

# Bhutan Policy Notes

## Attracting Foreign Direct Investment

### Key issues and challenges

**In recent years, Bhutan has been revising its policy and increasing its efforts to attract FDI inflows.** First, overall FDI inflows have been quite limited and have averaged less than \$20 million annually since 2010. In 2016, FDI inflows turned negative in Bhutan (\$-13 million), while they recovered in 2017 at \$10 million but fell to \$5 million in 2018. This is significantly lower than in other South Asian countries. In 2016, South Asia attracted \$54 billion in FDI, consisting of India (\$44 billion), Bangladesh (\$2.3 billion), Pakistan (2.0 billion), Sri Lanka (\$898 million), Nepal (\$106 million), and Afghanistan (\$100 million). It is even lower in per capita terms. India is the largest investor (mainly in the manufacturing industry), followed by Singapore (15%) and Thailand (13%), which invested chiefly in the service sector. Overall, 65% of FDIs came from Asia, 25% from Europe, 9% from America, and around 1% from the Oceania region. Most of the FDI projects are located in the capital Thimphu. Bhutan still is the Asian country attracting the least FDI (also due to its small size). This is in marked contrast to East Asia, where there have been significant flows. Currently, East Asia is the world's top recipient of FDI, and countries such as China, Vietnam, and Cambodia have benefited from the inflow of FDI, in terms of capital, technology, knowledge, and ideas.

**The existing policy regime governing FDI inflows is spelt out in the 2010 FDI Policy (amended in 2014).**

First, the Royal Government has a policy that allows FDI in both manufacturing and service sectors. This investment regime is governed by project-specific agreements and sectoral policies subject to several restrictions. Second, the approach enshrined in FDI law is the “negative list” approach, which provides the possibility for foreigners to invest mostly in joint ventures in all except for 16 areas. The negative list includes media and broadcasting, hotels rated three stars, arms, and tobacco. Third, FDI inflows into priority sectors have no ownership restrictions and can reach 100 percent foreign ownership in some select service sub-sector and are fast tracked in terms of approvals. These priority areas are education, health, five-star hotels and resorts, infrastructure, research and development. Fourth, the Government of Bhutan places both an upper limit and a floor on FDI in some sectors: with maximum foreign investors’ equity of 74% and minimum project cost of Nu 50 million and Nu 25 million for manufacturing and services respectively. <sup>1</sup> As opposed to earlier policies, minimum investment levels have been reduced in most sectors, and there is also a cap at 51 percent for equity in the financial sector. Fifth, foreign investors are now able to buy land and can invest in Bhutan with a minimum stake of 10%. Sixth, all FDI businesses will need to be incorporated under the Companies Act of the Kingdom of Bhutan 2000 and be approved by Government of Bhutan. Finally, all foreign companies are required to open a foreign currency account in a Bhutanese financial institution, and a measure has been introduced which makes it easier to exchange local currency into foreign currencies.

**Despite the policy there are several reasons why Bhutan is not getting significant FDI inflows.** Besides overall investment climate issues, there are administrative and policy challenges. First, the approval process remains complex and there is no single window or focal point for investors. Ministry of Economic Affairs is the main institution involved. Second, there remain equity restrictions, especially in manufacturing that make it hard for foreign companies to come and be able to find a joint venture with a local partner. Third, the minimum investment size does not allow for potentially important investment, especially in the IT and services sector. Fourth, it is still challenging to get a business investor visa and travel restrictions for investors make it hard for investors to come for scoping missions. Finally, the country

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<sup>1</sup> The FDI policy sets minimum project cost for priority areas in both manufacturing and services sector ranging from size ranges from Nu. 20 million in agro and forest-based sectors to Nu. 50 million in other priority manufacturing sectors and Nu. 200 million in health, education, and infrastructure sectors.

has not done enough to brand itself overseas and have a coordinated investment promotion strategy. Overall, FDI development is limited by a controlled system and an inadequate policy regime in the areas of industrial license, equity, immigration, trade, and finance.

As you say, an effective single window (or one stop shop) will be useful in this context. In your short-term list, I would add one more point—In our forthcoming work on FDI Pioneers in South Asia, we are seeing that the informational externalities and signaling from such investors can be extremely valuable, perhaps more so than a whole host of road shows.

## Policy Recommendations

### To address these issues, in the short term, the government needs to:

- Adopt policies to liberalize the FDI policy regime in several key areas.
- Minimize the need for initial approvals, as long as they show that they will conform with the operational regulations of the country and of the respective sectors, including on the environmental impact
- Streamline approval process for foreign and create a Single Window for investors to come and interface with the MOEA authorities.
- Automate approval for investments below a certain size.
- Remove all equity restrictions in manufacturing to allow foreign companies to come without the need for a joint venture.
- Reduce minimum investment size, especially in services sector and tech industries.
- Facilitate business investor visas to ensure ease of access to the country.
- Harmonize the tourism policy for regional and international tourism, including introducing fees for regional arrivals.
- Develop a set of regulations, clear oversight roles, and a communication strategy for Brand Bhutan
- Launch an Investment Summit
- Facilitate FDI inflows into the new special economic zones located in the south of the country, especially Jigmeling.
- Strive to attract an anchor investor or two, by targeting the investors, in one of the chosen sectors

### In the medium to long term, the government needs to:

- Strengthen institutional team dealing with FDI inflows at MOEA level.
- Deepen value chains through India and Bangladesh and strengthen bilateral relations with other countries
- Develop an effective market research team and investment promotion strategy.
- Upgrade internet infrastructure through investments, especially in cable and fiber optics.
- Develop the agribusiness sector through the promotion of storage and logistics infrastructure to facilitate exports of high-value products and help match FDI companies with local agribusiness.