses, at huge cost to the economy. In 2008, for example, 55 factories in the Hetauda industrial area (8 of which belong to multinational companies) were closed. The price tag of these closures, according to the Hetauda Industrial Area Management Limited, was from NRs6.6 million to NRs10 million a day.¹⁵⁷ At least in the case of the closure of industries in Hetauda, the then-government unwittingly had a hand: by mandating an increase in the minimum wages of unskilled workers from NRs3,300 to NRs4,600 per month, it forced the entrepreneurs to call this decision unfair and unsustainable, while the unions demanded that those already earning more than the minimum wage get a similar increase.

178. This does not bode well for the already ailing industry sector and points to the need for urgent labor market reforms to improve industrial relations and the overall investment climate. For such reasons the World Bank's *Doing Business Survey 2009* listed Nepal at the

bottom of the eight South Asian countries in a ranking on employing workers. In contrast, it topped the ranking for registering property.¹⁵⁸ The most recent budget statement (i.e., for FY2010) explicitly recognizes this problem of a weak business environment, and puts in place some measures designed to enhance it; such measures include (i) giving continuity to workable policies of the previous government, (ii) establishing a high-level Investment Board chaired by the prime minister with the objective of attracting national and foreign investment in large industry and infrastructure, (iii) encouraging small and cottage industries, (iv) making business processes (such as starting and closing a business) simpler, and (v) establishing a business-friendly tax system and guarantee of contract enforcement.

179. An associated risk emerges from the tendency of aggrieved parties to call for strikes with very short notice for any grievances, real or perceived. The economic costs of strikes are staggering for such a poor economy. During the political upheavals of April 2006, for example, ADB said the 3-week-long shutdowns of Kathmandu alone cost about NRs10 billion–NRs15 billion. Some have cited the diversified costs (such as investors' costs in hydropower projects, impact on government revenue, the cost claimed by insurance companies, the cost of deploying the security forces, and the cost of general strikes) amount to at least \$100,000 per day.¹⁵⁹

180. These problems are but some areas of concern the private sector has to face on a continuing basis; others include:

¹⁵⁶ See, for example, *Nepal News*. Nepali Industries Have Lost Rs 20 Billion due to Global Meltdown: Chaudhary. www.nepalnews.com/archive/2008/oct/oct28/news01.php

¹⁵⁷ The story is similar outside Hetauda. In one case in 2008, it was the personal intervention of the then-prime minister that helped reopen businesses. The matter did not escape India's attention: in November 2008, the visiting foreign minister raised with the then-prime minister the issue of industrial security and threats against Indian multinational firms operating in Nepal, and sought assurances that the matter would be handled promptly.

¹⁵⁸ Other rankings show the following: 3rd in enforcing contracts and closing a business; 4th in protecting investors (although this ranking will surely change in the next survey); 5th in starting a business, ease of doing business, dealing with construction permits, and paying taxes; and 7th in the region on trading across borders (World Bank. www.doingbusiness.org/economyrankings/?regionid=6).

¹⁵⁹ Pyakuryal, B. 2007. The Economic Costs of Strikes. 11 February. www.kantipuronline.com/kolnews.php?&nid=100377 A recent report by the United Nations' World Food Program (WFP) focuses on food security and the livelihood impacts of strikes in Nepal. According to WFP's calculation, one day of strikes causes total losses of up to Rs1 billion (Aryal, M. 2009. *Ban Bandas. Himal*, (441). 6–12 March). This is a staggering amount for any country; for one as poor as Nepal, it is catastrophic.

- | | |
|--|--|
| <ul style="list-style-type: none"> i. media harassment, including kidnapping and murders as well as vandalism of media houses;¹⁶⁰ ii. industrial insecurity stemming from the behavior of party-affiliated unions;¹⁶¹ iii. a varied understanding of PPP between government and the private sector; and iv. power shortages that have hit local industries and businesses very dearly.¹⁶² | <ul style="list-style-type: none"> ii. focusing on a few key areas of investment opportunity for external investors, including large-scale projects such as hydropower, industries such as cement, and other local resource-based industries and services;¹⁶³ iii. taking a firmer stand on corruption, and improving the business climate;¹⁶⁴ and iv. putting in place institutional mechanisms, such as reactivating the Investment Board and improving the licensing regime. |
|--|--|

F. Conclusions

181. Given the problems—and the opportunities—that political changes in Nepal present, the previous and current governments have been keen on moving ahead on multiple fronts:

- i. creating an environment for tapping the investment potential of nonresident Nepalese through provisions of dual citizenship;

182. The previous finance minister, at the 2008 joint meeting of IMF Board of Governors and the World Bank, reemphasized the commitment to improving governance and controlling corruption in the country. By all accounts, current governance trends indicate there is still a fair way to go to make the necessary improvements.

¹⁶⁰ Accusations fly thick and fast among the youth wings of the two major political parties as to who was responsible for what; and violence against other groups is very common. These youth groups mete out justice with a culture of impunity, and public authorities appear helpless to stem it.

¹⁶¹ A recent headline in the local daily (*The Himalayan Times*, 2008. Terror, Taxes Scourging Industry: FNCCI Prez. 8 November) sums up the situation very aptly.

¹⁶² In Dhanusa District, for example, about 60% of industries are on the verge of collapse. Almost 78 industries situated in the 10 industrial estates have already been shut down, and about 70,000 people have lost jobs, according to the Federation of Nepalese Chambers of Commerce and Industry (FNCCI) and the Industrial District Management. The 10 industrial estates are in Balaju, Patan, Bhaktapur, Hetauda, Dharan, Nepalgunj, Pokhara, Butwal, Birendranagar, and Rajbiraj.

¹⁶³ The government's wish list of such projects includes an international airport in Nijgadh, regional airports in Pokhara and Bhairahawa, a fast-track Kathmandu-Terai highway, north-south and east-west railways, and development of Bharatpur and cities in the western Terai plains.

¹⁶⁴ On this latter issue, the government has yet to make any measurable progress. Highway obstructions, intimidation of business, extortion, factory shutdowns by politically militant unions and the like make a mockery of this commitment. The proliferation of labor disputes and industrial insecurity has so infuriated the business community and scared away investors that the business community has repeatedly urged the government to take immediate action. (See, for example, Rai, D. 2008. Disunion: Labour Disputes and Industrial Insecurity Are Scaring Away Investors. *Himal*. (427) 28 November–4 December.) The situation is grim: according to the FNCCI, from April to the end of November 2008 alone, 20 entrepreneurs were murdered, 53 businessmen kidnapped, 54 companies closed, and 62 businesses shut down (*Nepali Times*. Disunion: Labor Disputes and Industrial Insecurity Are Scaring Away Investors. (427) www.nepalitimes.com.np/issue/2008/11/28/Headline/15411).

7. Summary

A. Major Trends

183. Even a cursory review of developments in the political economy of these four countries reveals that the immediate years ahead will pose substantial challenges to governments unless concerted action is taken to mainstream development, further reform the economies, make the political process more inclusive, and ensure proper accountability of public institutions. The review also highlights specific areas of governance that these governments will be focusing on: (i) the visioning exercise, (ii) continued political reforms (including decentralization/devolution and accountability of public institutions), and (iii) proper management of the economy.

184. **Visioning.** In all four countries, the new governments have put forward ambitious visions:

- i. In Bangladesh, this process has already started with
 - a. the vision of the Awami League in the manifesto it prepared prior to the December 2008 elections; and
 - b. approval of the national integrity strategy framework which, for the first time, enables the government to consider ways to enhance public sector integrity.
- ii. In Bhutan, the government's Vision 2020 has withstood the test of time, and its core components and principles remain just as valid.¹⁶⁵

- iii. In Maldives, a new constitution (and the expressed wishes of the new government) can be construed as a new vision and a new beginning.
- iv. In Nepal, this exercise has yet to commence, although the contours of the Interim Constitution, and the constitution-making process itself, could be considered an appropriate vision for now.

185. **Continued political reforms.** In the coming years, political reforms will be evident in the work of the four governments in two specific areas: (i) decentralization and devolution, and (ii) accountability of public institutions:

- i. In Bangladesh, the focus will likely be on reforming political party processes and strengthening accountability in the public sector, including building the capability of local bodies.
- ii. In Bhutan, this looks likely to center on strengthening Parliament and political parties as well as dzongkhags and gewogs. This duality of reform is critical to sustaining the process of institutionalization of political and economic reforms.
- iii. In the Maldives, devolution of authority and service delivery responsibilities to atolls are being emphasized as well as the finding of ways to strengthen accountability institutions that for a long time were serving below par.

¹⁶⁵ The vision (Planning Commission. 1999. *Bhutan 2020: A Vision for Peace, Prosperity & Happiness*. Thimphu) is a 20-year perspective on development outcomes for the country. With respect to good governance, the Good Governance Plus review of 2005 anticipated that, by 2020, the country will have had in place full development of the country's governance and legal institutions and the emergence of a system of jurisprudence respected by all. The review also detailed trends in decentralization (including intergovernmental fiscal transfers and empowered local governments in place), legal system evolution, and capacity development as they relate to instituting good governance within the parameters of the vision (Royal Government of Bhutan. 2005. *Good Governance Plus Review*. Thimphu. November).

- iv. In Nepal, the establishment of a federal state will itself signify the degree of devolution the government will push for.

186. **Proper management of the economy.** All four countries will give specific attention to better managing their economies, all of which will have been impacted by the current global economic crisis in some way. For countries such as Bhutan and Nepal, there may well be lag effects of the global slowdown, but all four governments have kept a steady watch on possible adverse impacts and ways to effectively address them. Attention will remain on mitigating the harmful effects of the global slowdown on marginalized populations, particularly in Bangladesh and Nepal. This is evident, for example, in the social safety net recently bolstered by both the caretaker government and the new government in Bangladesh.

B. Major Risks

187. In discussing these major trends, however, it is instructive to assess the types and severity of risks the four governments face. To begin with, there is always a strong possibility of lack of significant political will to address the pesky issues (for example, political party and civil service reforms in Bangladesh and social exclusion in Nepal). Other major risks are summarized in Table 10.

188. Table 10 only highlights some of the risks of the first and second types. But the governments of the four countries are well aware not only of the need to continue substantial economic and governance reforms but also of the pressures they face in managing the risks inherent therein. Their failure to successfully chart their way forward, despite the opportunities presented, could well reverse the substantial gains achieved to date. Therein are the governance and reform challenges to these governments.

C. Key Lessons

189. This brief review of the emerging governance and political economy of the four countries in South Asia that had elections in 2008 show some striking similarities in context and in the reform agenda. Some that stand out include the following:

- i. The global economic slowdown is surely an area of concern (even if not immediately) for these countries as remittances and tourist arrivals are hurt.
- ii. Given the political and economic reform agenda to date in these countries, second-generation reforms in the political economy are needed; these reforms could include substantial cutbacks of State-owned enterprises (SOEs), greater use of public-private partnerships, greater independence of civil servants from politicians, and others.
- iii. In all four countries, political consolidation and/or political pluralism and reforms will remain the need of the day; now that substantial and far-reaching political reforms have been initiated, they will need to be institutionalized, for example, across all branches of government.
- iv. The notion of devolution is also taking center stage in all four countries. It is a more pressing issue for Nepal, but, equally, Bhutan and the Maldives will need to pay close attention to devolution issues given their own stated intentions regarding local governance reforms.
- v. At least in Nepal, inclusiveness will be the primary demand as the government begins to concentrate even more on reversing the policy lapses of previous years.

190. Finally, the management of public expectations will also take center stage in these countries. As new political parties (and/or parties that have been out of power for some years) take the reins of power, public expectations of swift and prompt effective development actions will rise. If not managed properly, these expectations could well prove their bane, an issue all four countries are well aware of. How they manage public expectations will prove to be just as important as instituting policy reforms themselves in governance and political economy.

Table 10: Types of Risks in Governance and Political Economy

Country	Types of Risk ^a	
	Type 1	Type 2
Bangladesh	<ul style="list-style-type: none"> • <i>Loss of resolve to reform political party processes</i> <p>The caretaker government made solid progress on this, but to date there is still some lack of clarity on how the new government will proceed.</p> <ul style="list-style-type: none"> • <i>Unable to tackle civil service weaknesses</i> <p>Civil service weaknesses in Bangladesh are rather severe (for example, in the quota system); there is a danger that civil service reforms will not move faster.</p>	<ul style="list-style-type: none"> • <i>Anticorruption efforts wane or are redirected</i> <p>This has already been evident to some extent in the new government's failure to send several relevant anticorruption-related ordinances to parliament for ratification into acts.</p> <ul style="list-style-type: none"> • <i>Unable to manage agflation</i> <p>While this problem has receded for now, it potentially poses a type 2 risk because its impact is likely to be substantial should the phenomenon be evident again.</p>
Bhutan	<ul style="list-style-type: none"> • <i>Accountability institutions (RAA, PAC, ACC, and others) not strengthened adequately</i> <p>All three agencies play critical roles in the fight against corruption and mismanagement. Given the government's move toward decentralization, their roles look set to increase considerably.</p>	<ul style="list-style-type: none"> • <i>Aggressive RAA practices</i> <p>The risk here is of stifling public sector innovation; already several in the bureaucracy have highlighted this constraint.</p>
Maldives	<ul style="list-style-type: none"> • <i>Capacity gaps across the public sector</i> <p>The government has accepted that this problem is severe, and concerted and system-wide efforts are needed to manage this risk.</p>	<ul style="list-style-type: none"> • <i>Government resolve for fiscal discipline erodes further</i> <p>The ambitious and unrealistic economic projections of the previous government have been pared down, but the appetite to make the hard choices given the global economic slowdown may not be entirely evident in the medium term.</p> <ul style="list-style-type: none"> • <i>Underdeveloped formal accountability mechanisms</i> <p>The country has only recently had accountability institutions that were given suitable mandates; some, such as the Judicial Service Commission, are still mired in controversy.</p>
Nepal	<ul style="list-style-type: none"> • <i>Politics as usual</i> <p>Despite the momentous political changes and the promise of interparty collaboration there is now a clear sense that political parties have reverted to posturing and acting in narrow party interests rather than keeping in mind the long-term interests of the country.</p> <ul style="list-style-type: none"> • <i>Further erosion of political, economic, and civic discipline</i> 	<ul style="list-style-type: none"> • <i>Capacity gaps</i> <p>This is a systemic risk that both the government and the development partners are aware of; mitigating measures are in place more on a project or program basis rather than at a systems (or holistic) level.</p> <ul style="list-style-type: none"> • <i>Botched devolution policy</i> <p>While federalism is a key shared objective, the existing devolution policy may not be well managed by the government, hence it may be unable to contribute the federalism agenda.</p>

continued on next page

Table 10: continued

Country	Types of Risk ^a	
	Type 1	Type 2
	<p>This is a critical risk that seems to have hampered private sector enthusiasm, thus negatively impacting economic growth.</p> <ul style="list-style-type: none"> • <i>Private sector not enthused</i> <p>The private sector continues to believe that an enabling environment for strong private sector development is yet to be created; this is a serious risk that the government needs to be mindful of.</p>	<ul style="list-style-type: none"> • <i>Lack of focus on anticorruption efforts and mismanagement</i> <p>There was initial enthusiasm and appetite to address this problem comprehensively; but it is possible that other more pressing concerns will divert the government's attention as the constitution-making process picks up steam.</p>

ACC = Anticorruption Commission, PAC = Public Accounts Committee, RAA = Royal Audit Authority.

^a Types 1 and 2 risks are distinguished by their degree of impact and likelihood of occurrence. Type 1 risks are considered more severe than Type 2.

Source: Author.

Countries in Transition: A Brief Review of the Emerging Political Economy of Bangladesh, Bhutan, the Maldives, and Nepal

In 2008, four countries of South Asia (Bangladesh, Bhutan, the Maldives, and Nepal) held significant elections. The paper highlights various pertinent issues in the political economy of these four countries, and maps out the broad contours of the reforms they need to embark on.

For one, and in the short run, in the aftermath of the severe global economic crisis, all four countries will need to keep close tabs on the adverse economic impacts of the crisis on marginalized populations. In the more long term, they will need to focus on second-generation reforms including mainstreaming development, making the political process more inclusive, and ensuring proper accountability of public institutions. Finally, the report argues that in all these countries the management of public expectations for swift and effective development actions will also take center stage in the months to come. Indeed, how the governments go about managing these expectations will prove to be just as important as instituting the policy reforms themselves in governance and political economy.

About the Asian Development Bank

ADB's vision is an Asia and Pacific region free of poverty. Its mission is to help its developing member countries substantially reduce poverty and improve the quality of life of their people. Despite the region's many successes, it remains home to two-thirds of the world's poor: 1.8 billion people who live on less than \$2 a day, with 903 million struggling on less than \$1.25 a day. ADB is committed to reducing poverty through inclusive economic growth, environmentally sustainable growth, and regional integration.

Based in Manila, ADB is owned by 67 members, including 48 from the region. Its main instruments for helping its developing member countries are policy dialogue, loans, equity investments, guarantees, grants, and technical assistance.

Asian Development Bank
6 ADB Avenue, Mandaluyong City
1550 Metro Manila, Philippines
www.adb.org
ISBN 978-971-561-830-4
Publication Stock No. RPT090817

ISBN 978-971-561-830-4



Printed in the Philippines