



BHUTAN'S LABOR MARKET Toward Gainful Quality Employment for All

Prepared in Collaboration between the Ministry of Labour
and Human Resources, Royal Government of Bhutan and the
World Bank



WORLD BANK GROUP

© 2016 International Bank for Reconstruction and Development / The World Bank
1818 H Street NW
Washington DC 20433
Telephone: 202-473-1000
Internet: www.worldbank.org

This work is a product of the staff of The World Bank with external contributions. The findings, interpretations, and conclusions expressed in this work do not necessarily reflect the views of The World Bank, its Board of Executive Directors, or the governments they represent.

The World Bank does not guarantee the accuracy of the data included in this work. The boundaries, colors, denominations, and other information shown on any map in this work do not imply any judgment on the part of The World Bank concerning the legal status of any territory or the endorsement or acceptance of such boundaries.

Rights and Permissions

The material in this work is subject to copyright. Because The World Bank encourages dissemination of its knowledge, this work may be reproduced, in whole or in part, for noncommercial purposes as long as full attribution to this work is given.

Any queries on rights and licenses, including subsidiary rights, should be addressed to World Bank Publications, The World Bank Group, 1818 H Street NW, Washington, DC 20433, USA; fax: 202-522-2625; e-mail: pubrights@worldbank.org.

[Cover photo/illustration] [if applicable]
Design and Printed @ Kuensel Corporation Ltd.

Bhutan's Labor Market

Toward Gainful Quality Employment for All



ལས་གཞིའི་ཚན་ཁག།

དཔལ་ལྷན་འབྲུག་གཞུང་།

Ministry of Labour and Human Resources
Royal Government of Bhutan



FOREWORD

The Ministry of Labor and Human Resources (MOLHR), in partnership with the World Bank, is pleased to bring you this report which helps Bhutan look forward strategically to address the key labor market issues. As a Ministry mandated to address the challenges of unemployment in Bhutan, we are delighted that the report brings robust evidence focused on four issues: imbalances between the public and private sectors, barriers to private sector employment, labor market policies and social protection for workers. The report stresses important challenges of the labor market, including declining rates of participation in the labor force and pockets of unemployment and quantitative and qualitative underemployment, and raises issues which are more hidden such as labor market stratification.

The report confirms that improving the private sector's access to labor, both unskilled and skilled, is paramount, and this is a key focus of MOLHR activities. The report recommends to complement existing training and entrepreneurship support programs by more thorough and tailored employment services that take better account for the distinct labor market challenges in rural and urban areas. This is indeed a policy direction we intend to follow.

The report suggests that creating a national social assistance system as a unified mechanism for the sharing of rents will be instrumental in supporting the rebalancing of the agricultural, nonfarm private and public sectors. The MOLHR has already been drafting a social protection framework for workers, which attempts to equalize options and opportunities for workers in different segments of the private sector, including informal work. These efforts are in addition to those aimed at improving social protection for workers in the formal economy and employees of private companies. Among other things, the draft social protection framework suggests the introduction of pensions that are easily portable across different types of work and the greater use of existing insurance schemes

The report also rightly identifies several other recommendations which are beyond the mandate of the MOLHR and sometimes require other key government entities and the private sector to work together. Taken together, these identify a way for Bhutan to take a development path that redefines the balance between the public and private sectors by providing demand-side opportunities for the private sector to grow and establishing a smart partnership between public and private sectors.

I am confident that this report will influence the policy direction of the Royal Government of Bhutan, and expect it will also encourage development partners and private sector to think along new lines. How we address issues of labor in Bhutan, will be an ongoing effort and priority of the Royal Government of Bhutan, and this report paves the way for us to take a balanced approach.

NGEEMA SANGAY TSEMPO
MINISTER
MINISTRY OF LABOUR AND HUMAN RESOURCES

THE WORLD BANKINTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL DEVELOPMENT ASSOCIATION**Bhutan Country Office**BDB Building, Norzin Lam
Chubachu, Thimphu, Bhutan.Mailing Address: P.O. Box 244
Thimphu
Bhutan**FOREWORD**

The Kingdom of Bhutan is an exceptional country with a formidable development success story. For more than 30 years, the Royal Government of Bhutan has prioritized human development through the promotion of the unique philosophy of Gross National Happiness. During this time, economic growth and development have been rapid and pro-poor. Bhutan is nestled in the eastern Himalayas and its terrain comprises steep mountains crisscrossed by snow-fed rivers. This means the country is blessed with considerable hydropower generation potential. While this raises the prospect of tremendous development opportunities in the future, it also presents challenges.

This report suggests that hydropower development can in particular be expected to create and exacerbate a number of significant labor market challenges. Already today, Bhutan's private sector faces difficulties in being competitive and attracting well-qualified labor. Once massive hydropower projects that are planned or under construction come on stream, these difficulties might become even more severe because of an across-the-board increase in labor costs. Moreover, informal, rural and agricultural workers will risk being left behind. Therefore, in the years to come the impact of hydropower construction and generation on the availability and quality of jobs will need to be consciously managed.

The report presents practical recommendations on four key issues critical for exploiting the window of opportunity created by Bhutan's hydropower development: imbalances between the public and the private sector, barriers to private sector development, labor market policies and social protection for workers. The foremost recommendation is to redefine the balance between the public and private sectors by providing demand-side opportunities for the private sector to grow. Improving the private sector's access to labor is also vital. In this context, Bhutan's nonfarm private sector needs more predictable, systematic access to foreign labor to compensate for the shortage of domestic labor. Besides, combined with more effective active labor market programs, an income support program could contribute to an approach to labor market policies that protects and fosters formalization and nonfarm private sector jobs. Finally, the creation of a national social assistance system through the consolidation of social protection programs and modernization of social protection systems could improve equity and efficiency.

The objective of Bhutan's National Employment Policy is to achieve full, productive, gainful, and decent employment for the people of Bhutan, which shall drive the country towards high levels of human development. The Royal Government of Bhutan is to be congratulated for placing such high emphasis on the creation of a sufficient number of high-quality jobs. I hope this report can provide a practical guide to help the Government fulfill its objective by successfully using the tremendous labor market opportunities of Bhutan's hydropower generation potential while mastering the emerging challenges. I also hope that it will mark the beginning of another period of fruitful partnership in the area of social protection and labor between Bhutan and the World Bank.

A handwritten signature in blue ink that reads "Yoichiro Ishihara". The signature is written in a cursive, flowing style.

Yoichiro Ishihara
Resident Representative in Bhutan
The World Bank

CONTENTS

Figures	iv
Tables	v
Boxes	v
Acronyms and Abbreviations	vii
Acknowledgements	viii
Executive Summary.....	ix
Country Context.....	ix
Labor Market Challenges	xi
The Way Forward	xv
Recommendations	xvi
1 Introduction	1
1.1 Background	1
1.2 Key Labor Market Indicators	3
1.3 Priority Policy Challenges	7
1.4 Report Overview	11
2 Imbalances between the Public and Private Sectors.....	14
2.1 Country Context and Recent Developments.....	14
2.2 Challenges and Current Government Approach	22
2.3 Policy Recommendations.....	23
3 Barriers to Private Sector Employment.....	26
3.1 Country Context and Recent Developments.....	26
3.2 Challenges and Current Government Approach	32
3.3 Policy Recommendations.....	36
3.4 Supplementary Tables.....	39
4 Labor Market Policies.....	46
4.1 Country Context and Recent Developments.....	46
4.2 Challenges and Current Government Approach	50
4.3 Policy Recommendations	52
5 Social Protection for Workers.....	57
5.1 Country Context and Recent Developments.....	57
5.2 Challenges and Current Government Approach	64
5.3 Policy Recommendations.....	66
6 Conclusion.....	69

References.....	71
Appendix.....	74
Bhutan Labour Force Survey 2014 and Bhutan Enterprise Survey 2015	74

FIGURES

Figure 1—Time Series and Forecasts of Components of Economic Growth.....	x
Figure 2—Proportion of Public and Private Sector Employment to Total Employment, by Education Level	xiii
Figure 3—Proportion of Households Covered by Select Education- and Labor-Related Social Programs and Social Protection Programs, by Household Head Occupation	xiv
Figure 4—Composition of Private Sector Employment and Immigration Rules As an Obstacle to Operations, by Firm Size.....	xv
Figure 1.1—Time Series and Forecasts of Electricity Export Earnings and Components of Economic Growth.....	2
Figure 1.2—Informal Labor as a Percentage of Total Employment, by Education and Household Wealth Quintile.....	5
Figure 1.3—Unemployment Rate by Education and Household Wealth Quintile	7
Figure 1.4—Proportion and Percentage Change in Share of Total Population in Urban v. Rural Areas in Different Countries	8
Figure 1.5—Exports of Mineral Products as Percentage of Total Exports and Youth Bulge Index in Different Countries.....	9
Figure 1.6—Percentage of Pension Contributors in the Labor Force and Old-Age Dependency Ratio in Different Countries	10
Figure 2.1—Proportion of Public Sector and General Government Employment to Total Employment, by Educational Level.....	14
Figure 2.2—Proportion of public sector and general government employment among total employment in different countries	15
Figure 2.3—Characteristics of Workers by Employment Sector.....	16
Figure 2.4—Characteristics of Jobs by Employment Sector.....	17
Figure 2.5—Estimated Wage Differential between Public and Private Sectors.....	18
Figure 2.6—Estimated Wage Differential between Public and Private Sectors, by Country.....	19
Figure 2.7—Non-Monetary Benefits of Workers, by Employment Sector	20
Figure 2.8—Proportion of Unemployed Who Want Public Sector and Government Jobs, by Education Level	21
Figure 2.9—Reasons the Unemployed Prefer Public Sector Jobs.....	21
Figure 3.1—Composition of Bhutan’s Private Sector, by Firm Size.....	26
Figure 3.2—Composition of Bhutan’s Private Sector, by Industry.....	27

Figure 3.3—Employment Share of Microenterprises in Different Countries	28
Figure 3.4—Proportion of Temporary Workers by Firm Size and Industry.....	29
Figure 3.5—Proportion of Non-Bhutanese Workers by Firm Size and Industry.....	30
Figure 3.6—Wage Distribution and Educational Attainment, by Citizenship Status.....	30
Figure 3.7—Share of Firms that Offer Training or See Lack of Skilled Manpower as an Obstacle, by Firm Size	35
Figure 5.1—Proportion of Households Affected by Major Shocks that Experience Declines in Income, Assets or Food Consumption.....	57
Figure 5.2—Coping Strategies in Response to Major Shocks.....	58
Figure 5.3—Proportion of Households Receiving Benefits from Various Social and Social Protection Programs	60
Figure 5.4—Proportion of Households Covered by Various Social Programs, by Income Quintile.....	61
Figure 5.5—Proportion of Households Covered by Education and Labor Social Programs and Social Protection Programs, By Household Head Occupation.....	63
Figure 5.6—Proportion of Urban Households Covered by Work-Related Fringe Benefits, by Household Head Employment Sector.....	64

TABLES

Table 1—Summary of Recommendations for Balanced Development	xx
Table 1.1—Key Labor Market Indicators for 2013 and 2014.....	4
Table 1.2—Determinants of Labor Force Participation and Sectoral Choice.....	6
Table 3.1—Job Creation by Firm Size and Industry	31
Table 3.2—Main Obstacles to Firms’ Operations	39
Table 3.3—Labor-related Obstacles to Firms’ Operations	40
Table 3.4—Main Reasons for Firms’ Difficulties in Retaining Workers.....	41
Table 3.5—Inadequate Skill Supply as an Obstacle to Firms’ Operations.....	42
Table 3.6—Employees’ Skills: Rating by Employers and by Employees Themselves	43
Table 3.7—Employees’ Soft Skills: Ratings by Employers.....	44
Table 4.1—Children’s Work and Education in Bhutan v. Other Lower-middle Income Countries.....	48
Table 4.2—Taxes in Selected Countries as a Percentage of Commercial Profits	49
Table 4.3—Evidence on the Effectiveness and Cost-effectiveness of Active Labor Market Programs.....	51

BOXES

Box 1.1—Urbanization and Internal Migration	12
---	----

Box 3.1—Promoting Private Sector Development	44
Box 4.1—International Migration and Economic Self-Reliance	53
Box 4.2—Economic Effects of Bhutan’s Labor Inspections	54
Box 5.1—Increasing Productivity in the Agricultural Industry	66

ACRONYMS AND ABBREVIATIONS

ADB.....	Asian Development Bank
BES.....	Bhutan Enterprise Survey
BLFS.....	Bhutan Labour Force Survey
BLSS.....	Bhutan Living Standards Survey
GDP.....	Gross Domestic Product
GEP.....	Guaranteed Employment Program
GNHC.....	Gross National Happiness Commission
IEC.....	Information, Education and Communication
ICT.....	Information and Communication Technology
ISIC.....	Industrial Classification of All Economic Activities
ILO.....	International Labour Organization
LMO.....	Labor Market Observatory
LPG.....	Liquid Petroleum Gas
MoE.....	Ministry of Education
MoF.....	Ministry of Finance
MoH.....	Ministry of Health
MoLHR.....	Ministry of Labour and Human Resources
MW.....	Megawatt
NGO.....	Non-governmental Organization
NPPF.....	National Pension and Provident Fund
NSB.....	National Statistics Bureau
RGoB.....	Royal Government of Bhutan
SEED.....	Skills for Employment and Entrepreneur Development
THPP.....	Targeted Household Poverty Programme
UNESCO.....	United Nations Educational, Scientific and Cultural Organization

All dollar amounts are in U.S. dollars unless otherwise specified.

ACKNOWLEDGEMENTS

This report is a joint product of Bhutan's Ministry of Labour and Human Resources and the World Bank. It was prepared by a team from the World Bank Social Protection and Labor Global Practice led by Achim Schmitten and Jasmine Rajbhandary. The core team also included Anastasiya Denisova, Arvo Kuddo, Cem Mete, Amr Moubarak and Michael Weber.

While this report is the product of a collaborative effort, Achim Schmitten was the primary author for the executive summary and Chapters 1, 2 and 6. Chapter 3 was primarily written by Anastasiya Denisova. Arvo Kuddo, Michael Weber and Amr Moubarak were the authors in charge of Chapter 4. Jasmine Rajbhandary was the primary author of Chapter 5.

The team wishes to acknowledge input from Genevieve Boyreau on the executive summary, Winston Daves on Box 5.1, Robert Palacios on social insurance and Massimiliano Santini on Box 3.1, as well as helpful comments and suggestions by Om Bhandari, Laurent Bossavie, Afra Chowdhury, Ira Gang, Arvind Jain, Adriana Kugler, Mark LaPrairie, Tenzin Lhaden, Martin Rama, Massimiliano Santini, Iffath Sharif, Hiroki Uematsu and other World Bank colleagues. The team also wishes to thank Anna Abras and Pradeep Singh for valuable research assistance, Elisabeth Schwinn for meticulous copyediting and Tara Nidhi Bhattarai, Amira Nikolas and Elfreda Vincent for able administrative support.

The peer reviewers for the report were Ihsan Ajwad and Qaiser Khan. Their advice is gratefully acknowledged.

Special thanks are due to counterparts of the Royal Government of Bhutan and in particular former Secretary Dasho Pema Wangda and all officials of the Ministry of Labour and Human Resources for their productive cooperation throughout the work on this report and Jamyang Tshomo as the focal point in the Ministry of Labour and Human Resources' Policy and Planning Division for all the coordination on behalf of the Royal Government of Bhutan. Invaluable feedback on preliminary findings was provided by various bodies of the Royal Government of Bhutan, including the Ministry of Education and the Ministry of Finance during a workshop hosted by the Ministry of Labour and Human Resources and in written form by Ministry of Information and Communications.

Overall guidance and support was provided by Johannes Zutt, Qimiao Fan, Geneviève Boyreau, Yoichiro Ishihara and Pablo Gottret. The team is grateful for their guidance and support.

The findings, interpretations and conclusions expressed in this report are those of the authors and do not necessarily reflect the views of Bhutan's Ministry of Labour and Human Resources, the World Bank Group, its Executive Directors, or the countries they represent.

EXECUTIVE SUMMARY

COUNTRY CONTEXT

The Royal Government of Bhutan (RGoB) places great emphasis on the creation of a sufficient number of high-quality jobs to achieve full employment. The vision of Bhutan’s Ministry of Labour and Human Resources is “a Nation where all its citizen have the opportunity for a gainful and quality employment characterized by harmonious and productive relationship in the workplace and the broader community,” while the goal of Bhutan’s National Employment Policy is “the achievement of full, productive, meaningful, gainful and decent employment for the people of Bhutan, which shall drive the country towards achieving high levels of human development and contribute to the maximization of the Gross National Happiness.” To achieve Bhutan’s target of full employment, new jobs for approximately 120,000 job seekers entering the labor market need to be created during the period of the country’s 11th Five-Year Plan (2013 to 2018).

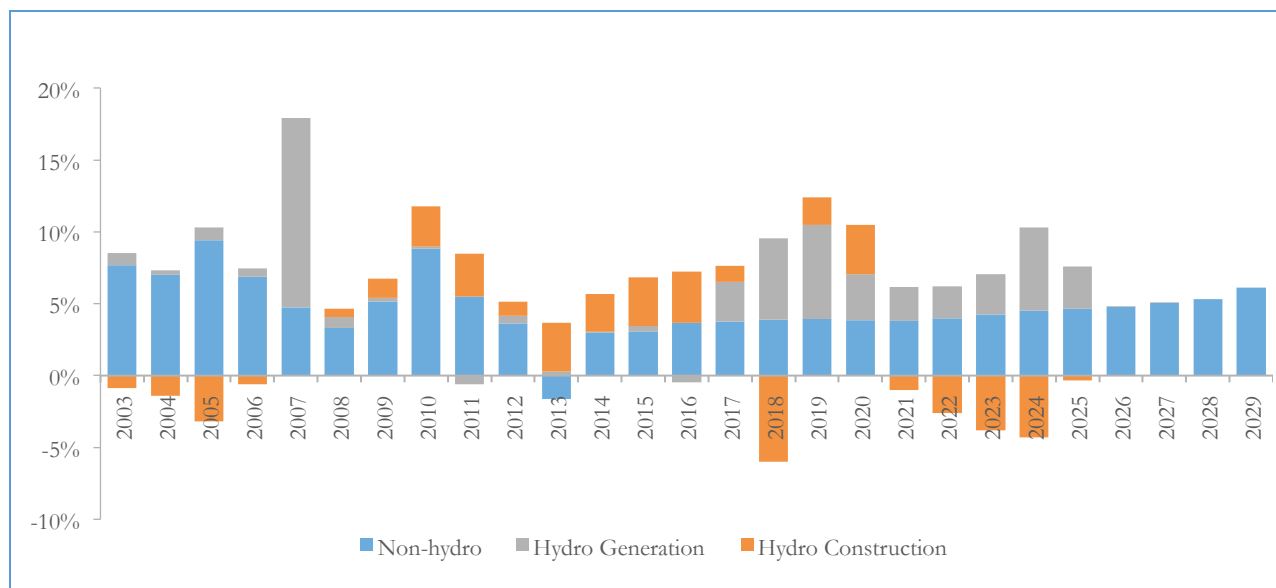
This report aims to provide robust evidence to inform the RGoB’s policy-making with regard to critical labor market challenges, underlying causes and potential solutions. Building on a conceptual framework introduced in the World Bank’s World Development Report 2013: Jobs, the analysis takes into account policy fundamentals that are essential for both growth and job creation, labor market policies that can help ensure that growth translates into employment opportunities and a list of policy priority areas where jobs might do the most for development given Bhutan’s specific country context. The report relies primarily on two data sources that provide recent robust and complementary information on labor supply and demand in Bhutan: First, the Bhutan Labour Force Survey (BLFS) 2014, a representative labor force survey with a newly expanded questionnaire that was implemented by the MoLHR with support from the World Bank. Second, the Bhutan Enterprise Survey (BES) 2015, a survey of firms conducted by the World Bank that improved the understanding of the conditions, experiences and perspectives of Bhutan’s nonfarm private firms. The report also uses evidence from previous studies, legal documents, and discussions with experts and stakeholders from Bhutan and beyond.

In recent decades, Bhutan has seen rapid, sustained economic growth and broad-based, inclusive poverty reduction. Bhutan’s Gross Domestic Product (GDP) per capita reached Nu 156,267 (\$2,560 at current exchange rates) in 2014. Bhutan is now officially classified by the World Bank as a lower-middle income country. Between 2007 and 2012, the proportion of Bhutan’s population with consumption below the official poverty line dropped by half (from 23 per cent in 2007 to 12 per cent in 2012). Over the same period Bhutan’s extreme poverty rate, measured by the international poverty line of \$1.90 a day declined from 8 percent to 2 percent. Multidimensional poverty indices and indicators related to education and health outcomes have also improved significantly in recent years.

In the next few years, Bhutan’s potential for hydropower generation will present tremendous development opportunities. Bhutan’s terrain comprises steep mountains crisscrossed by snow-fed rivers with considerable hydropower generation potential of an estimated 30,000 megawatts (MW). Of this potential, 1,606 MW are already operational. An additional 3,153 MW are projected to be on line in 2018, with another 2,170 MW following shortly. The development of Bhutan’s hydropower generation capacity will have a direct impact on several key macroeconomic indicators. In particular, it is expected to lead to a large increase in export revenues and sustained economic growth. The World Bank forecasts that electricity export earnings will jump from less than Nu 20 billion in 2015 (\$300 million at current exchange rates) to more than Nu 67 billion in 2019 and Nu 145 billion in 2025. The contribution of hydropower to economic growth will mostly come from the boost it will give to aggregate demand during the construction phase of the different projects and the additional revenue these projects will generate at the time of commissioning. Between 2013

and 2019, hydropower generation is expected to add an additional percentage point to Bhutan’s annual economic growth. Taking into account the hydropower projects in the pipeline and under construction, Bhutan’s GDP per capita is forecast to double within about 15 years, reaching \$6,000 by 2030. The development of the hydropower industry is also expected to contribute to continued rapid poverty reduction (Figure 1).

Figure 1—Time Series and Forecasts of Components of Economic Growth



Source: World Bank 2015a.

At the same time, hydropower development risks exacerbating existing labor market challenges, in particular with regard to sectoral imbalances. General challenges created or exacerbated by hydropower development are likely to include macroeconomic management and reinvesting natural resource revenues into national assets (infrastructure, human capital and institutions). In addition, hydropower development will make some labor market challenges that are already apparent today more pressing, especially in sectors that do not directly benefit from the money that is projected to flow into Bhutan. Already, the nonfarm private sector faces difficulty being competitive and attracting well-qualified labor. Once the planned massive hydropower projects come on stream these difficulties will likely worsen due to overall higher labor costs. Moreover, workers in the informal, rural and agricultural part of the economy risk falling even further behind.

Supported by Bhutan’s advantageous development trajectory, its current labor market conditions appear favorable compared to those in many other lower-middle income countries. In 2014, around 62 percent of Bhutan’s population aged 15 and older was part of the labor force. This meant that Bhutan was better able than many other lower-middle income countries to make good use of the economic potential offered by its population. Bhutan’s current overall unemployment rate of 2.6 percent is relatively modest by international standards. Recently, there have also been trends toward almost universal enrollment in primary education and rapidly increasing enrollment rates in secondary and tertiary education. In fact, among all South Asian economies, the most significant change in primary net enrollment rates between 2001 and 2010 took place in Bhutan. Over a single decade, Bhutan’s primary net enrollment rate increased by 30 percentage points to 88 percent. In parallel, the country’s secondary gross enrollment rate increased from under 40 percent to around 70 percent. Recently, an ever greater emphasis has been placed on tertiary education.

Bhutan’s positive labor statistics hide important challenges, including declining rates of participation in the labor force and pockets of unemployment and quantitative and qualitative underemployment. Labor force participation rates have been steadily declining in recent years, dropping from 69 percent in 2010 to 63 percent in 2014. The decline in labor force participation has been particularly steep for women. This is a common phenomenon in lower-middle income countries. In low income countries, most able-bodied adults must work to sustain their household’s livelihood, whereas the relative prosperity of lower-middle income countries makes it possible for some adults to become homemakers. In Bhutan, the decline in labor force participation rates might have been reinforced by the insufficient availability of child care services. Besides the declining labor force participation rates, Bhutan’s labor market includes pockets of unemployment and underemployment. Unemployment is a concern for the young, urban, relatively well-educated and well-off. While quantitative underemployment is not high by international standards, it is prevalent among younger workers and women. In 2014, among women the underemployment rate reached 1.5 percent; among workers aged 15 to 24 it stood at 1.9 percent. There are also widespread reports of qualitative underemployment, that reports of workers being employed in jobs that do not make the best use of their qualifications and skills.

Informal labor is a particular concern as it is widespread among the general population and endemic in certain groups, such as individuals with low education, from rural areas, and from poor households. Bhutan still remains a largely rural and agrarian economy. Typically for such an economy, the ratio of informal employment to total employment is relatively high. World Bank staff estimates put the informal labor rate at around 80 percent. The proportion of informal jobs is highest among workers with no schooling, at 93 percent. Informal labor is also closely related to poverty. Nearly all, 98 percent, of workers from households in the poorest quintile engage in informal work. Informal employment is frequently seen as a concern because informal workers tend to be less productive and lack social protection. Government policies meant to improve the living conditions of workers rarely reach the informal economy.

Bhutan’s labor market challenges with regard to unemployment, underemployment and informality can be traced back to the stratification of its labor market. The stratification of the labor market into three segments—the public sector, the private non-agricultural sector and the private agricultural sector—is reinforced by labor market regulations, particularly those regarding foreign labor, and by some social protection programs that are biased toward the public sector, formal employment and urban areas. Given the major hydropower projects coming on stream in the next few years, now is the time for Bhutan to decide how to manage the proceeds from hydropower development and labor market stratification.

LABOR MARKET CHALLENGES

Notwithstanding Bhutan’s unique qualities, it may be characterized as a country that is rich in natural resources, agrarian and urbanizing as well as sharing some traits with small island nations. According to the systematic classification proposed by the World Bank *Jobs* report. Bhutan is an “agrarian” economy. More than half, 60 percent, of its population lives in rural areas where work consists mainly of small-scale and subsistence agriculture and related industries, and is thus mostly informal. In addition, Bhutan is classified as an “urbanizing” economy, since the share of the population in urban areas has risen by a rather significant 8 percentage points over the last ten years. Urbanizing economies frequently struggle to integrate rural-to-urban migrants into urban labor markets, and therefore see higher unemployment rates in urban areas as compared to rural ones. Following the classification of the *Jobs* report, Bhutan is also a resource-rich country. In 2012, minerals (including electricity) accounted for 43 percent of the country’s exports. This proportion is expected to increase more in the future. Resource-rich countries often have substantial foreign exchange earnings but sometimes struggle to translate this wealth into the creation of a sufficient number of jobs that guarantee living standards, improve productivity and foster social cohesion. While Bhutan is of

course not an island, to some extent it also shares the characteristics of small island nations, in particular a small size and remote location. These lead to a relatively high cost base for any kind of productive activity, especially for activities oriented toward external markets. This means that diversification of the economy and the export base are more difficult to achieve in Bhutan than in some other countries.

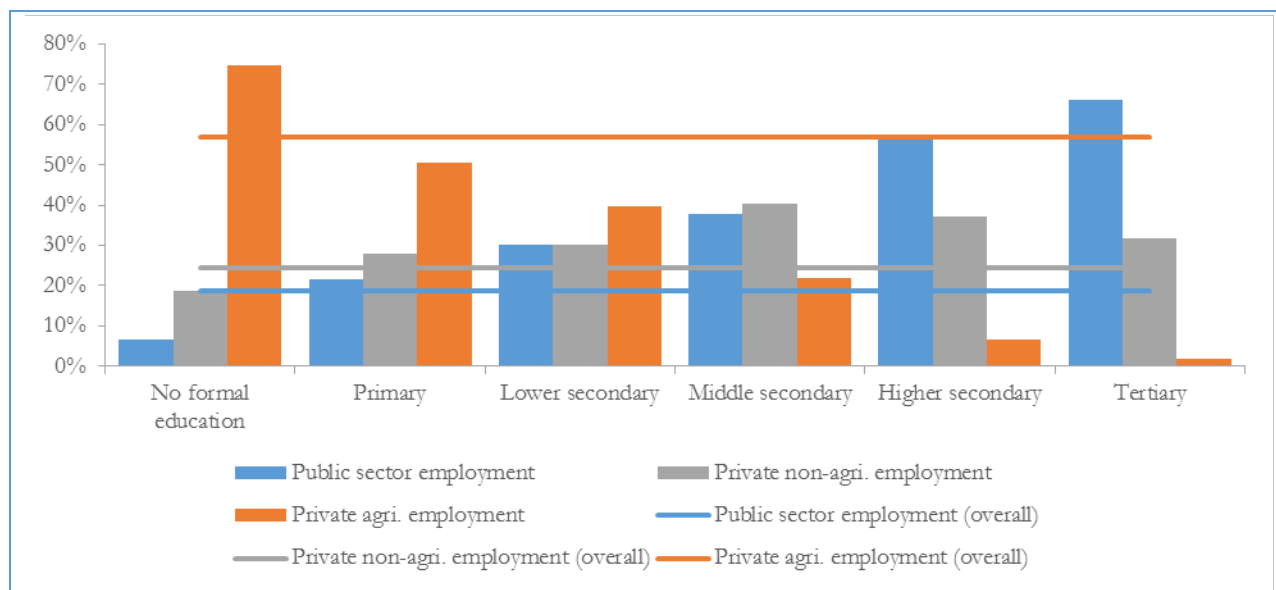
This multi-faceted classification calls for analyzing possible links, conflicts, and complementarities between any proposed recommendations. In Bhutan, an urban-rural gap exists, especially with respect to poverty, food security and access to formal sector jobs and services. This gap is closely linked to the prevalence of agricultural jobs in rural areas, as opposed to non-agricultural jobs in urban centers. Globally, the private sector is the main engine of job creation and the source of almost nine out of every ten new jobs. A prosperous private, non-agricultural sector is seen by many as an important engine of growth, development and jobs that can gradually improve firms' productivity and workers' living standards and protection. While Bhutan's agricultural sector is shrinking in relative terms, it is still large and will continue to dominate employment for years to come. Through hydropower development, natural resources offer a strong growth and revenue driver which, if well managed, can support a broad-based and inclusive growth path for Bhutanese society. Being small, remote and landlocked also calls for a particular set of measures. As noted previously, like small island states, Bhutan's geographic limits on productivity and growth pose challenges to raising and sustaining the demand for and supply of human capital.

Bhutan's labor market has been stratified into the public sector, the private non-agricultural sector and the private agricultural sector. The public sector accounts for about a fifth of all jobs and almost half of the jobs outside agriculture. General government employment—a subsector of the public sector that includes the civil service, other government agencies and the armed forces but not public/government companies—accounts for more than three-quarters of public sector employment and for one-seventh of all jobs. As only 43 percent of Bhutan's workers are employed outside agriculture, and public sector employment is entirely non-agricultural, almost half of all jobs outside agriculture are in the public sector. Public sector workers have relatively secure, well-paying jobs and access to education- and labor-related social protection programs. The sector employs a large number of young, relatively well-educated and well-off individuals, often in urban areas. The second segment of the labor market, and by far the largest, is the agricultural sector. In 2014, 57 percent of workers were active in agriculture. This sector provides low salaries, few fringe benefits, and restricted access to education- and labor-related social protection programs. It mostly employs less educated workers from poorer households in rural parts of the country and also serves as an alternative source of employment for those struggling to find work elsewhere. The third segment of the market is the private non-agricultural sector, which in many ways lies between the two other sectors. The sector has struggled to develop, largely because of competition for well-educated workers from the public sector but also because of its high cost base and insufficient productivity. It remains underdeveloped and accounts for only a quarter of all jobs, barely more than half of those outside agriculture.

Workers in the public sector are generally younger, more urban and from richer families than workers in the nonfarm private sector, who are in turn generally younger, more urban and richer than workers in agriculture. In a small country like Bhutan, a large public sector can prevent the emergence of a vibrant nonfarm private sector as it reduces the number of workers available and able to work in this sector. Since a majority of the Bhutan's relatively few highly educated workers are in the public sector, the problem appears particularly acute for the country. Among workers without formal education, 75 percent are employed in the agricultural sector, 19 percent in the nonfarm private sector, and 6 percent in the public sector. Among workers with tertiary education, the pattern is the opposite. Sixty-six percent of workers with tertiary education are employed by the public sector, 32 percent are employed in the private sector outside agriculture, and less than two percent in agriculture. Age and location are two other variables with striking differences between the three sectors. For instance, 48.3 percent of public sector workers are age 15 to 34 and

only 4.3 percent of workers are 55 or older. In the nonfarm private sector 49.5 percent of workers are under 35, while 10.1 of workers in this sector are older than 55. Among workers in agriculture, 30.4 percent of them are younger than 35 and 26.1 older than 55. With regard to location, 52.4 percent of private sector jobs outside agriculture and 98.4 percent of private sector jobs in agriculture are located in rural parts of Bhutan. Less than one third—32.6 percent—of public sector jobs are located in rural areas (Figure 2).

Figure 2—Proportion of Public and Private Sector Employment to Total Employment, by Education Level



Source: World Bank staff estimates based on BLFS 2014.

Notes: Primary education includes pre-primary. Religious education excluded.

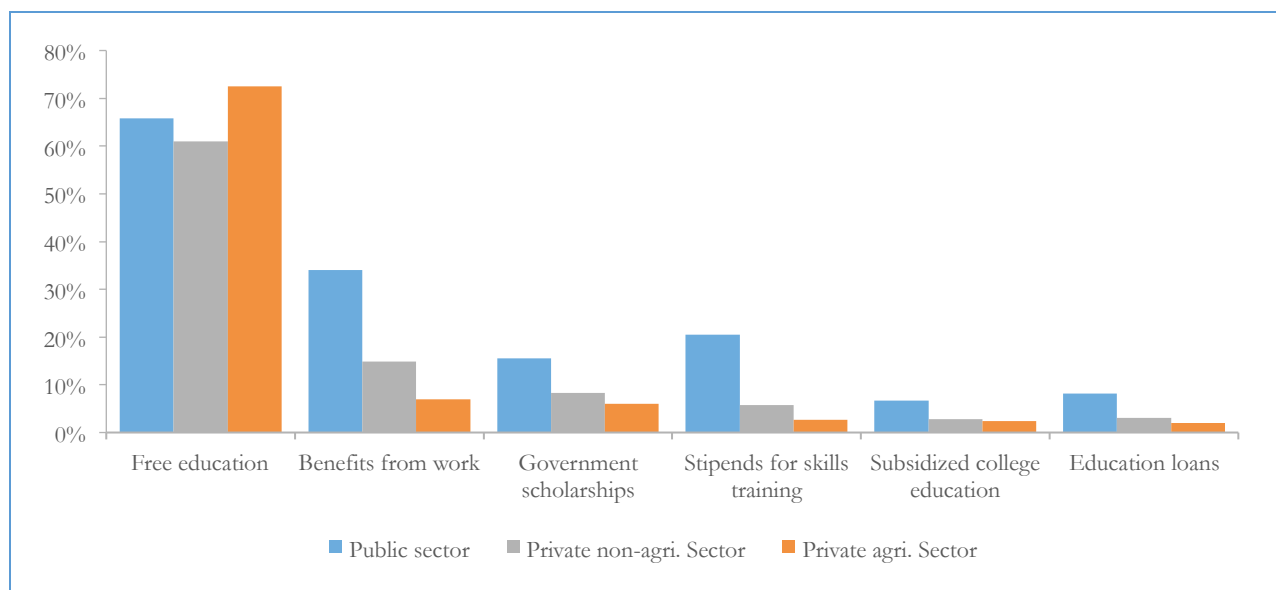
Decent earnings, job security, high productivity and other attributes that make a job attractive are most widespread in the public sector and least common in agriculture. The private nonfarm economy takes up a middling position. While some differences between the three sectors in job attributes can be traced back to the distinct characteristics of workers in each sector, this can only explain part of the picture. Even when controlling for workers’ characteristics, significant differences remain. For instance, the prevalence of self-employment, casual and regular work differs significantly between the public and the private sector. An overwhelming majority of public sector jobs are for regular paid employees, whereas the private sector offers a much smaller proportion of this type of jobs. In the public sector, 94 percent of jobs are for regular paid employees. In the private sector, 27 percent of jobs outside agriculture and a negligible proportion of jobs inside agriculture are filled by regular paid employees. Instead, the private sector makes much greater use of other job types, in particular self-employed workers outside agriculture (47 percent) and unpaid family workers in agriculture (64 percent).

The private nonfarm sector is squeezed by competition from the public sector, a high cost base, insufficient productivity, and stringent labor market regulations constraining the availability of foreign labor. One outcome of the public sector’s dominance in the labor market is widespread queuing for public sector jobs, which in turn is a major reason for the relatively high unemployment rate among young, well-educated and well-off city dwellers. Unemployment rates are higher for exactly the population groups that are prevalent in the public sector and prefer public sector jobs (especially young individuals in urban areas with a relatively high level of education). Quantitative and anecdotal evidence confirms that a number of

unemployed individuals do not take up private sector job offers because they would prefer to work in the public sector.

Some of Bhutan’s social protection programs reinforce existing imbalances between public, the private nonfarm and private agricultural sectors. Education- and labor-related social programs are accessed first by households headed by public sector workers, second by nonfarm private sector workers, and lastly by farm workers. Although free education is used in relatively even proportion by all three groups, benefits from work, government scholarships, subsidized college education and education loans are all more widely accessed by households whose head works in the public sector than by other households. For instance, stipends for skills training can improve workers’ productivity and allow them to secure better jobs. But whereas 21 percent of households headed by public sector employees use such stipends, only 6 percent of households headed by private sector nonfarm workers and only 3 percent of households headed by agricultural employees do (Figure 3).

Figure 3—Proportion of Households Covered by Select Education- and Labor-Related Social Programs and Social Protection Programs, by Household Head Occupation

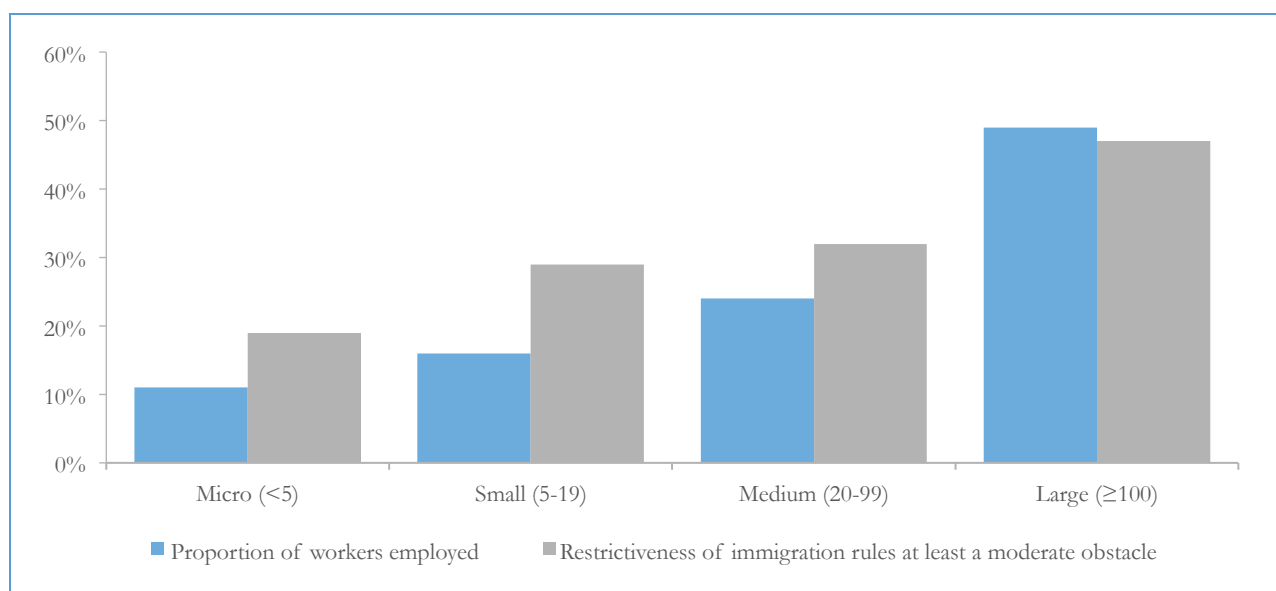


Source: World Bank staff estimates based on BLFS 2014.

Similarly, labor regulations, particularly restrictions on hiring foreign workers, have made labor scarcer by limiting the private sector’s access to labor from outside Bhutan. In principle, private nonfarm enterprises might react to competition from the public sector by hiring foreign workers. In practice, this is not always straightforward. As a consequence, many view restrictive immigration rules as a significant obstacle to their operations. In fact, the exact same types of firms that account for most of the jobs in Bhutan’s nonfarm private sector are also those that are most constrained by the country’s immigration rules. According to a recent World Bank Enterprise Survey among nonfarm private enterprises in Bhutan, a plurality of jobs in this sector are created by relatively large companies; relatively large companies are in turn those affected most by restrictive immigration policies. Large companies with at least 100 workers account for 49 percent of jobs in the nonfarm private sector, and 47 percent of these companies complain about the restrictiveness of immigration rules. Medium-sized firms with 20 to 99 workers account for a smaller proportion of jobs (24 percent of jobs) and a smaller proportion of these firms (32 percent) say they are constrained by immigration rules. Small firms with five to 19 workers and microenterprises with fewer than

five workers together account for only 25 percent of all jobs in the nonfarm private sector and less than 30 percent of this group sees the restrictiveness of immigration rules as an obstacle to their operations (Figure 4).

Figure 4—Composition of Private Sector Employment and Immigration Rules As an Obstacle to Operations, by Firm Size



Source: World Bank staff estimates based on BES 2015.

Notes: Private nonfarm enterprises only. Notes: Grey bars from answers to the question “To what degree is the restrictiveness of immigration rules an obstacle to the current operations of this establishment?”

THE WAY FORWARD

In the years to come, the impact of hydropower construction and generation on the availability and quality of jobs will need to be consciously managed. Even when investments in extractive industries represent a sizable fraction of a developing country’s GDP and lead to spectacular increases in export revenue, they tend not to create many jobs. Countries have basically followed two distinct strategies to spread the wealth resulting from natural resources. The first option is a public-sector-led development path that places citizens in well-paid public sector jobs. Alternatively, they take a private-sector-led development path, aiming to create jobs outside of the extractive industries and to develop a diversified economy. Further complicating the calculation, Bhutan is in the distinct situation of being not only resource-rich but also agrarian, and it shares similarities with small islands. Therefore, the agricultural sector will deserve considerable attention for years to come.

Some countries confronted with resource booms have successfully followed a private-sector-led development path. Norway offers what may be the most famous example of a resource-rich country that has successfully followed a private-sector-led development path. With strong backing from the labor movement, centralized collective bargaining agreements ensure that real wage growth is moderate. Wage moderation supports employment opportunities for everybody, to the point that the unemployment rate remained close to three percent during the recent global financial crisis. Norway’s oil revenue is used for long-term investments rather than being immediately converted into higher labor earnings or public sector jobs. Norway is also well-known for its comprehensive welfare state and considerable investments in education and training. Among resource-rich countries elsewhere, the United Arab Emirates has also managed to follow a private-sector-led development path and to diversify its economy through financial and logistics services.

Many states around the Persian Gulf have taken a different, public-sector-led path, making national citizens direct beneficiaries of their resource bonanza through well-paid jobs in the public sector. In most states around the Persian Gulf, the general government sector and public enterprises account for more than 60 percent of all formal sector employment, while the formal private sector is rather small. For instance, employment in the formal private sector is almost nonexistent in Iraq and below ten percent of total employment in Egypt. While the public-sector-led development path has enabled a large proportion of the population to benefit from resource rents, it has also had unintended negative consequences. In many states around the Persian Gulf, public sector jobs are rationed and some groups, such as women and youth, have less access to them than do older males (and those with good connections). In addition, menial jobs are routinely performed by immigrants on temporary contracts who receive modest pay and benefits. As a result, public sector jobs have become a window to rent sharing for some but do not give a stake in society to others.

Now is the time for Bhutan to choose between three very different development paths: public-sector-led, private-sector-led or balanced. So far, Bhutan has mostly followed a public-sector-led development path. Today, it is in a similar situation to other resource-rich countries that have made citizens the direct beneficiaries of their resource bonanza through well-paid jobs in the public sector. For a long time, Bhutan's public sector has been seen as the most desirable sector for those aspiring to a successful career. Even today, the majority of young, urban and relatively well-educated and well-off workers in Bhutan are either employed in the public sector or aspire to secure a public sector job. To a certain extent, hydropower development would make it possible for Bhutan to continue along a public-sector-led development path. The likely outcomes would be continued dominance of labor by the public sector, sustained challenges for Bhutan's fledgling private nonfarm enterprises, continued divergence between the situation of public sector workers and workers in the informal, agricultural sector, and possibly challenges in the medium term to social cohesion, due to an insufficient number of well-paid public sector jobs.

Hydropower development creates a window of opportunity to set out on an alternative, more balanced development path. The objective of balanced development would not be to weaken the public sector but to allow more nonfarm private sector jobs to emerge and prosper to support the creation of a growing number of private-sector jobs that secure living standards, increase productivity and foster social cohesion. In this context, returns from Bhutan's natural resources would not be used to create of well-paid public sector jobs but instead to finance social programs, social protection programs, labor market programs or other initiatives that will support the path to a new equilibrium and sustainable development for generations to come. For Bhutan to pursue a balanced development path, a comprehensive approach to sectoral rebalancing will be needed. Rebalancing would strengthen the relative position of workers in the private non-agricultural sector compared to the public sector and could not omit the many workers in the private agricultural sector. While a balanced development path holds promise, it would not be entirely without risks. Some resource-rich countries that have refrained from following a public-sector led development path have diversified their export base. Because of Bhutan's high cost base and specific geographic situation, this will be a tougher option for the country.

RECOMMENDATIONS

Only a concerted effort to establish interlinked and complementary policy reforms will assure that Bhutan is firmly on track to balanced development. In contrast, partial reforms are likely to be less successful and to face more difficult obstacles. For example, rebalancing the earnings gap between the public and the private sector by slowing the pace of wage increase in the public sector might well make younger, well-educated workers available to the nonfarm private sector. But unless that sector also has easier access to low-skilled workers (either from Bhutan or abroad) and opportunities to grow and develop, reducing the

earnings gap will ultimately not create more private sector jobs. A comprehensive package of policy reforms would address a range of interlinked and complementary areas, including labor demand (both by the private and the public sector); labor supply (education, skills); social protection; and labor market policies, programs and interventions.

The foremost recommendation is to redefine the balance between the public and private sectors by providing demand-side opportunities for the private sector to grow, as laid out in the recent World Bank Macroeconomic and Public Finance Note (World Bank 2015a). Today, Bhutan’s young people vote with their feet in preferring public over private sector jobs. To rebalance the jobs market, government must encourage and support private sector growth. With large hydropower revenues flowing into the Treasury in the coming years, the public sector will have to crowd in private sector jobs by deliberately creating “smart partnerships” between the public and the private sector. As revenues will flow into Bhutan, the prices of non-tradable goods and services (such as land and real estate) will increase relative to the price of tradable goods (such as food or software), constraining private sector competitiveness in external markets. Policy reforms aimed at developing a more supportive investment climate can partially offset this disadvantage but may turn out to be insufficient in light of the magnitude of the inflows Bhutan will receive. Thus, a pro-active public finance approach supporting the emergence of a private sector is needed as well.

New approaches to procurement of infrastructure building and maintenance can deliver very positive results. Many private sector companies work as contractors for the government, and because they need to play by the rules to be eligible for government contracts, they provide jobs complying with labor regulations. Outsourcing a larger proportion of non-core government activities, such as maintenance or IT services, could also go a long way toward providing new opportunities for the private sector at the same time that it would increase spending efficiency. Bhutan’s experience in these areas has not been encouraging so far, but to some extent this reflects problems with the design of public procurement, rather than with the approach.

While outsourcing at the margin can lead to failure, the government could be proactive in generating the scale necessary to bring costs down, and in designing tenders in a way that addresses imperfect competition. This can be accomplished by consolidating purchases across agencies. An area in which the government could reach the scale needed to elicit a competitive private sector response is in the framework agreements for IT services. Greater scale can be attained by relying on multi-year framework agreements instead of individual transactions to procure goods and services. Importantly, the benchmarking of eligible bids relative to competitive prices would provide a safeguard to avoid proceeding with potentially costly tenders. Border prices—including import duties and taxes—can be used as the price ceiling whenever possible.

Recent years have seen the emergence of a wide range of public-private partnerships (PPPs), with varied degrees of risk taken by the private and public sectors. “Smart partnerships” between the private and public sectors can take a variety of forms, ranging, for example, from concessions to public service contracts (PSCs). The latter define rights and obligations between a public entity (such as a government or municipality) and a public or private provider, including the formula for the service payments made to the provider in return for the delivery of services. PSCs should also make provision for capital investments. Arrangements of this sort are being increasingly used with success in the public transport sector in Eastern Europe. Bhutan could usefully explore entering into such PSCs for public urban transport or with other public organizations which receive public subsidies.

Improving the private sector’s access to labor, both unskilled and skilled, is paramount. The private sector suffers from skills shortages and mismatches, while two-thirds of workers with tertiary education are

employed in the public sector. This situation limits the development of a vibrant private sector and the creation of more well-paying and otherwise desirable private sector jobs. To address this issue, investments in improving the quality of education and training (preschool, tertiary and professional) and increasing access to it are needed. Greater education will improve workers' job prospects and productivity and ultimately stimulate private sector employment. Bhutan could also benefit from making sure education and training interventions incorporate the development of core technical skills (such as computer skills) and soft skills (such as leadership and team work skills) that many employers currently see as insufficiently established.

Equalizing public sector compensation packages with nonfarm private sector packages is necessary to make private sector jobs as attractive as public jobs. Keeping adjustments of public sector wages modest to allow private sector wages to catch up will be an important element of balancing Bhutan's development. Today, compensation packages are more generous for the public sector than the private sector. For instance, while the majority of workers should be entitled to receive a range of different fringe benefits, in fact such coverage is incomplete. Public sector workers are more likely to receive all types of benefits. For each of 8 fringe benefits covered in the BLFS 2014, coverage among public sector workers easily exceeds 90 percent, but only between around 25 percent and 65 percent of private sector workers receive each particular benefit. It is recommended that public and private sector compensation packages be gradually aligned by ensuring that public sector wages grow at a modest pace, at most in line with private sector wages.

Fringe benefits and pension coverage need to be gradually aligned between the public and the nonfarm private sector. Even though fringe benefits and pensions are mandated by law, only a relatively small share of Bhutan's private sector workers can avail themselves of tips, gratuity, provident fund payments, overtime payments, paid leave (annual, sick, casual or parental) and compensation for work accidents or occupational diseases. Public awareness campaigns and greater efforts to enforce existing labor regulations could help align benefits between the public and the private sector. At the same time, it is important not to overburden the formal or semi-formal private sector with regulations that would put it at a disadvantage compared to the significant part of the private sector that is informal and does not necessarily follow regulations. Therefore, reductions in fringe benefits offered to public sector workers that are not legally mandated—such as free or subsidized housing—might ultimately be necessary.

The overly generous pension scheme is a major factor skewing the compensation balance towards employment in the public sector. Previous studies have found that the pension wealth that accumulates over a full career is equivalent to roughly 14 times the workers' wage. (In South Asia, only Sri Lanka showed a higher figure). Were this to be taken into account as an annual flow of deferred compensation it would result in a significant public-private wage differential. Moreover, the defined benefit scheme will eventually run deficits if not reformed. Parametric reforms to reduce the mismatch between long run revenues and expenditures would also reduce the gap between public and private sector compensation.

Expanding pension coverage is an important long run objective but expanding the public sector scheme to private sector workers will simply create a larger tax wedge and may promote informality. One alternative would be to promote voluntary participation in defined contribution scheme through matching contributions aimed to benefit lower income workers in particular. Matching contributions (as opposed to tax deductions) have been introduced in a number of countries including China and India and have the potential for reaching both formal and informal private sector workers with some capacity to save.

In light of the fundamental change in the revenue outlook since the inception of the pension scheme in 2001, the government may want to reconsider the current contribution rate model for both public and private sector workers. After decades of low coverage, many countries are moving away from the traditional Bismarckian social insurance model and delinking pensions and health insurance from employment status. A broad social pension scheme would not only ensure coverage but would also encourage

the demand and supply of labor in the formal private sector relative to an expanded payroll tax-financed scheme.

Bhutan’s nonfarm private sector needs more predictable, systematic access to foreign labor to compensate for the shortage of domestic labor, both skilled and unskilled. As mentioned above, many firms see the restrictiveness of immigration rules as a significant obstacle to their operations. What is more, in many cases the skills of Bhutanese and non-Bhutanese workers complement each other. Many foreign workers either have specialized qualifications that Bhutanese workers lack or are willing to perform tasks in which Bhutanese workers are reluctant to engage. This means smarter regulation of non-Bhutanese workers would actually also increase the employment prospects of Bhutanese workers and reinforce the positive impacts of other policies that address the domestic supply of labor (in particular an expansion of quality education). Based on international best practices, three broad principles could guide policymakers in Bhutan to develop an orderly, well-regulated process to manage economic immigration. First, the process should be market-driven: that is, immigration flows should be aligned with labor market demands as well as with Bhutan’s overall economic, social and cultural objectives. Second, it should be comprehensive: a comprehensive immigration system would recognize the need for immigrants of different types but also differentiate among these types. Third, it should be balanced: it should seek to maximize the employment of Bhutanese citizens and minimize any negative impacts of immigration on Bhutanese workers while also protecting immigrant workers from mistreatment or abuse.

Creating a national social assistance system as a unified mechanism for the sharing of rents will be instrumental in supporting the rebalancing of the agricultural, nonfarm private and public sectors. While universal access to free education and healthcare benefits the whole population and Bhutan’s social protection programs are generally progressive, ensuring protection of all workers would require an enhanced focus on workers in the informal economy, particularly in small-scale and subsistence agriculture. For rural households, a large majority of risks to income, assets and food consumption are climate- or weather-related. Therefore, the expansion of measures that encourage savings among agricultural households as well as the introduction and scale-up of agricultural insurance is critical. Equally critical is to ensure that those who are no longer able to work in agriculture for physical reasons receive income support, allowing them to live at a minimum standard. There is also a need to gradually modernize and expand existing social assistance programs. For example, it would be useful to expand the Targeted Household Poverty Programme and link its database with that of other social protection programs. The modernization of social assistance programs could be guided by an expansion of the evidence base around the impacts of existing programs through increased monitoring and impact assessments.

Combined with more effective active labor market programs, an income support program could contribute to a “flexicurity” approach that protects and fosters formalization and nonfarm private sector jobs. Today, Bhutan already has relatively flexible employment protection legislation. Combined with the introduction of an income support program for unemployed private sector workers, the launch of more effective active labor market programs (including more thorough and tailored employment services), could have significant impact on workers’ formalization and their interest in private sector jobs. Under this scenario: First, employment protection legislation would continue to be used mainly to safeguard core labor standards. Second, the income support program would be financed out of general government revenues to minimize disincentives for formalization. Third, active labor market programs would support retraining and job search assistance for job seekers. Such a “flexicurity” approach might give more workers the confidence to take on the risks inherent with any private sector job and pursue employment opportunities in the private as opposed to the public sector.

Coordinated enactment of interlinked and complementary policy reforms will help overcome barriers to the enactment of reforms and maximize their expected impacts. Some of the proposed policy

options can be expected to have a greater impact than others. Moreover, some will be easier to implement in terms of both technical challenges and political economy hurdles. Enacting reforms that interlink and complement each other simultaneously could be expected to maximize their impact, help overcome some barriers to implementation and put Bhutan on a firm track to balanced development. At the same time, practical considerations might make it necessary to pursue a staggered reform process. Should this be the case, it would be advisable to begin with reforms that lay the groundwork for other reforms, are relatively easy to implement and promise high impact. Once these reforms are in place, they will build momentum for the subsequent pursuit of policy options that are more difficult to implement or that require more analysis (Table 1).

Table 1—Summary of Recommendations for Balanced Development

Recommendation	Implementation		
	Ease	Time	Impact
Outsourcing a larger proportion of non-core government activities, such as maintenance or IT services, could go a long way toward providing new opportunities for the private sector at the same time that it would serve to increase the efficiency of spending.	Easy	Short-term	Medium
Demand-side opportunities for the private sector to grow can include a wide range of PPPs, with varying degrees of risk taken by the private and public sectors.	Difficult	Medium-term	High
Adjustments to public sector wages should follow adjustments to private sector wages and not <i>vice versa</i> ; gradually, wages and fringe benefits offered to public and private sector workers need to be aligned.	Moderate	Long-term	Medium
Bhutan's nonfarm private sector needs more predictable and systematic access to complementary foreign labor to compensate for the shortage of domestic labor, both skilled and unskilled.	Difficult	Medium-term	High
Bhutan could invest in expanded access to and in particular quality of education and training and making sure education and training interventions incorporate the development of core technical skills and soft skills that many employers currently see as insufficiently established.	Moderate	Long-term	High
Bhutan would benefit from measures that enhance the capacity of the government to oversee labor regulations and occupational safety and health standards and strengthen the capacity of regional employment and labor offices to effectively deliver services.	Moderate	Short-term	Medium
Bhutan could complement existing training and entrepreneurship support programs by more thorough and tailored employment services that for instance take better account for the distinct labor market challenges in rural and urban areas.	Easy	Medium-term	Low
The modernization of social assistance programs could start with expansion of the Targeted Household Poverty Programme and the establishment of a link between its database and that of other social protection programs.	Moderate	Medium-term	High
Narrowing the compensation gap between public and private sector workers would necessitate gradual alignment of the pension coverage between sectors and introduction of an income support scheme for private sector workers. Both expanded pensions and income support should be financed from general government revenue.	Difficult	Long-term	Medium
Expansion of the evidence base for the impact of existing social protection and labor programs through increased monitoring and impact assessments could guide the improvement and consolidation of social protection and labor programs.	Easy	Short-term	Low

BHUTAN'S LABOR MARKET: TOWARD GAINFUL QUALITY EMPLOYMENT FOR ALL

1 INTRODUCTION

1.1 BACKGROUND

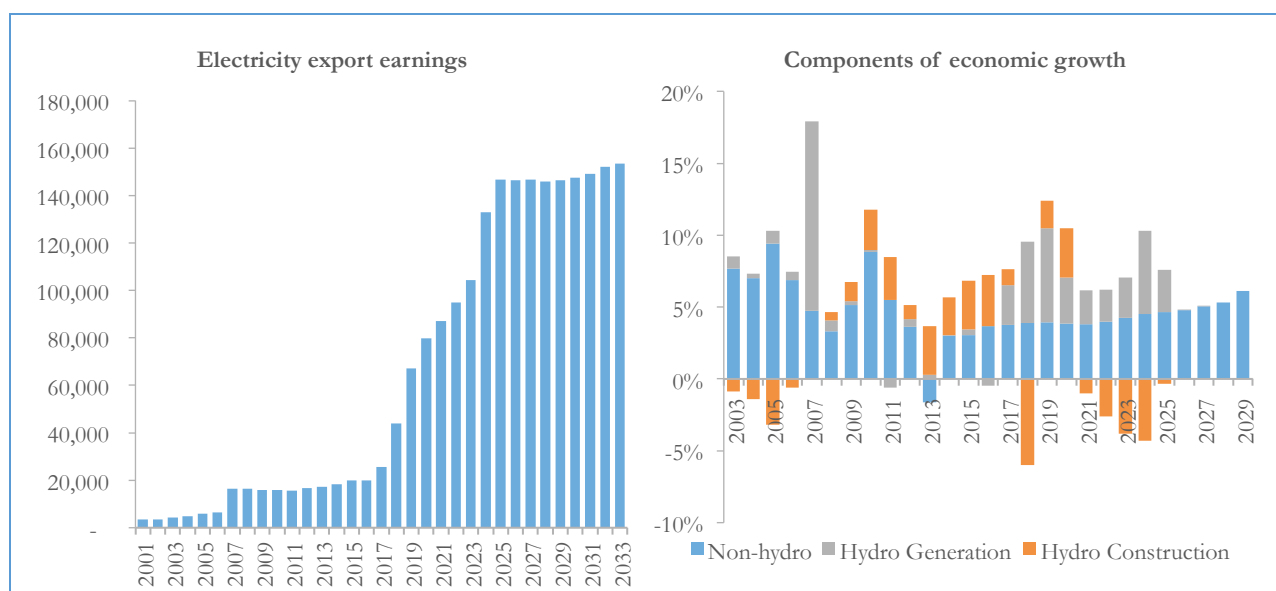
1. **The Royal Government of Bhutan (RGoB) places great emphasis on the creation of a sufficient number of high-quality jobs for its citizens.** The vision of Bhutan's Ministry of Labour and Human Resources (MoLHR) is "a Nation where all its citizen have the opportunity for a gainful and quality employment characterized by harmonious and productive relationship in the workplace and the broader community." The goal of Bhutan's National Employment Policy is "the achievement of full, productive, meaningful, gainful and decent employment for the people of Bhutan, which shall drive the country towards achieving high levels of human development and contribute to the maximization of the Gross National Happiness". Accordingly, to achieve the country's target of full employment—defined as an unemployment rate of not more than 2.5 percent—new jobs for approximately 120,000 job seekers entering the labor market need to be created during the period of Bhutan's Eleventh Five-Year Plan (2013 to 2018). Sixty percent of job seekers entering the labor market during this period will have completed at least ten years of schooling. They will seek jobs commensurate with their educational level. (GNHC 2013).

2. **This report aims to provide robust evidence to inform RGoB policy making on labor market issues. It uses new evidence on labor demand and supply to delve into the fundamental challenges constraining the availability and quality of jobs in Bhutan.** The report identifies significant and urgent labor market challenges, the causes underlying these challenges and potential solutions. It focuses on four issues that are key for Bhutan's labor market: imbalances between the public and the private sector, barriers to private sector development, labor market policies and social protection for workers. Building on a conceptual framework introduced in the World Bank's World Development Report 2013: Jobs (World Bank 2012d), the analysis takes into account policy fundamentals that are essential for both growth and job creation, labor market policies that can help ensure that growth translates into employment opportunities and policy priority areas where jobs might do the most for development, given Bhutan's specific country context.

3. **In recent decades Bhutan has seen rapid, sustained economic growth and broad-based, inclusive poverty reduction.** Bhutan's Gross Domestic Product (GDP) per capita reached Nu 156,267 (\$2,560 at current exchange rates) in 2014 according to the World Development Indicators, and Bhutan is now officially classified as a lower-middle income country. As noted by the National Statistics Bureau (NSB) and the World Bank (2014), between 2007 and 2012 the proportion of Bhutan's population below the official poverty line dropped by half (from 23 per cent in 2007 to 12 per cent in 2012). Over the same time period Bhutan's extreme poverty rate, measured by the international poverty line of \$1.90 a day, declined from 8 to 2 percent. Multidimensional poverty indices and indicators related to education and health outcomes have also seen significant improvement in recent years, and Bhutan has become more and more integrated into the global economy.

4. Bhutan continues to develop rapidly and the country’s hydropower generation potential raises the prospect of tremendous development opportunities in the future. Bhutan’s terrain comprises steep mountains crisscrossed by snow-fed rivers with considerable hydropower generation potential of an estimated 30,000 megawatts (MW). As detailed in World Bank (2015a), of this potential 1,606 MW are already operational and an additional 3,153 MW are projected to be online in 2018, with another 2,170 MW following shortly thereafter. The development of hydropower generation capacity will have a direct impact on several key macroeconomic indicators. In particular, it is expected to lead to a large increase in export revenues and sustained economic growth. The World Bank (2015a) forecasts that electricity export earnings will jump from less than Nu 20 billion in 2015 (about \$300 million at current exchange rates) to more than Nu 67 billion in 2019 and Nu 145 billion in 2025. The contribution of hydropower to economic growth will mostly come from the boost it will give to aggregate demand during the construction phase of the different projects and the additional revenue these projects will generate at the time of commissioning. Again according to World Bank (2015a), between 2013 and 2019 hydropower generation is expected to add an additional percentage point to Bhutan’s annual economic growth. Taking into account the hydropower projects in the pipeline and under construction, Bhutan’s GDP per capita is forecast to double within about 15 years, reaching \$6,000 by 2030. The development of the hydropower industry is also expected to contribute to continued rapid poverty reduction (Figure 1.1).

Figure 1.1—Time Series and Forecasts of Electricity Export Earnings and Components of Economic Growth



Source: World Bank 2015a.

Note: Figures on electricity export earnings are in million Nu.

5. At the same time, hydropower development is also expected to create or exacerbate a number of significant challenges, including those facing the labor market. As detailed in World Bank (2015a), challenges created or exacerbated by hydropower development are likely to include macroeconomic instability and a lack of economic self-reliance. In addition, hydropower development will make some labor market challenges that are already apparent more pressing, especially in those industries that will not directly benefit from the money that is projected to flow into Bhutan. As detailed in Chapter 2 of this report, the private sector already faces difficulties in being competitive and attracting well-qualified labor. Once the planned massive hydropower projects come onstream, higher labor costs could worsen these difficulties. Moreover, informal, rural and agricultural workers risk being left behind.

6. **Thus, while hydropower generation presents a huge opportunity for Bhutan's development over the coming decades, this opportunity will need to be consciously managed, with an eye on its impact on labor and the availability and quality of jobs.** The World Development Report 2013 stresses that even when investments in extractive industries represent a sizable fraction of a developing country's GDP and lead to spectacular increases in export revenue, they tend not to create many jobs. The report notes that countries have basically followed two distinct strategies to spread the wealth resulting from natural resources. The first strategy has been to place citizens in well-paid jobs in the public sector. This strategy has been pursued in many states around the Persian Gulf. While it has made some Gulf country citizens direct beneficiaries of the natural resource bonanza, the strategy has also had negative consequences. In particular, it has often led to a situation where immigrants perform menial jobs, while public sector jobs are rationed. This has in turn meant that some groups, such as women and youth, have had limited access to public sector jobs. The second strategy has been to create jobs outside of the extractive industries and to diversify the export base. For instance, the United Arab Emirates has managed to diversify its economy beyond the natural resource industry and has created jobs in financial and logistics services and other industries. Norway offers another example of a resource-rich country that has successfully followed a private-sector-led development path. With major hydropower projects coming onstream in the next few years, now is the time for Bhutan to decide if it wants development to follow a path led by the public sector, the private sector or to create a balance between the two paths.

1.2 KEY LABOR MARKET INDICATORS

7. **Compared to many other lower-middle income countries, current labor market conditions in Bhutan appear favorable; labor force participation rates are high, overall unemployment rates low and gender differences small.** According to the Bhutan Labour Force Survey (BLFS), in 2014 around 62 percent of Bhutan's population aged 15 and older was part of the labor force. This meant that Bhutan was better able than many other lower-middle income countries to make use of the economic potential its population offers.¹ In 2014, the labor force participation rate was 71 percent for men and 55 percent for women. This difference in labor force participation rates between genders is significant but relatively small compared to the average for lower-middle income countries. Nor is Bhutan's current overall unemployment rate of 2.6 percent high by international standards. Unemployment is more prevalent in urban areas than in rural Bhutan (Table 1.1).²

8. **Recently, there has been a trend toward almost universal enrollment in primary education, along with rapidly increasing enrollment rates in secondary and tertiary education.** More than 60 percent of individuals in the Bhutanese labor force have no formal education, according to the BLFS 2014. Just 7 percent complete primary education but not secondary education and around 24 percent complete secondary education but not tertiary education. Less than 7 percent of the labor force has completed some kind of tertiary education. The large proportion of individuals with little or no education can be traced to Bhutan's former position as a rural society that long lacked a well-developed educational system. At the same time, as noted in World Bank (2014b), of all South Asian economies the most significant change in primary school enrollment rates took place in Bhutan between 2001 and 2010. Over a single decade, Bhutan's primary net enrollment rate increased by 30 percentage points to 88 percent. At the same time, secondary gross

¹ The labor force participation rate is calculated as the share of the population aged 15 years or older that is in the labor force, with the labor force defined as encompassing all persons who worked or were unemployed during the week before the BLFS interview (cf. ILO, 2011).

² While this report relies on data from the BLFS 2014, information on key labor market indicators from the BLFS 2015 has recently become available. Key labor market indicators for 2014 presented here are generally consistent with those now available for 2015. For instance, the unemployment rate in 2015 was 2.5 percent, only 0.1 percent different than in 2014.

enrollment increased from under 40 percent to around 70 percent of the population. Recently, Bhutan has placed greater emphasis on tertiary education.

Table 1.1—Key Labor Market Indicators for 2013 and 2014

Indicator	2013		2014	International average
Population	745,939	↗	755,710	
Population aged 15 and over	529,178	↗	557,047	
Labor force	345,786	↗	348,742	
Labor force participation rate	65.4%	↘	62.6%	58.1%
Male labor force participation rate	72.1%	↘	71.0%	73.0%
Female labor force participation rate	58.9%	↘	54.8%	43.9%
Proportion of public sector employment among total employment	20.1%	↘	18.9%	
Proportion of informal employment among total employment			79.8%	
Proportion of agricultural employment among total employment	56.3%	□	56.7%	
Unemployed persons	9,916	↘	9,174	
Overall unemployment rate	2.9%	↘	2.6%	9.9%
Youth unemployment rate	9.9%	↘	9.4%	19.4%
Male unemployment rate	2.2%	↘	1.9%	8.5%
Female unemployment rate	3.8%	↘	3.5%	13.4%
Rural unemployment rate	1.6%	↘	1.2%	
Urban unemployment rate	6.5%	↗	6.8%	

Source: World Bank staff estimates based on BLFS 2013, BLFS 2014 and ILO ILOSTAT database.

Notes: Informality is defined as work not in regular wage or salaried work or high-end self-employment. International averages are unweighted averages for lower-middle income countries.

The positive statistics hide a number of important challenges, including declining labor force participation rates, a dominant public sector and pockets of quantitative and qualitative underemployment. Labor force participation rates have steadily declined in recent years, dropping from 69 percent in 2010 to 63 percent in 2014. This decline has been particularly steep for women. Other challenges for Bhutan’s labor market include the relative predominance of public sector employment—discussed in more detail in Chapter 2—and pockets of underemployment, especially among younger workers and women. In 2014, quantitative underemployment amounted to 1.1 percent of total employment in 2014. While this rate is quite low, among women it reached 1.5 percent and among workers aged 15 to 24 it stood at 1.9 percent. In addition, there are also widespread reports of qualitative underemployment.³

9. Informal work is a particular concern because it is widespread among the general population and endemic among certain groups, such as individuals with low education, from rural areas, and from poor households. While attention has recently focused on the relatively high urban unemployment rate, Bhutan remains a largely rural, agrarian economy. This is reflected in the high proportion of informal employment to total employment, which World Bank staff estimates at around 80 percent.⁴ Informal

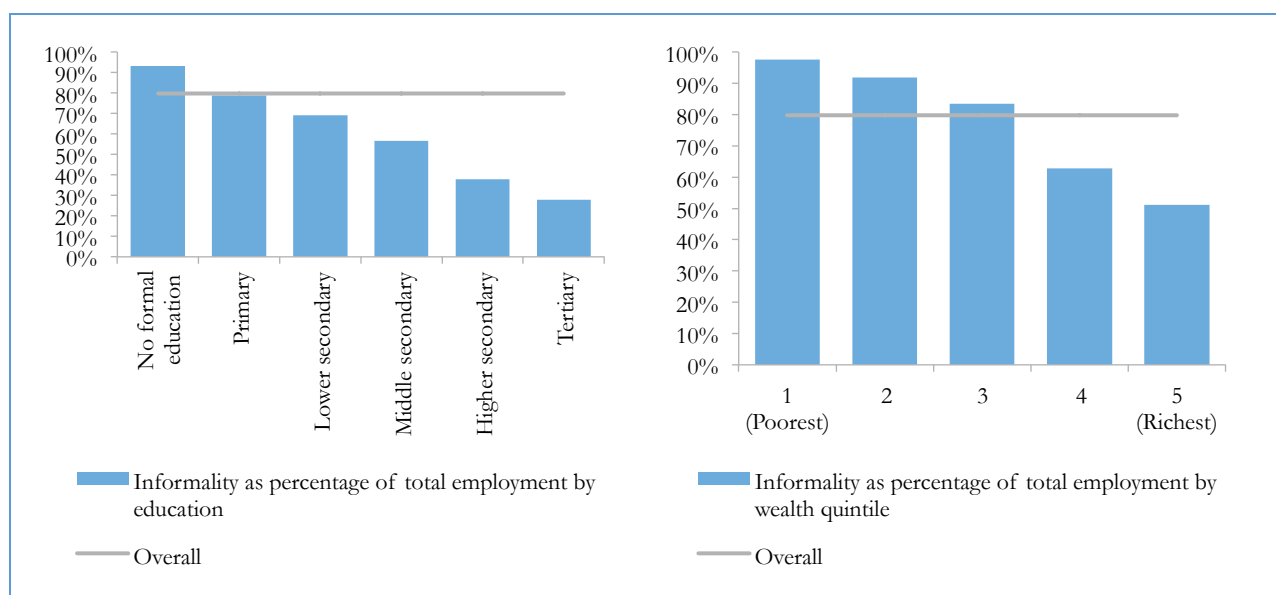
³ Following ILO (2011), the quantitatively underemployed are defined as all persons in employment who had worked less than 35 hours per week during the week before the BLFS interview and were willing to work additional hours. It is more difficult to define qualitative underemployment in precise terms but it is generally understood to workers that are employed in jobs that do not make the best use of their qualifications and skills

⁴ It is challenging to define and measure informal employment. Building on ILO (2013) this report defines informal employment as encompassing all workers who work as casual paid employees, contract/piece paid workers, self-employed workers and family workers. In addition to that, informal employment also includes those regular paid employees without a contract of employment

employment can be a concern because informal workers tend to have low productivity and lack social protection. Government policies meant to improve the living conditions of workers rarely reach the informal economy.

10. Informal labor is a complex, multifaceted phenomenon that is shaped by both the modes of socioeconomic organization and the relationship the state establishes with private agents through regulation and monitoring. World Bank (2012b) argues that development and formalization do not necessarily go hand in hand. Instead, formalization is shaped by a number of structural parameters and is hence a consequence of policy choices. According to World Bank (2012b), cross-country regressions show that labor informality is negatively and significantly related to the strength of law and order, business freedom from regulation, and average years of secondary schooling. It is positively and significantly associated with sociodemographic transformation factors (agricultural share, youth population, and rural population).

Figure 1.2—Informal Labor as a Percentage of Total Employment, by Education and Household Wealth Quintile



Source: World Bank staff estimates based on BLFS 2014.

Notes: Primary education includes pre-primary. Workers with religious education are excluded.

11. In Bhutan, informal labor is closely linked to lack of education and poverty, among other variables. The incidence of informality decreases with increased educational attainment. At 93 percent, the proportion of informal jobs is highest among workers with no schooling. On the other end of the scale, less than 30 percent of workers with tertiary education are informally employed. Informality is also closely related to poverty. While the BLFS 2014 does not contain data that allow the classification of households according to Bhutan’s official poverty line, it is possible to use a stylized wealth index to categorize households into five quintiles. Based on this classification, 98 percent of workers from households in the poorest quintile are engaged in informal work. In contrast, the informality rate stands only at 51 percent among workers from the richest fifth of households. More formally, econometric estimates using the BLFS 2014 confirm that certain individuals—in particular those who are older, have less education and are from less well-off households—are significantly more likely to be engaged in agricultural jobs, a close proxy for informal work. For instance,

and/or access to any kind of fringe benefits (gratuity, provident fund payments, overtime payments, annual payments, sick leave, casual leave, maternity/paternity leave, or compensation for injury, disability or death due to work accidents or occupational disease).

the marginal effect of an additional year of age at the means of all other explanatory variables on the probability of working in agriculture is 0.1 percent (everything else being equal). An individual with primary education is 19.3 percent less likely to work in agriculture than an otherwise comparable individual with no formal education (Figure 1.2 and Table 1.2).⁵

Table 1.2—Determinants of Labor Force Participation and Sectoral Choice

Determinants of different labor market states	Labor Market States			
	Inactive	Public sector	Private non-agriculture	Private agriculture
Education (reference category: no formal education)				
Primary education	29.5%*	2.8%*	-13.0%*	-19.3%*
Lower secondary education	18.8%*	5.6%*	-8.6%*	-15.8%*
Middle secondary education	12.9%*	8.2%*	-2.0%	-19.0%*
Higher secondary education	18.4%*	11.8%*	-1.8%	-28.3%*
Lower tertiary education	21.9%*	12.1%*	-2.7%	-31.3%*
Higher tertiary education	194.1%*	35.4%*	46.8%*	-276.3%*
Socio-demographic characteristics (reference category: rural, male and non-Bhutanese)				
Urban	10.1%*	7.7%*	7.9%*	-25.7%*
Female	17.7%*	-8.0%*	-8.4%*	-1.3%
Bhutanese	5.4%	11.6%*	-10.8%*	-6.1%
Age	-0.6%*	0.3%*	0.3%*	0.1%*
Households wealth	-0.7%	1.4%*	4.6%*	-5.3%*

Source: World Bank staff estimates based on BLFS 2014.

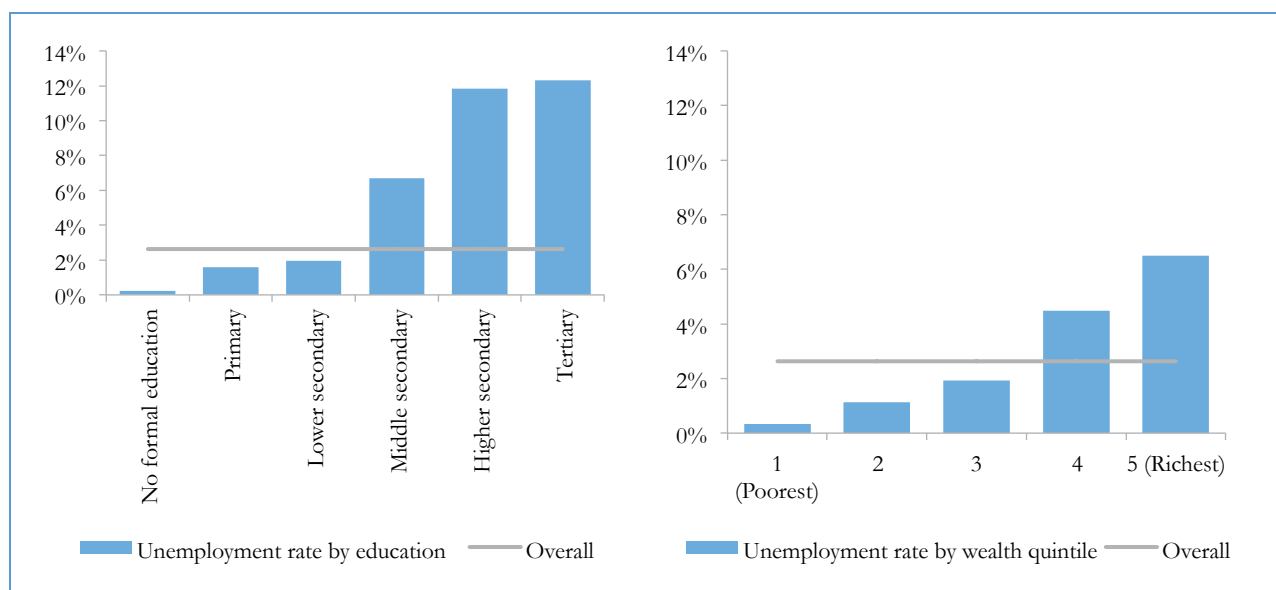
Notes: An * indicates statistical significance on the five percent level. Primary education includes pre-primary. Workers with religious education are excluded. Location variables are not displayed. The table lists marginal effects at the means of all explanatory variables from logistical regressions for labor force participation and sectoral choice for both the discrete and the continuous explanatory variables. As with all statistical techniques, logistical regressions are subject to statistical error and should be interpreted with caution.

12. Unemployment should be seen as a challenge for specific groups—including the young, urban, relatively well-educated and well-off—and should be considered in the context of overall labor market challenges. As mentioned above, compared to other economies with a similar level of economic development, Bhutan’s overall unemployment rate is low. At the same time, unemployment rates are much higher for specific groups. As previously noted, the urban unemployment rate is four times higher than the rural rate. As with informal labor, unemployment is closely related to education and household wealth: However, the trend lines run in opposite directions. Unlike the incidence of informal labor, which decreases with wealth and education, unemployment is more prevalent among better educated individuals and richer households. Whereas the unemployment rate is extremely low for individuals with no formal education (0.2 percent), it is 12.3 percent for individuals with tertiary education. Similarly, the unemployment rate is 0.3 percent for individuals in the poorest 20 percent of households but 6.5 percent for those in the richest

⁵ To construct a wealth index that is a close approximation of household wealth, this report uses a principal components analysis to convert a range of distinct but possibly correlated measures of household wealth (ownership of dwelling, different types of livestock and land as well as consumer goods like mobile phones, rice cookers, composite bows or cars, and electricity connection) recorded in the BLFS 2014 into exactly one measure for household wealth. Following World Bank (2003), it is assumed that the first principal component is an adequate measure of wealth. Subsequently, households are classified into wealth quantiles, i.e. five groups of equal size ordered by the value of their household wealth.

quintile. Overall, unemployment seems to be more common among young, urban, relatively well-educated and well-off persons. This means policies to address it need to target these specific groups. Furthermore, one might ask why unemployment is particularly elevated for certain groups. In Chapter 2, this report argues that one important reason is the overwhelming attractiveness of the civil service and the willingness of many job seekers to wait for openings in the public sector (Figure 1.3).

Figure 1.3—Unemployment Rate by Education and Household Wealth Quintile



Source: World Bank staff estimates based on BLFS 2014.

Notes: Primary education includes pre-primary. Workers with religious education are excluded.

13. Alarmism about youth unemployment is unwarranted. It is true that Bhutan’s youth unemployment rate stands at 9.4 percent. This rate is more than three times higher than the general unemployment rate and considerably above the target set by the RGoB’s Eleventh Five-Year Plan, which aims for full employment and a youth unemployment rate at or below 2.5 percent. However, one has to keep in mind that youth unemployment rates measure the proportion of the youth labor force that is without work and looking for a job. The rate does not account for those who are inactive or those in education or training. In countries where enrollment in secondary and tertiary education is high, a more meaningful and policy-relevant variable is the share of unemployed youth in the overall youth population. As already mentioned above, in recent years Bhutan has seen rapidly increasing enrollment rates in secondary and tertiary education. As a result, in 2014 only 27 percent of individuals aged 15 to 24 participated in the labor market. Thus, Bhutan’s youth unemployment rate of 9.4 percent in 2014 corresponded to a 2.5 percent share of unemployed youth in the youth population. According to data from the International Labour Organization (ILO), this was the lowest percentage of unemployed youth in the youth population among all South Asian countries.

1.3 PRIORITY POLICY CHALLENGES

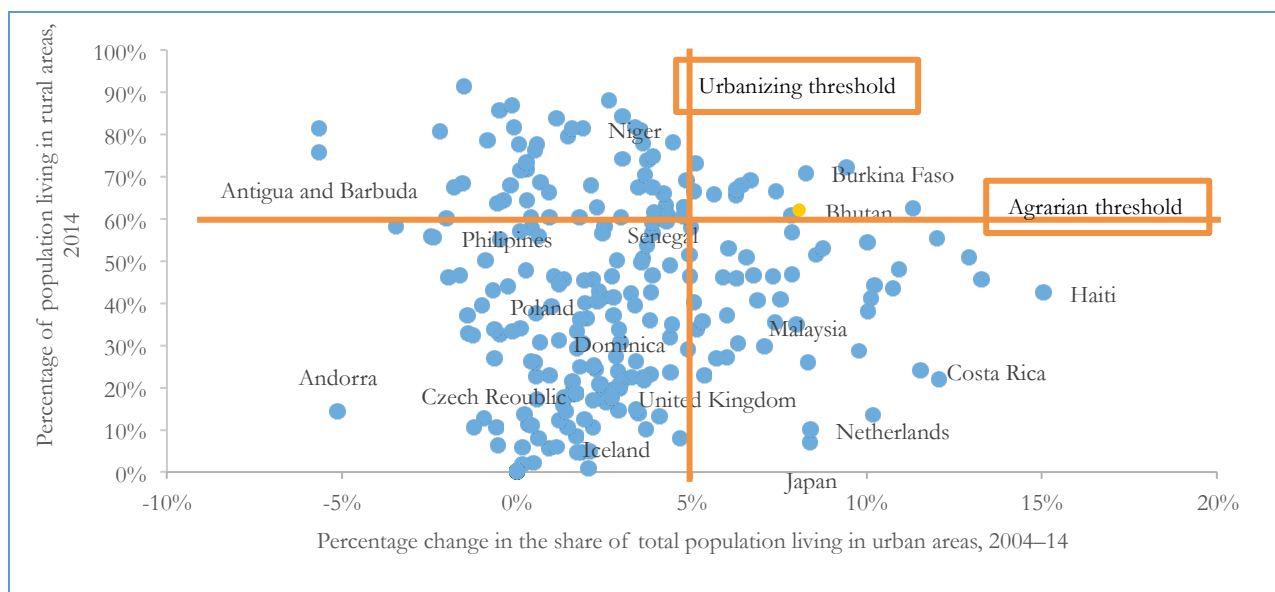
14. Conceptually, this report is guided by the classification of jobs challenges in the World Development Report 2013. The World Development Report 2013 introduces a “jobs challenges” typology that uses systematic criteria and a data-driven methodology to distinguish between six distinct country types with specific priority policy challenges. It classifies countries as urbanizing, agrarian, formalizing, aging,

resource-rich, or having high youth unemployment.⁶ Obviously, many countries face not just one but several of these challenges. The World Development Report 2013 stresses that the criteria used to categorize countries are not mutually exclusive.

15. The classification of jobs challenges used by the World Development Report 2013 makes it possible to get an initial sense of the kinds of jobs that promote development in a particular setting.

The typology introduced in the report allows a first identification and prioritization of a country’s particular policy challenges and the steps that can be taken toward overcoming it. However, the report also emphasizes, “The types of jobs that can contribute the most to development depend on the country context. Jobs that connect the economy to the world may matter the most in some situations; in others, the biggest payoff may be for jobs that reduce poverty or defuse conflict” (World Bank 2012d, p. 17).

Figure 1.4—Proportion and Percentage Change in Share of Total Population in Urban v. Rural Areas in Different Countries



Source: World Development Indicators database.

Notes: Urbanizing threshold and agrarian threshold as defined in World Bank 2012d.

16. According to the World Development Report 2013 classifications, Bhutan is an agrarian economy. An agrarian economy is one in which the majority of the population lives in rural areas where work consists mainly of small-scale and subsistence agriculture and related industries. A country is considered agrarian if 60 percent or more of its population lives in rural areas. This is the case for Bhutan, where 62 percent of the population lived in rural areas in 2014. An urban-rural gap also remains in many dimensions, including with respect to poverty, food security and access to services (Figure 1.4).

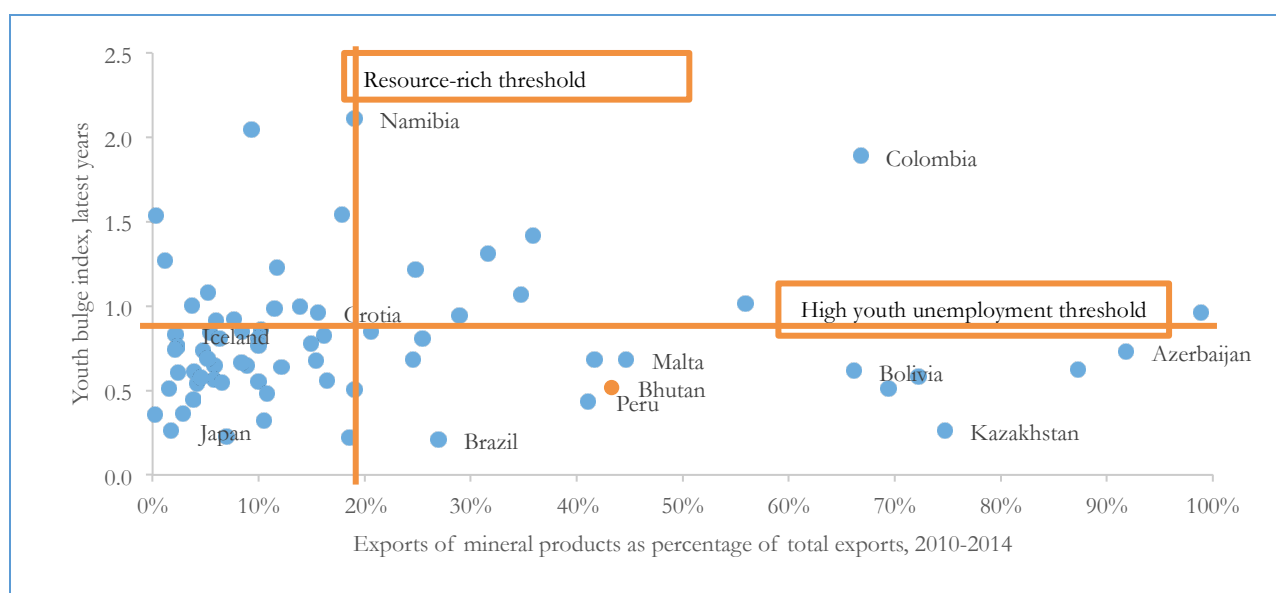
17. The World Development Report 2013 argues that in agrarian economies the main avenues to improving living standards are to increase agricultural productivity, create a dynamic economic environment in cities and promote labor reallocation from rural to urban areas. A combination of more productive smallholder farming and more urban jobs connected to global markets can spark a positive

⁶ According to the World Development Report 2013, small island states and conflict-affected countries are two additional country types that face separate priority policy challenges. As Bhutan is neither a small island nor a conflict-affected country, these are not directly relevant for Bhutan. At the same time, the main challenge for small island states is that their geography limits productivity and growth. Due to Bhutan’s small size and remote location, the country in fact faces similar challenges.

spiral of productivity growth and improvement in living standards. It also leads to the expansion of off-farm employment opportunities, which in turn can be an important driver of poverty reduction.⁷

18. Bhutan is classified as an urbanizing economy. A country is considered to be urbanizing if the share of the population in urban areas has risen by 4.5 percentage points or more over a 10-year period. In Bhutan, the share of the population living in urban areas increased by 8 percentage points between 2004 and 2014 (Figure 1.4 and Box 1.1).

Figure 1.5—Exports of Mineral Products as Percentage of Total Exports and Youth Bulge Index in Different Countries



Source: UN COMTRADE database and ILOSTAT database.

Notes: Youth bulge index, resource-rich threshold and high youth unemployment threshold as defined in World Bank 2012d.

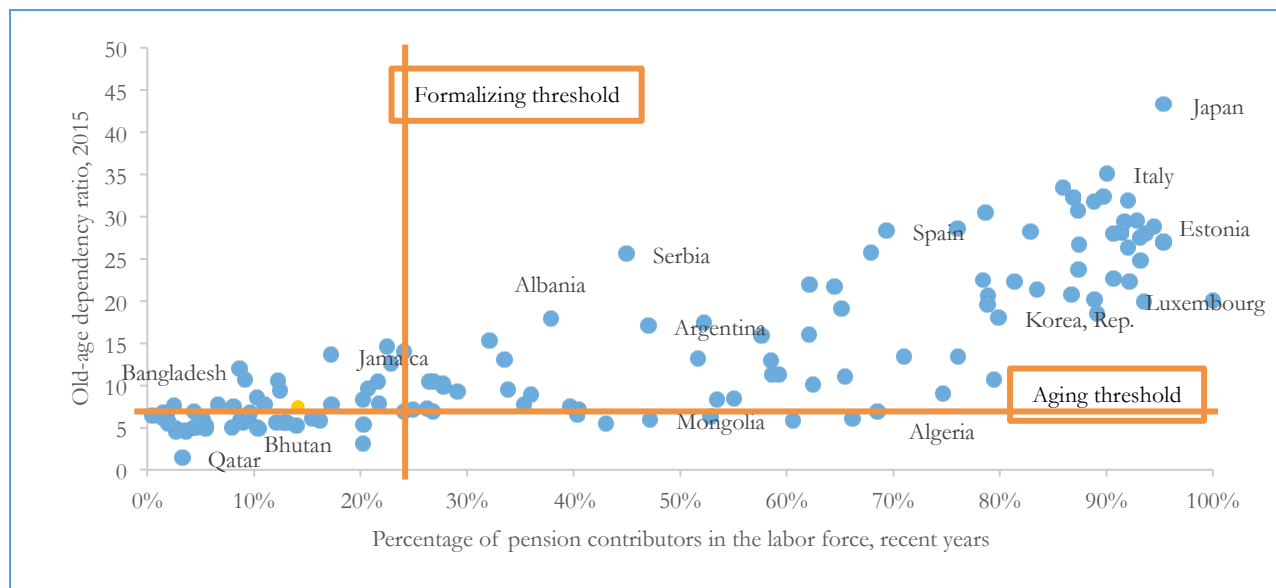
19. In general, urbanizing economies benefit from jobs that provide opportunities for women, move the economy up the export ladder, integrate rural-to-urban migrants and do not lead to excessive congestion. As detailed in World Bank (2014a), governments of urbanizing economies face challenges related to quickly integrating migrants into the urban economy, avoiding exclusion and urban poverty and minimizing the costs of congestion. Other priority areas for urbanizing economies are urban planning and management and the provision of opportunities for women (as in the course of urbanization countries typically pass through an important developmental juncture at which the participation of women in work outside the home begins to rise significantly)

20. Following the classification of the World Development Report 2013, Bhutan is a resource-rich country. Resource-rich countries are those where mineral exports account for at least 20 percent of total exports. Even before the hydropower boom expected in the coming years materializes, Bhutan easily surpasses this threshold. In 2012 mineral exports—which according to the Harmonized Commodity Description and Coding System of the World Customs Organization include the export of electrical energy—accounted for 43 percent of the country’s exports. More recent data are not yet available.

⁷ World Bank (2014a) argues that most job challenges can best be understood as a continuum along which a country can move and that the thresholds introduced by the World Development Report 2013 and reproduced are potentially a source of contention in that how they are chosen determines which challenges countries could prioritize. As also argued in World Bank (2014a), the exercise should be seen as insightful and stimulating rather than as definitive or conclusive.

21. Good jobs for resource-rich countries are those outside the extractive industries and those not subsidized through wealth transfers. As already mentioned above and explained in World Bank (2014a), the extractive industries necessary to exploit mineral resources rarely create a lot of jobs, and few of these jobs last beyond the initial construction phase. Moreover, if mineral resources account for a large share of export revenue, this can attract large inflows of foreign exchange that may induce inflation and “Dutch-disease” effects, causing a country’s currency to appreciate and reducing the competitiveness of tradable industries. As a consequence, for resource-rich countries the best forms of work are those outside of the extractive industries and those not subsidized through transfers (Figure 1.5).

Figure 1.6—Percentage of Pension Contributors in the Labor Force and Old-Age Dependency Ratio in Different Countries



Source: World Bank Pensions database and United Nations Populations Division World Population Prospects database.

Note: Formalizing threshold and aging threshold as defined in World Bank 2012d.

22. According to the World Development Report 2013, Bhutan is classified as neither an aging country, one with a formalizing economy, nor one with a particularly elevated level of youth unemployment. Formalizing economies are defined as those where pension contributors represent 25 to 75 percent of the total labor force. Aging societies have an elderly population (aged 65 or above) that is more than 8 percent of the working-age group (15-to-64-year-olds). According to recent data from the World Bank Pensions Database and the United Nations Populations Division World Population Prospects, Bhutan belongs to neither category. To assess whether a country has particularly high levels of youth unemployment, the World Development Report 2013 proposes a “youth bulge index.” The youth bulge index is calculated by multiplying total youth employment by the youth unemployment rate and dividing the resulting figure by total population. A score of 0.90 or above signifies high youth unemployment. At 0.52, Bhutan’s score is well below the threshold. This confirms the assertion made above that alarmism about youth unemployment is unwarranted (Figure 1.5 and Figure 1.6).

23. The classification of Bhutan as agrarian, urbanizing and resource-rich has implications for the country’s prioritization of its policy challenges. The systematic classifications of countries by the World Development Report 2013 should not be seen in isolation; they can imply complementary priority policy challenges or the need to prioritize among a set of conflicting challenges. In Bhutan’s case the agrarian nature of the economy points to a priority policy challenge of promoting labor reallocation to urban areas to

promote productivity growth. At the same time, urbanizing economies can face congested urban areas due to the large number of arriving rural-to-urban migrants. As a result, strong trade-offs exist with regard to any policy that would explicitly encourage or discourage rural-to-urban migration in Bhutan.

1.4 REPORT OVERVIEW

24. The remainder of the report digs deeper into select key issues for Bhutan’s labor market. It is guided by Bhutan’s current situation and future prospects, the state of key labor market indicators and the priority policy challenges presented in this chapter. Throughout the report, Bhutan’s classification as an agrarian, urbanizing and resource-rich economy serves as a guiding thread that ties to a number of different issues defining Bhutan’s labor market and the road toward gainful and quality employment for all. These different issues serve to organize the different chapters of the report.

25. The report concentrates on important and urgent labor-related issues. The report does not try to be exhaustive or to dissect all possible topics affecting Bhutan’s labor market. Instead, it selectively focuses on some of the most important and urgent issues. In terms of methodology, it relies on a desk review of existing studies, evidence and legal texts, on discussions with experts and stakeholders from Bhutan and on two primary data sources that provide recent, robust information on labor supply and demand in Bhutan. The BLFS 2014 is a representative labor force survey with a newly expanded questionnaire that was implemented by the MoLHR with support from the World Bank. The Bhutan Enterprise Survey (BES) 2015 is a firm survey conducted by the World Bank that improved understanding of the conditions, experiences and perspectives of Bhutan’s nonfarm private firms.⁸

26. Chapter 2 addresses imbalances between the public and private sectors. Whether to place citizens in public sector jobs or to focus on jobs outside of the extractive industries is a key strategic choice for resource-rich countries. This chapter documents that Bhutan’s public sector is oversized for a small, landlocked country with a relatively undiversified economy. It also demonstrates that overall compensation packages for workers are more generous in the public sector (in violation of the “prevailing wage principle” established by Fogel and Lewin, 1974) and that the unemployment rate among a number of population groups is elevated due to queuing for public sector jobs. The chapter finds that if Bhutan wants to avoid the pitfalls facing other resource-rich countries that rely mostly on public sector jobs and jobs subsidized through transfers, a comprehensive approach to sectoral rebalancing is needed—not to weaken the public sector but to allow private sector jobs to emerge and prosper.

27. Chapter 3 outlines barriers to private sector employment. This chapter analyzes Bhutan’s labor market from the perspective of labor demand. This approach is motivated by the priority policy challenges of creating jobs that are not subsidized through transfers and creating urban jobs connected to global markets. The chapter investigates the validity of often-heard complaints about skills mismatches. It also analyzes the relative importance of different labor-related constraints on business such as competition for workers, labor regulation and inadequate worker education or motivation. The chapter argues that reinforcing efforts to foster broad-based private sector development and productivity could increase the attractiveness of the private sector as an employer of highly educated workers and strengthen its capacity to absorb a higher number of job seekers. Bhutan could also consider focusing education and training interventions on the development of a core set of technical skills and soft skills demanded by the country’s private sector, and on ensuring that training content is relevant and in line with labor demand.

⁸ Both the BLFS 2014 and the BES 2015 achieved a high degree of reliability through the use of computer-assisted personal interviews. For more information on the BLFS 2014 and the ES 2015, cf. the Appendix, MoLHR (2015) and World Bank (2015d).

28. Chapter 4 analyzes Bhutan’s labor market policies. The chapter examines Bhutan’s labor market regulations (like the minimum wage, employment protection legislation, provisions against child labor and occupational safety and health standards), labor market interventions (active and passive labor market policies where costs of interventions are borne by all taxpayers whether they participate in the labor market or not) and labor market institutions (industrial relations) from a legal and a quantitative point of view. Specific emphasis is put on the implementation of labor market regulations on the ground as well as on policies regulating the movement of people into and out of Bhutan. Restrictions on the movement of people are particularly significant because they are directly related to Bhutan’s stated goal of achieving economic self-reliance by 2020 (GNHC 2013).

29. Chapter 5 analyzes the adequacy of existing social protection measures for different groups of workers. In addition, it identifies specific groups of vulnerable workers in need of protection. Following the terminology in World Bank (2012c), the chapter is concerned both with social protection programs (including social safety nets such as cash transfers, school feeding and targeted food assistance, and social insurance such as old age and disability pensions and unemployment insurance) and with other social programs (like Bhutan’s universal access to free education and healthcare). It investigates workers’ vulnerability to different shocks and the adequacy of existing social protection measures for distinct groups of workers. Subsequently, it identifies specific groups of vulnerable workers in need of social protection and outlines possible policy responses, including recommendations for the government’s future social protection strategy. The chapter argues that the appropriate set of social protection policies will partly depend on whether the government implicitly cares for workers by assigning them possibly unproductive or unnecessary public jobs. If the government instead pursues private sector development and broad-based economic growth, a much more comprehensive social protection system will be required.

30. Chapter 6 reviews the report’s findings and summarizes potential policy options. The chapter goes back to the introductory section describing Bhutan’s development success story and discussing the country’s future hydropower developments and both their huge potential and the challenges they pose with respect to Bhutan’s labor market. In the process, the chapter reiterates the report’s main findings, recapitulates common themes from Chapter 2 to Chapter 4 and summarizes possible policy options for the short, medium and long term.

BOX 1.1 URBANIZATION AND INTERNAL MIGRATION

As in many other urbanizing countries, in Bhutan the labor market is affected by a constant flow of labor migrating from rural to urban areas. The first decennial Population and Housing Census of Bhutan carried out in 2005 offers a detailed picture of this flow. The census defines internal migrants as individuals who were born in Bhutan but reside somewhere other than their place of birth. The Census documents 111,770 rural-to-urban migrants. This group of rural-to-urban migrants accounts for the biggest population flow, followed by an almost equal number of rural-to-rural migrants (111,548 individuals).

In addition to large numbers of rural-to-urban migrants and rural-to-rural migrants, the Census counts 19,992 people who moved from urban to rural areas while 23,874 individuals moved from one urban center to another. Among Bhutan’s twenty *dzongkhags* (districts), Thimphu (the district that includes the eponymous capital) received the highest number of migrants. The census counted 54,685 individuals who moved to Thimphu from another *dzongkhag*. Second and third place among *dzongkhags* in terms of incoming migrants go to Chhukha (25,951) and Sarpang (17,997), respectively. Both of these *dzongkhags* received less than half as many internal migrants as Thimphu.

The Census also records the reasons behind individuals' migration decisions. According to the census, a plurality of migrants (32 percent) migrated for family reasons. The second most frequently cited reason is employment (17 percent) followed by education and training (15 percent), marriage (11 percent) and work transfers (10 percent). Seven percent of respondents indicate they migrated to live with relatives, and 3 percent for resettlement. The remaining 7 percent moved for other unspecified reasons.

Finally, the Census records specific "push" and "pull" factors that influenced individuals' decisions to move from rural to urban areas. According to the census, a lack of educational facilities is the most common reason for individuals in Bhutan to leave rural areas (46 percent). Further "push" factors for leaving rural areas include: a lack of job opportunities (17 percent), inadequate service facilities (15 percent), and small land holdings (7 percent). In terms of pull factors, the primary reason for migrating to a city is the availability of better employment opportunities (33 percent). Further pull factors include relocation of the spouse (24 percent), religious pursuits (9 percent) and better business opportunities (4 percent).

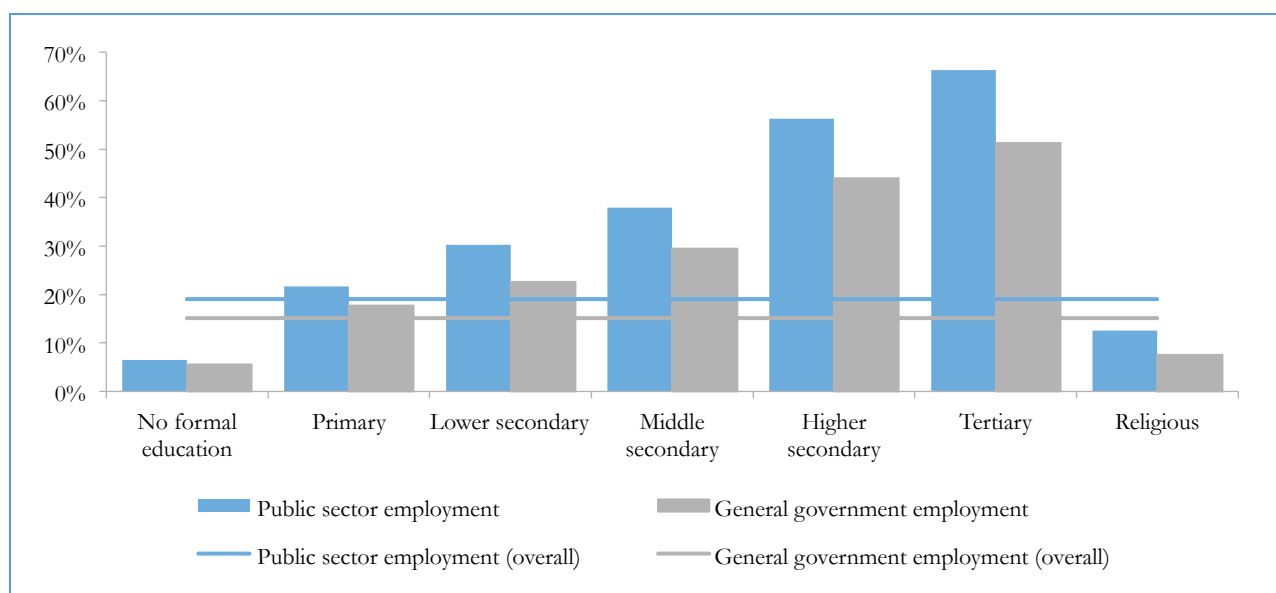
Source: GNHC 2013.

2 IMBALANCES BETWEEN THE PUBLIC AND PRIVATE SECTORS

2.1 COUNTRY CONTEXT AND RECENT DEVELOPMENTS

31. This chapter addresses imbalances between Bhutan’s public and private sectors. As discussed in Chapter 1, whether to primarily place citizens in public sector jobs or to focus on jobs outside the extractive industries is a key strategic choice for many resource-rich countries. Against this backdrop, the chapter documents the excessive size of Bhutan’s public sector and finds that this is especially problematic for Bhutan, a small, landlocked country with an underdeveloped private sector (see Chapter 3). It also demonstrates that overall compensation packages for workers are more generous in the public sector and that unemployment among a number of population groups is elevated as they wait to secure public sector jobs. It argues that if Bhutan wants to avoid the situation of other resource-rich countries that rely mostly on public sector jobs and jobs subsidized through transfers, a comprehensive approach to sectoral rebalancing is needed—not to weaken the public sector but to allow private sector jobs to emerge and prosper.

Figure 2.1—Proportion of Public Sector and General Government Employment to Total Employment, by Educational Level



Source: World Bank staff estimates based on BLFS 2014.

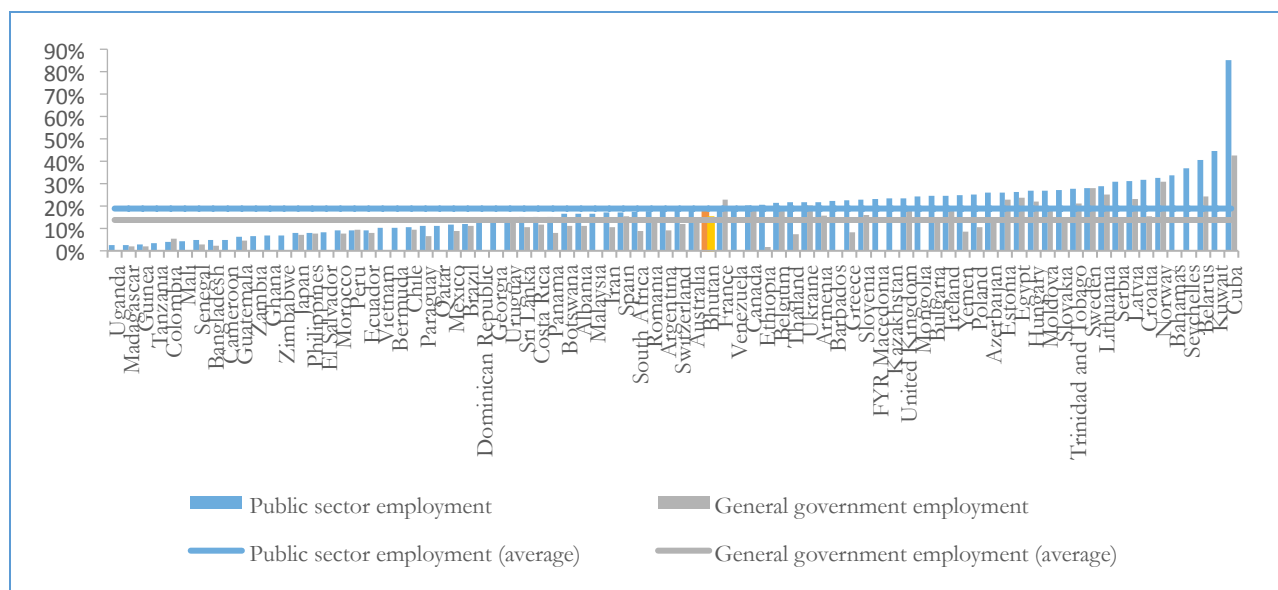
Note: Primary education includes pre-primary.

32. **Bhutan’s public sector is relatively large; it accounts for about a fifth of all jobs and almost half of the jobs outside agriculture.** Overall, 19.1 percent of jobs in Bhutan are in the public sector—defined as the civil service, other government agencies, the armed forces and public/government companies. General government employment—a subsector of the public sector that, following ILO (1999), includes the civil service, other government agencies and the armed forces but not public/government companies—accounts for more than three-quarters of public sector employment and for 15 percent of all jobs. Given that only 43.3 percent of Bhutan’s workers are employed outside agriculture and public sector employment is entirely non-agricultural, 44.1 percent of all jobs outside agriculture are in the public sector (Figure 2.1 and Table 1.1).

33. Two-thirds of Bhutanese with a tertiary education work in the public sector, which limits the pool of talent available to the private sector. Only 6.5 percent of workers without formal education are employed in the public sector. As for educated workers, 21.6 percent of those with a primary education and 30.2 percent, 37.9 percent and 56.3 percent of those with lower, middle and higher secondary education, respectively, work in the public sector. Fully 66.3 percent of workers with tertiary education are employed in the public sector. In fact, more than half (51.2 percent) of workers with tertiary education work in general government. The fact that a substantial majority of workers with tertiary education are in the public sector—in particular, in general government—severely limits the pool of talent available to private sector firms (Figure 2.1).

34. An oversized public sector is especially problematic for a small, landlocked country that has an underdeveloped private sector. Countries differ widely in the proportion of jobs that are located in the public as opposed to the private sector. For instance, according to internationally comparable definitions, public sector employment accounts for less than 3 percent of overall employment in Uganda, Madagascar and Guinea but more than 40 percent of overall employment in Belarus, Kuwait and Cuba. An analysis of data for a large number of different developing and developed countries shows that globally, an average of 18.9 percent of all workers are employed in the public sector and 13.8 percent in the government. Overall public sector employment in Bhutan is on a par with the international average, although general government employment is somewhat higher. However, this figure is high for a small, landlocked country such as Bhutan that has a relatively underdeveloped private sector (Figure 2.2).

Figure 2.2— Proportion of Public Sector and General Government Employment to Total Employment, by Country



Source: World Bank staff estimates based on BLFS 2014, ILO ILOSTAT database and World Bank 2012c.

Note: Public sector employment includes state-owned enterprises, general government employment does not. Data are for different years.

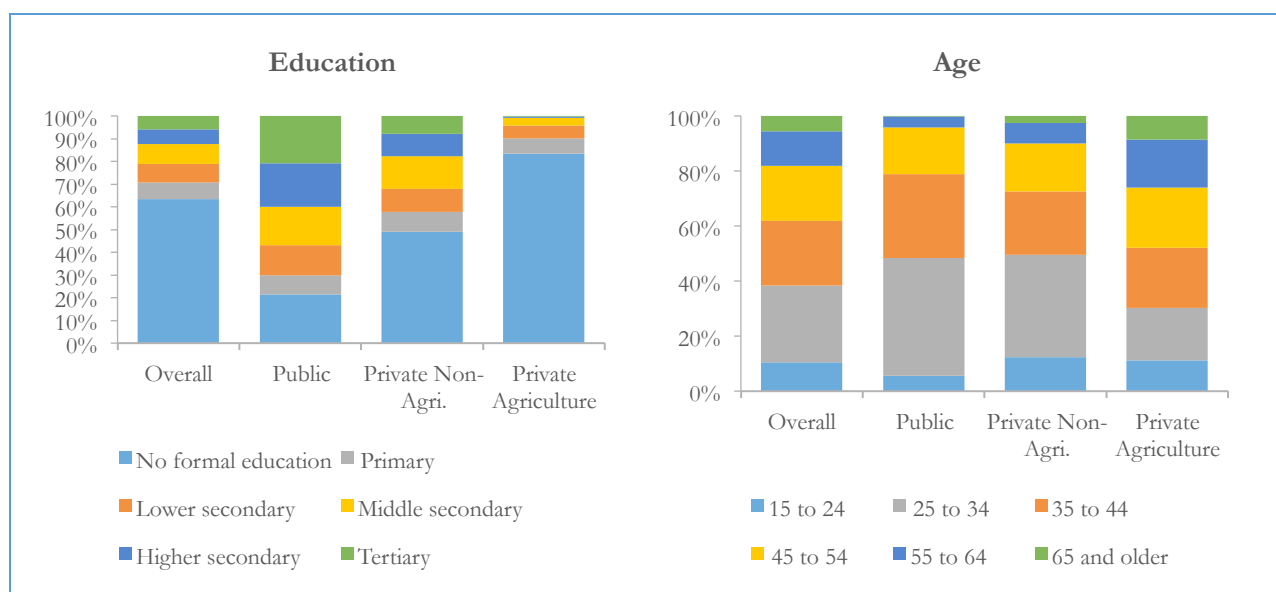
35. Workers and jobs in Bhutan’s public sector have very different characteristics than those in its private sector. A range of sociodemographic and productive characteristics clearly distinguish a typical public sector worker from a typical private sector worker. Chief among these differences are education and age. Jobs in Bhutan’s public and private sectors also differ with respect to prevalent job types and urban or rural location. Significant differences also exist between private sector workers in jobs inside and outside of agriculture. This hints at two areas of conflict in Bhutan’s labor market: first between the public sector and

the private non-agricultural sector (see Chapter 3), and second, between the private non-agricultural and the private agricultural sector (see Chapter 4).

36. Public sector workers are comparatively well-educated. Over the last few decades, Bhutan has made impressive improvements in increasing access to education. Nonetheless, the overall education level of the country’s workforce is still relatively low. In the private sector, 49.1 percent of workers outside agriculture and 83.4 percent of workers in agriculture have no formal education. Conversely, only 7.9 percent of private sector workers outside agriculture and 0.2 percent of private sector workers in agriculture have a tertiary education. Public sector workers tend to be much better educated. Only 21.5 percent of workers in the sector have no formal education, and 20.9 percent of them have a tertiary education. The percentage of workers with secondary education is also much higher in the public than the private sector. These numbers reflect the large proportion of well-educated workers active in the public sector, as mentioned above (Figure 2.3).

37. Public sector workers tend to be younger than private sector workers. Overall, 38.3 percent of workers in Bhutan are aged 15 to 34 while 18.2 percent of workers are aged 55 or older. However, in the public sector 48.3 percent of workers are aged 15 to 34. Just 4.3 percent of public sector employers are aged 55 or older. At the same time, 49.5 percent of private sector workers outside agriculture and 30.4 percent of private sector workers in agriculture are younger than 35, while 10.1 percent of private sector workers outside agriculture and 26.1 percent of private sector workers in agriculture are older than 55 (Figure 2.3).

Figure 2.3—Characteristics of Workers by Employment Sector



Source: World Bank staff estimates based on BLFS 2014.

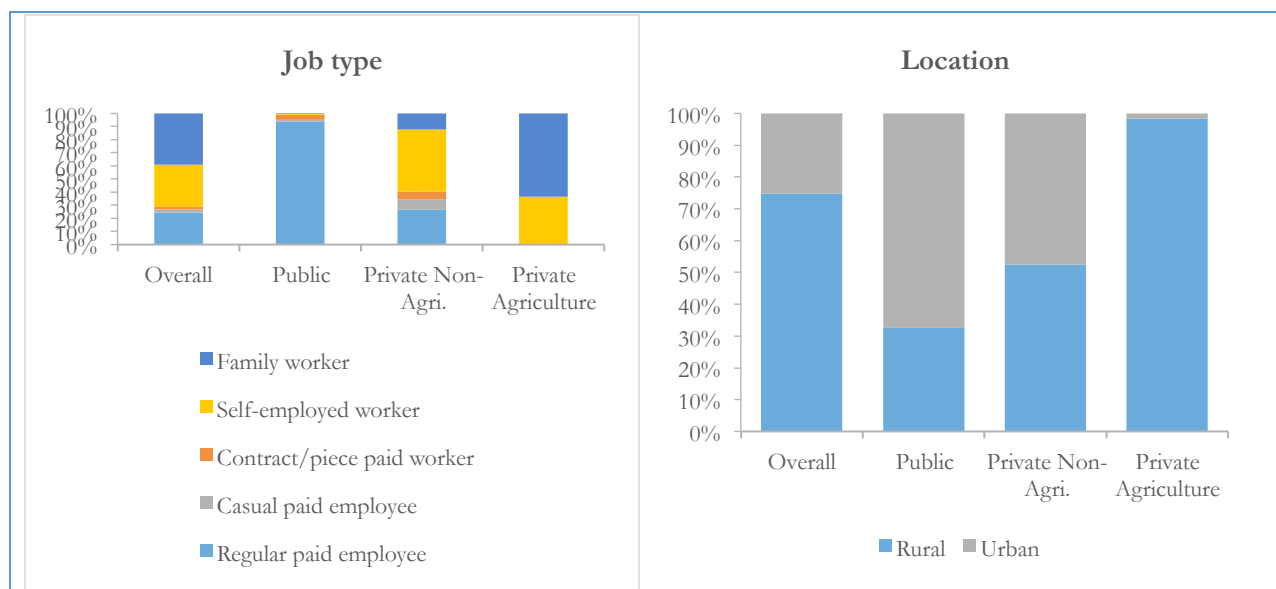
Notes: Primary education includes pre-primary. Workers with religious education are excluded.

38. The prevalence of self-employment, casual and regular work differs significantly between the public and private sectors. An overwhelming majority of public sector jobs are for regular paid employees, while the proportion of this type of job in the private sector is much smaller. In the public sector, 93.8 percent of jobs are for regular employees. In the private sector, 26.7 percent of jobs outside agriculture and a negligible proportion of agricultural jobs are filled by regular employees. Instead, the private sector makes much greater use of self-employed workers outside agriculture (47.2 percent) and unpaid family workers in agriculture (63.5 percent). Casual employment and contract work only play a role in the nonfarm private

sector, where 8.1 percent of jobs are allocated to casual employees and 5.9 percent to contract workers (Figure 2.4).

39. Significant differences exist between the public and the private sector with respect to job location. As mentioned in Chapter 1, the World Development Report 2013 classifies Bhutan as an agrarian economy. Accordingly, 74.9 percent of jobs are located in rural areas. However, while a majority of agricultural and nonfarm private sector jobs are rural (98.4 percent and 52.4 percent, respectively), less than one third—32.6 percent—of public sector jobs are located in rural areas (Figure 2.4).

Figure 2.4—Characteristics of Jobs by Employment Sector



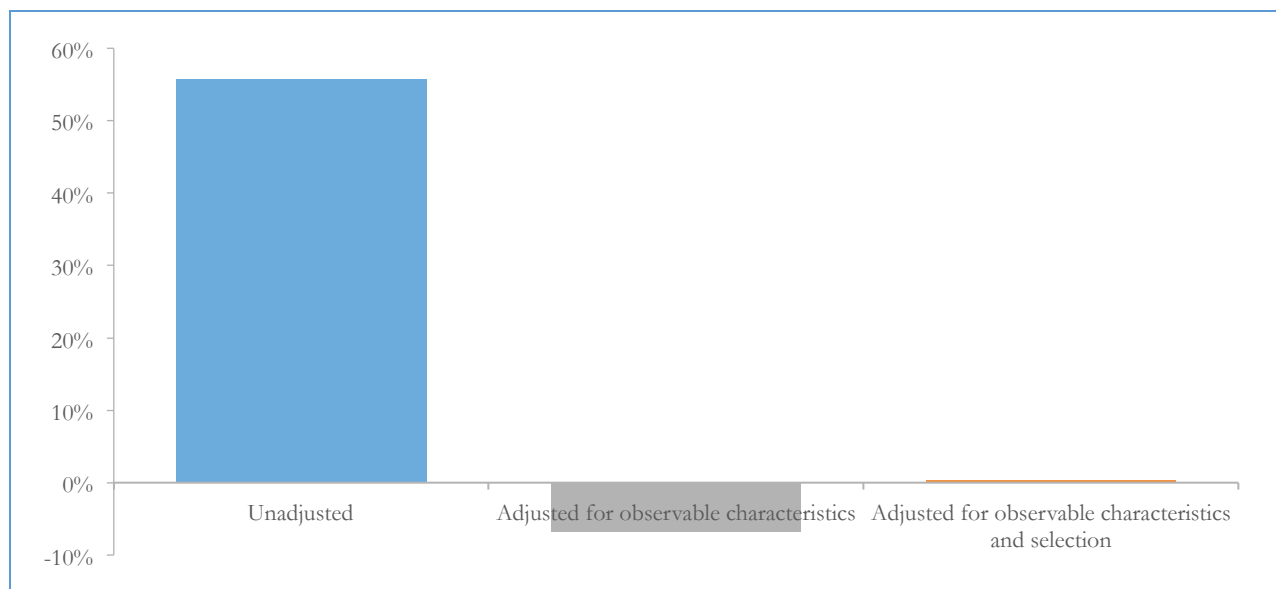
Source: World Bank staff estimates based on BLFS 2014.

40. To assess the relative position of public and private sector workers it is imperative to compare their overall compensation packages. The processes that determine the generosity of workers’ overall compensation packages—which include wages but also fringe benefits, pensions and other forms of social insurance, the level of job security, job prestige and other intangibles—differs fundamentally between the public and the private sectors. Competition tends to impose discipline on private sector compensation packages, whereas most public sector compensation packages are not governed by market forces. Public sector compensation is instead influenced by political developments, government priorities and similar non-market processes. In an influential paper, Fogel and Lewin (1974) establish that by law, public sector workers in many jurisdictions are supposed to receive compensation equivalent to that of private sector workers performing comparable work. Fogel and Lewin (1974) argue that while this “prevailing wage principle” is sensible in terms of equity and efficiency, in practice it is often violated.

41. Average wages in Bhutan’s public sector are significantly above those in the private sector, but this wage differential can be accounted for by differences between public and private sector workers and jobs. In Bhutan, average wages are 55.7 percent higher in the public than in the private sector. However, since both workers and jobs are very different in each sector, a simple comparison of average wages is misleading. Instead, statistical techniques can be used to control for differences between public and private sector workers and jobs to compare pay for workers with similar education and jobs. In addition to observable differences, the estimated wage gap between public and private sector might also be influenced by the self-selection of workers in any one sector. Statistical techniques can again be used to control for this self-

selection. If one controls for observable characteristics and sector self-selection, the public sector wage premium practically disappears. Average public sector wages adjusted for observable characteristics and selection are only 0.4 percent higher than average private sector wages. This difference is not statistically significant (Figure 2.5).⁹

Figure 2.5—Estimated Wage Differential between Public and Private Sectors



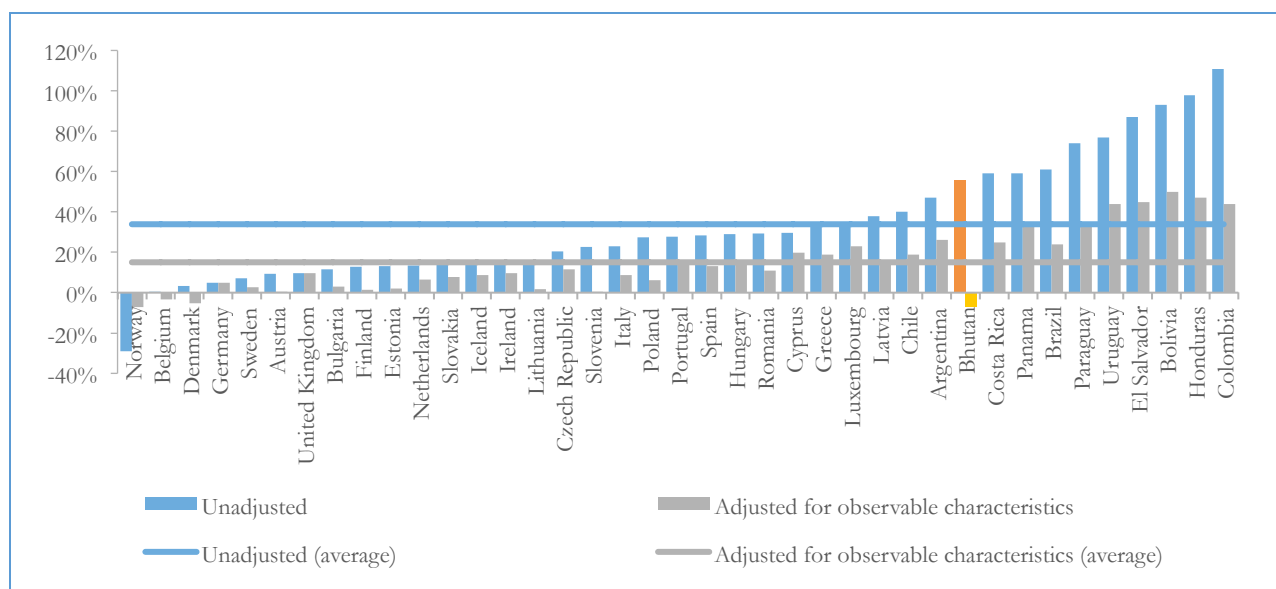
Source: World Bank staff estimates based on BLFS 2014.

Notes: An * indicates statistical significance on the five percent level. Wage differentials are only estimated for workers with non-zero wages. For methodological details, see Schmillen 2016.

42. Disparities between workers or jobs explain a larger proportion of the public/private wage gap in Bhutan than in almost all other countries for which comparable data exist. Evidence on the public/private wage gap adjusted for observable characteristics and self-selection into sectors is not widely available. But a number of studies have attempted to compare both naïve average wage gaps between the private and public sector and wage gaps adjusted for worker and job characteristics. While there is substantial variation between countries, most of these studies find a pattern that is qualitatively similar to the one observed for Bhutan. In other words, average wages in the public sector are usually higher than in the private sector, but this wage gap tends to diminish if it is adjusted for observable characteristics. For instance, in many European and Latin American countries the average naïve wage premium for public sector workers is 34 percent. The wage premium adjusted for observable characteristics shrinks to 15 percent. What distinguishes Bhutan from most other countries is the quantitative difference between the country’s very sizable raw public sector wage premium and the practically nonexistent wage gap once characteristics are controlled for. In fact, observable characteristics of workers or jobs explain a larger proportion of Bhutan’s public/private wage gap than in almost all other countries for which comparable evidence exists (Figure 2.6).

⁹ The statistical techniques used here are Oaxaca-Blinder decompositions of the pay gap into job characteristics and returns to those characteristics (cf. Schmillen, 2016, for methodological details). As all statistical techniques, they are subject to statistical error and should be interpreted with caution.

Figure 2.6—Estimated Wage Differential between Public and Private Sectors, by Country



Source: World Bank staff estimates based on BLFS 2014, Mizala, Romaguera and Gallegos (2011) and Christofides and Michael (2013).

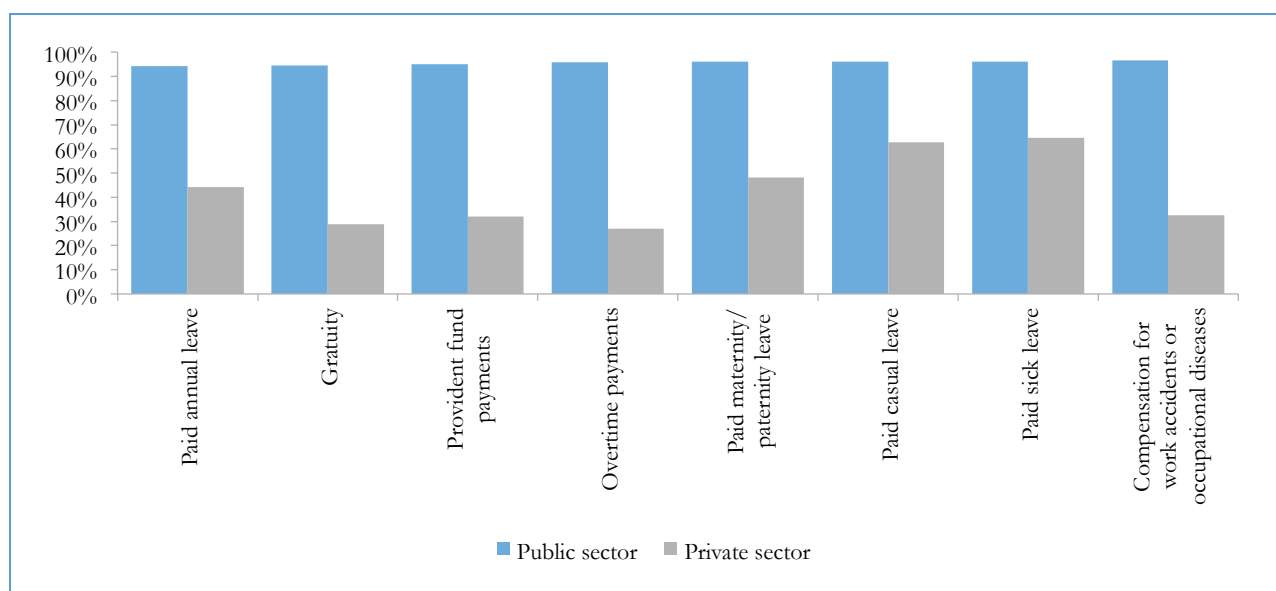
Notes: Data are for different years. In the case of Bhutan, wage differentials are only estimated for workers with non-zero wages.

43. Overall compensation packages received by Bhutan’s public sector workers, however, are far more generous than those offered in the private sector. In a sense, Bhutan’s public sector follows what has been called the prevailing wage principle (once wage gaps are appropriately adjusted). In other words, the country’s public sector workers tend to receive wages equivalent to those earned by private sector workers performing comparable work (Fogel and Lewin 1974). At the same time, wages are only one element of overall compensation. This is an important observation since overall compensation packages received by Bhutan’s public sector workers tend to be far more generous than those offered in the private sector. For instance, public sector workers have better access to pensions and other social insurances, better coverage by free or subsidized housing and other fringe benefits, more job security and greater prestige. Therefore, to align overall compensation packages between the public and the private sector and truly satisfy the prevailing wage principle, Bhutan’s public sector wages would need to be lower than private sector wages for comparable work.

44. Public sector workers are much more likely to receive a wide range of benefits in addition to base salary, including free or subsidized housing, gratuities, provident fund payments and compensation for work accidents or occupational diseases. For many public sector workers, particularly civil servants, free or subsidized housing is an important element of overall compensation. This benefit is much less common for private sector workers. Moreover, public sector workers are much more likely to receive a wide range of other fringe benefits. The BLFS 2014 collects data on whether workers receive one or more of the following eight distinct fringe benefits: gratuity, provident fund payments, overtime payments, paid annual leave, paid sick leave, paid casual leave, paid maternity/paternity leave and compensation for work accidents or occupational diseases. While the majority of workers should by law be entitled to all eight fringe benefits, in practice coverage is incomplete, and public sector workers are more likely to receive all

eight types of benefits. For each of the eight benefits, coverage among public sector workers easily exceeds 90 percent, whereas only 25 to 65 percent of private sector workers receive any particular benefit (Figure 2.7).¹⁰

Figure 2.7—Non-Monetary Benefits of Workers, by Employment Sector



Source: World Bank staff estimates based on BLFS 2014.

Notes: Comparisons are between regular paid employees, casual paid employees and contract or piece-paid workers in state-owned or private enterprises only.

45. Bhutan’s public sector is seen as the sector of choice by many job seekers, especially those with secondary or tertiary education. Data from the BLFS 2014 shows many unemployed persons would like to work in the public sector and are even willing to forego private sector job opportunities to look for work in the public sector. Highly educated persons are particularly keen to find a job in the public sector. According to the BLFS 2014, 70.6 percent of unemployed or inactive respondents with higher secondary education and 86.8 percent of respondents with tertiary education stated that they desire a job in the public sector. Among respondents without formal education, only 40 percent expressed a preference for public sector jobs. Jobs in government are seen as the most attractive form of employment. More than half, 51.9 percent, of all unemployed or inactive respondents in the BLFS expressed a preference for government employment, while 66 percent of respondents with tertiary education did so (Figure 2.8).¹¹

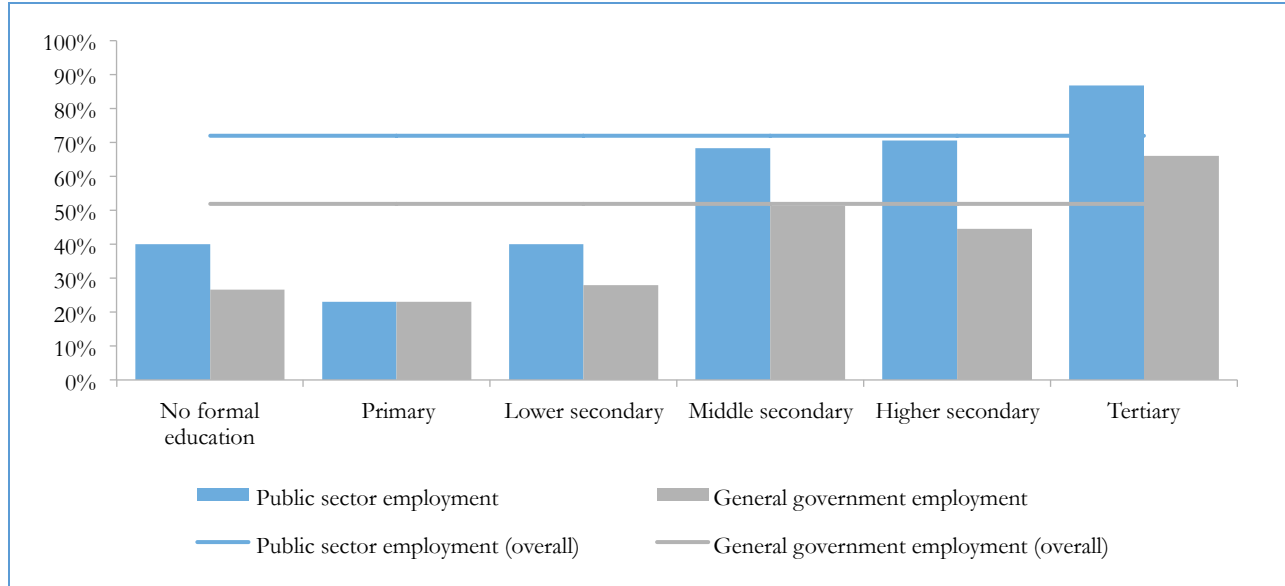
46. The (perceived) superior salary, good benefit packages and high job security of the public sector are among the main reasons cited for why public sector jobs are so attractive. Respondents to the BLFS 2014 gave a relatively wide range of reasons for preferring public sector jobs. Among the most frequently cited the notion that public sector jobs would be a good fit and align with respondents’ personal interests. In addition, the public sector’s high reputation, high salaries, and flexibility were often mentioned. A number of unemployed or inactive respondents to the survey had actually rejected private sector jobs that

¹⁰ The BLFS 2014 only contains data on fringe benefits for regular paid employees, casual paid employees and contract / piece paid workers in state-owned or private enterprises. It seems safe to assume that differences between the public and the private sector would be even more pronounced if data on fringe benefits were also collected for other groups of workers.

¹¹ The findings from the BLFS are confirmed by a recent survey among unemployed youth in Bhutan, where 50.3 percent of respondents said they would prefer to work for the government and another 32.4 percent aspired to a job in a state-owned enterprise (MoLHR and UNDP, 2013).

were offered to them. Asked about their reasons, 27 percent of respondents cited a lack of job security. Other oft-cited reasons for not taking up a private sector job included the lack of benefits, a bad fit, long working hours and an inadequate salary (Figure 2.9).

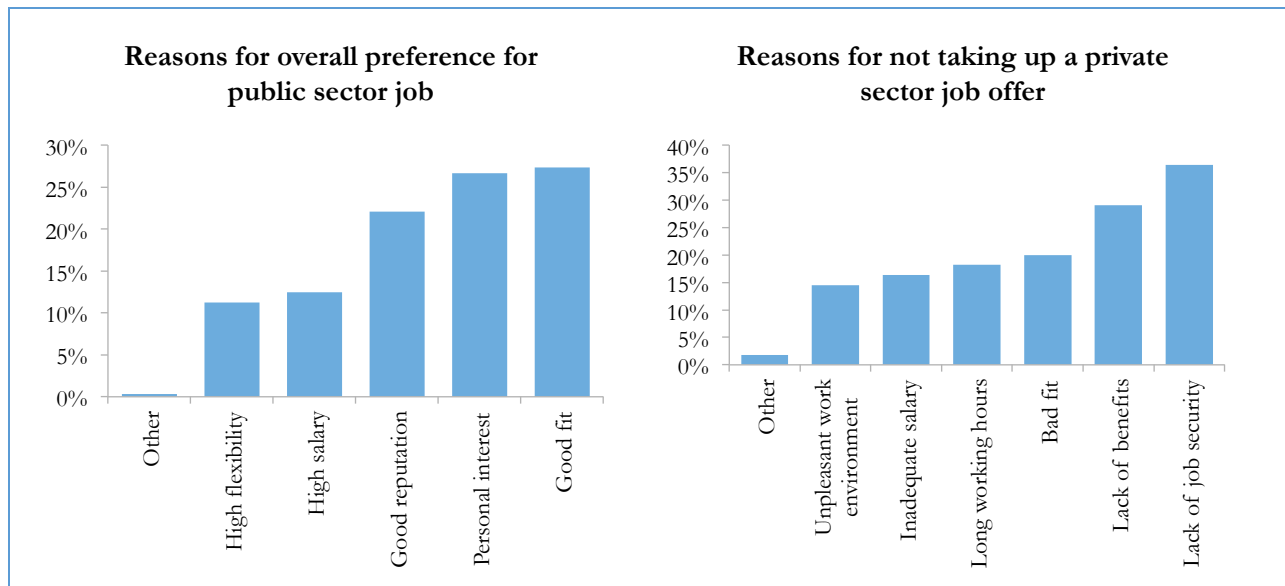
Figure 2.8—Proportion of Unemployed Who Want Public Sector and Government Jobs, by Education Level



Source: World Bank staff estimates based on BLFS 2014.

Notes: Numbers are not weighted. Primary education includes pre-primary. Workers with religious education are excluded.

Figure 2.9—Reasons the Unemployed Prefer Public Sector Jobs



Source: World Bank staff estimates based on BLFS 2014.

Note: Numbers are not weighted.

2.2 CHALLENGES AND CURRENT GOVERNMENT APPROACH

47. Widespread queuing for public sector jobs is a major reason for high unemployment rates among young, well-educated and well-off city dwellers. Unemployment rates are elevated for exactly those population groups that have a strong preference for public sector jobs (especially those with a medium to high level of education). Quantitative as well as anecdotal evidence confirms that a number of unemployed individuals do not take up private sector job offers because they would prefer to work in the public sector. These are symptoms of widespread queuing for public sector jobs. Queuing has a number of negative consequences. It not only stymies the development of a vibrant private sector but also increases the number of unemployed individuals. Unemployment, in turn, goes hand in hand with a fall in earnings and consumption. If employers discriminate against individuals with unemployment experience or human capital deteriorates during periods of inactivity it can even have long-term negative consequences (Schmillen and Umkehrer 2013).

48. An oversized public sector is particularly problematic for a small, landlocked country such as Bhutan that has a relatively underdeveloped private sector. As noted in Chapter 1, Bhutan's priority policy challenges include the need to create urban jobs connected to global markets and jobs not subsidized through transfers. These types of jobs depend on a vibrant private sector. While the overall size of Bhutan's public sector is not excessively large by international standards, the situation still appears problematic. In a small country like Bhutan an overwhelming public sector can prevent the emergence of a strong private sector as it reduces the number of workers available and able to work in the private sector. This problem is particularly acute for Bhutan because the growth of the private sector is hindered by several barriers (see Chapter 3) and because a majority of the country's relatively small number of highly educated workers are currently active in the public sector. These workers are for the most part not available for work in nascent private industries like information technology or outsourcing that is dependent on a pool of well-qualified workers.

49. Lucrative compensation packages in the public sector reinforce workers' preference for public sector jobs and inhibit private sector growth. In effect, they further reduce the already limited pool of young, well-educated and skilled workers available for work in the private sector, and increase reservation wages. Nascent private industries that depend on the availability of a pool of well-qualified workers can often only count on the few younger job seekers not already committed to public sector jobs. For the large majority of this group there is no realistic prospect of government employment; hiring by the civil service has been subdued in recent years. Still, many job seekers prefer to wait for public sector jobs or are open a private sector job only if it offers the same elevated—or simply unaffordable, see Chapter 3—compensation packages that can be found in the public sector.

50. With major hydropower projects coming on stream within the next few years, the government will have more incentive to further expand the public sector and to increase the generosity of the compensation packages offered to public sector workers. As has happened in many Persian Gulf countries, at some point Bhutan might be tempted to use the increased fiscal space generated by hydropower development to “solve” the challenge of high unemployment among young, well-educated individuals by expanding the size of the public sector, more specifically of government employment. At the same time, pressure may rise to use the additional revenue to improve public sector compensation as a way to spread the gains derived from the hydropower projects.

51. If not countered, these incentives will likely lead to increased pressure on the private sector without substantially decreasing unemployment. While the objectives of limiting unemployment and spreading the gains derived from hydropower projects would be laudable, increasing public sector employment and further decoupling public sector compensation packages from the private sector could have

a number of negative consequences. Increasing the relative attractiveness of the public sector might induce even more people to wait for a public sector job. This would increase the already acute challenge faced by the private sector in competing for young, well-qualified job applicants (see Chapter 3). Moreover, it would actually increase in the unemployment rate. Thus the “solution” of reducing unemployment by increasing the size of the public sector might only work in the very short term. Finally, it might also prove fiscally unsustainable.

52. The RGoB has recognized that Bhutan’s future development crucially depends on a vibrant private sector and private sector employment. The Eleventh Five-Year Plan stipulates that an “enabling environment for private sector development and stimulating export growth” is one of the main objectives for the trade, industries and mines sector. Similarly, the RGoB has indicated that public sector employment—especially the civil service—will no longer grow in line with job seekers’ expectations and will not absorb all job seekers entering the labor market.

53. On the policy side, a number of helpful initiatives have been launched to strengthen the private sector. The RGoB has, for instance, embarked on an ambitious plan to improve Bhutan’s position in the World Bank’s annual Doing Business Report ranking. Bhutan was in position 141 out of 189 countries on this ranking in 2013. Subsequently, Bhutan’s Prime Minister and Cabinet committed to placing Bhutan in the top 100 countries on the report within two years. By 2016, Bhutan ranked 71st out of 189 countries in the ease of doing business, according to the report. This made it the best-performing country in South Asia, placing it behind only a handful of other lower-middle income countries such as Armenia, Georgia, Kosovo, Kyrgyz Republic and Mongolia. While some of the improvement in the Doing Business ranking can be attributed to reforms initiated by the RGoB, it is in part also due to modifications in the methodology underlying the ranking.

2.3 POLICY RECOMMENDATIONS

54. If Bhutan wants to avoid the situation of other resource-rich countries that rely mostly on public sector jobs, a comprehensive approach to sectoral rebalancing is needed. As mentioned in Chapter 1, the World Development Report 2013 notes that resource-rich countries have basically followed two distinct strategies to spread the wealth resulting from natural resources: First, some countries have rapidly expanded the public sector workforce. Second, other countries have aimed to support the creation of private sector jobs outside of the extractive industries. If Bhutan decides that it wants to follow a more balanced development path, now is the time for the country to begin to address imbalances between the public and the private sector. These imbalances are already strikingly apparent today and likely to become more pronounced once hydropower projects that are currently planned or under construction come on stream. As in the future Bhutan will continue to need highly qualified, skilled and motivated public sector workers, the rebalancing should not imply a weakening of the public sector but rather a levelling of the playing field between public and private sector work.

55. The prevailing wage principle could be established gradually if adjustments to public sector wages follow adjustments to private sector wages—not *vice versa*. Public and private sector compensation packages could in theory be rebalanced in four ways: (i) a reduction in public sector wages, (ii) a reduction in public sector non-wage fringe benefits, (iii) an increase in private sector wages, and (iv) an increase in private sector fringe benefits. However, while it is relatively easy to raise public sector wages, wage

cuts usually face heavy resistance.¹² In the public sector, political considerations might make outright wage cuts next to impossible. A sudden increase in private sector wages also appears unrealistic, as Bhutan's private sector firms already today struggle with unaffordable wage costs (see Chapter 3). Moreover, around the world government efforts to actively increase private sector wages (for example, through abrupt increases in minimum wages or the imposition of wage brackets) have a bad track record. Therefore, it appears more realistic to gradually align the public and private sectors by ensuring that public sector wages if adjustments to public sector wages follow adjustments to private sector wages. In practice, this would mean private wage growth at a modest pace and (at most) in line with private sector wage growth.

56. To actually meet the prevailing wage principle, the fringe benefits for public and private sector workers would need to be gradually aligned. Even though equality of benefits is often already mandated by law, only a relatively small share of Bhutan's private sector workers can avail themselves of fringe benefits like gratuity, provident fund payments, overtime payments, paid annual leave, paid sick leave, paid casual leave, paid maternity/paternity leave and compensation for work accidents or occupational diseases. Public awareness campaigns and renewed efforts to enforce existing labor regulations—further discussed in Chapter 4—could gradually lead to an alignment of fringe benefits in the public and the private sector. At the same time, it is important not to overburden the formal or semi-formal private sector with regulations that would put it in a disadvantage compared to the (still overwhelming) part of the private sector that is informal and does not necessarily adhere to applicable regulations (see Chapter 5). Therefore, reductions in certain fringe benefits offered to public sector workers that are not legally mandated—such as free or subsidized housing—might ultimately be necessary. Political space for public sector fringe benefit reductions might be easier to create if a national social protection system and a mechanism for broad sharing of rents were both put in place at the same time.

57. The development of a social protection strategy for workers, the alignment of pension coverage between public and private sector workers and the introduction of an income support scheme for jobless private sector workers could further balance the attractiveness of public sector and private sector jobs. As explained in more detail in Chapter 5, existing social protection measures for private sector workers fail to protect a large proportion of these workers from prevalent shocks and vulnerabilities. While the propensity of certain shocks (such as unemployment due to closure of a workplace) will always be greater in the private than the public sector, a comprehensive social protection strategy for workers could nevertheless help make private sector jobs more attractive to workers. Reforms to social insurance provisions, such as the alignment of pension coverage between public and private sector workers and the introduction of an income support scheme for jobless private sector workers, could also be considered—though in these cases one would need to carefully study their fiscal costs, expected effect on different groups of workers and potential tradeoffs (see the discussion in Chapter 5).

58. Continuing the current policy of limiting growth in the public sector workforce, especially the civil service, would send a clear signal that Bhutan will face up to its priority policy challenges. In recent years, different government representatives have repeatedly and publicly stated that growth in Bhutan's public sector workforce, especially the civil service, will be limited for years to come and that college and university graduates cannot all expect to find jobs there as out of 20,000 yearly graduates only 1,000 can expect to attain positions in the civil service. Clear commitment to continued slow growth in the public sector workforce would send a clear signal to job seekers about the need to acquire skills relevant for private sector work. It would thus respond to one of the priority policy challenges of Bhutan as a resource-rich economy by

¹² This phenomenon has been called downward nominal wage rigidity and been documented for many countries. The most prevalent explanation is that nominal wage cuts damage worker morale and that morale is in turn a key determinant of worker productivity (cf. e.g., Kahn, 1997, and Elsby, 2009).

supporting a diverse range of private sector jobs outside of the hydropower industry that are not subsidized through transfers. It would also have other important effects far beyond the labor market, including on public finances.

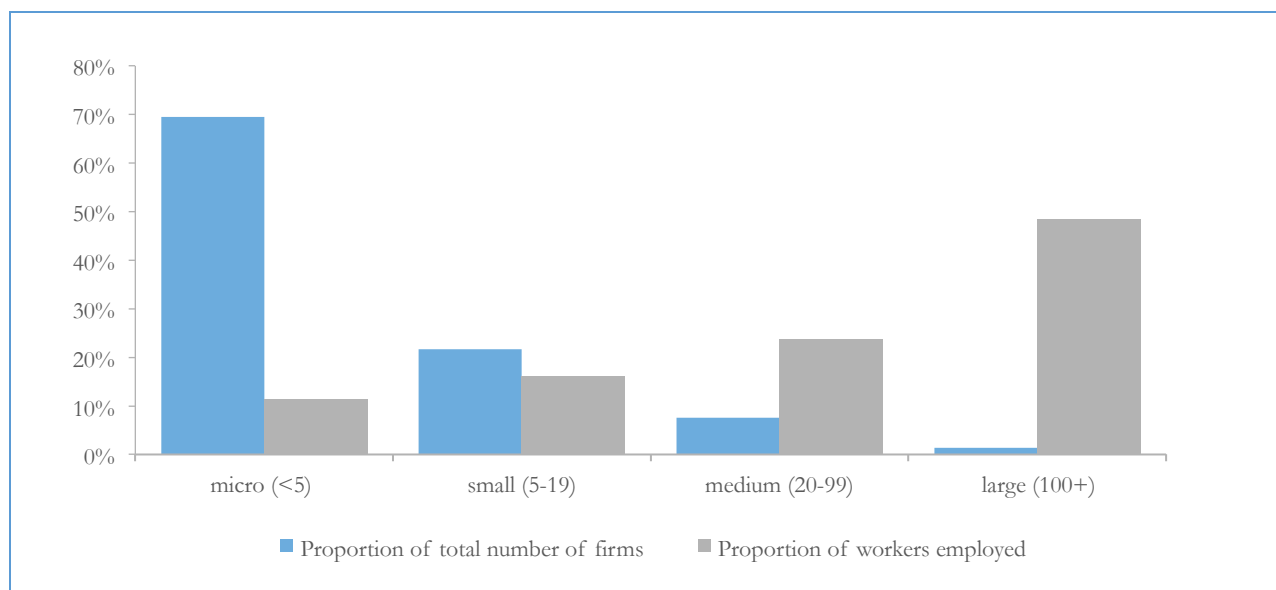
59. A reform of the civil service examinations—in particular greater emphasis on private sector work experience—could increase the quality of civil service recruits and reduce queuing for public sector jobs. Bhutan’s civil service examinations are a rigorous and highly competitive procedure to select the best qualified candidates. They emphasize formal academic achievements, technical expertise, communication skills in English and Dzongkha, analytical skills and a range of other relevant selection criteria. However, private sector work experience is not one of the main criteria. This has at least two effects. First, candidates who do not pass the civil service examinations at their first attempt or graduate at an inopportune time but still want to strive for a civil service job have an incentive to prepare for the next round of examinations by studying the relevant subjects and possible exam questions— not by gaining work experience. Second, while incoming civil servants are technically qualified and highly skilled they rarely possess private sector work experience, even though that would often increase their effectiveness. If the civil service examinations rewarded private sector work experience, this could both reduce the time spent queuing for public sector jobs and increase the quality of civil service recruits. In this context, Singapore’s experience may be interesting. That country’s civil service follows a recruitment model that places a high level of emphasis on private sector work experience. Many observers consider it to be a model bureaucracy characterized by high quality and efficiency (UNDP 2015).

3 BARRIERS TO PRIVATE SECTOR EMPLOYMENT

3.1 COUNTRY CONTEXT AND RECENT DEVELOPMENTS

60. **This chapter outlines barriers to private sector employment in Bhutan.** As Chapter 2 illustrated, there is little sign of the private sector being the main engine of growth and job creation in Bhutan since more than 50 percent of jobs outside of agriculture are in the public sector. Both the Tenth and the Eleventh Five-Year Plans (for 2008 to 2013 and 2013 to 2018, respectively) recognize the underdevelopment of the private sector and highlight the need to focus on improving the quality and quantity of private sector employment. This chapter investigates both the demand and supply sides of private sector employment, using recent data on a representative sample of 367 firms (253 of them small, medium-sized or large enterprises and the remaining 114 microenterprises) and 659 of their employees collected through the BES 2015. The BES 2015 is an enterprise survey covering private enterprises in Bhutan's manufacturing and service industries that was conducted by the World Bank in mid-2015. After establishing the context of the issues, the remainder of this chapter analyzes the dynamics of job creation, addresses worker retention and labor-related obstacles to firms' operations, discusses current policies undertaken by the government, and suggests additional policy options.

Figure 3.1—Composition of Bhutan's Private Sector, by Firm Size



Source: World Bank staff estimates based on BES 2015.

Note: Private nonfarm enterprises only.

61. **While there are many more small firms than large firms in Bhutan, nonfarm private sector employment is dominated by relatively large enterprises.** According to the BES 2015, microenterprises with less than five employees make up close to 70 percent of all firms in Bhutan. Small firms with five to 19 employees account for around 22 percent of all firms, medium-sized enterprises with 20 to 99 employees for about seven percent and large firms with 100 or more employees for only about one percent of all firms in the economy. However, while large firms represent only a very small fraction of all firms in Bhutan, they employ almost 50 percent of all private sector workers in the manufacturing and service industries.

Microenterprises, in contrast, account for only for about ten percent of nonfarm private sector employment (Figure 3.1).

62. The service industry accounts for about 90 percent of the firms and the jobs in Bhutan’s nonfarm private sector. Of the four industries covered by the BES 2015, the food and beverage industry represents 1 percent of firms and a roughly equal share of jobs. Other manufacturing firms make up 8 percent of firms and 11 percent of jobs. The service industry is much more important than manufacturing in terms of the total number of firms and workers. Tourism alone accounts for 31 percent of firms and 18 percent of jobs, which means that the industry is of great importance for nonfarm private sector employment (and also that it consists mostly of relatively small firms). Other firms in the service industry make up the remaining 60 percent of firms and 70 percent of the jobs in Bhutan’s nonfarm private sector (Figure 3.2).

Figure 3.2—Composition of Bhutan’s Private Sector, by Industry



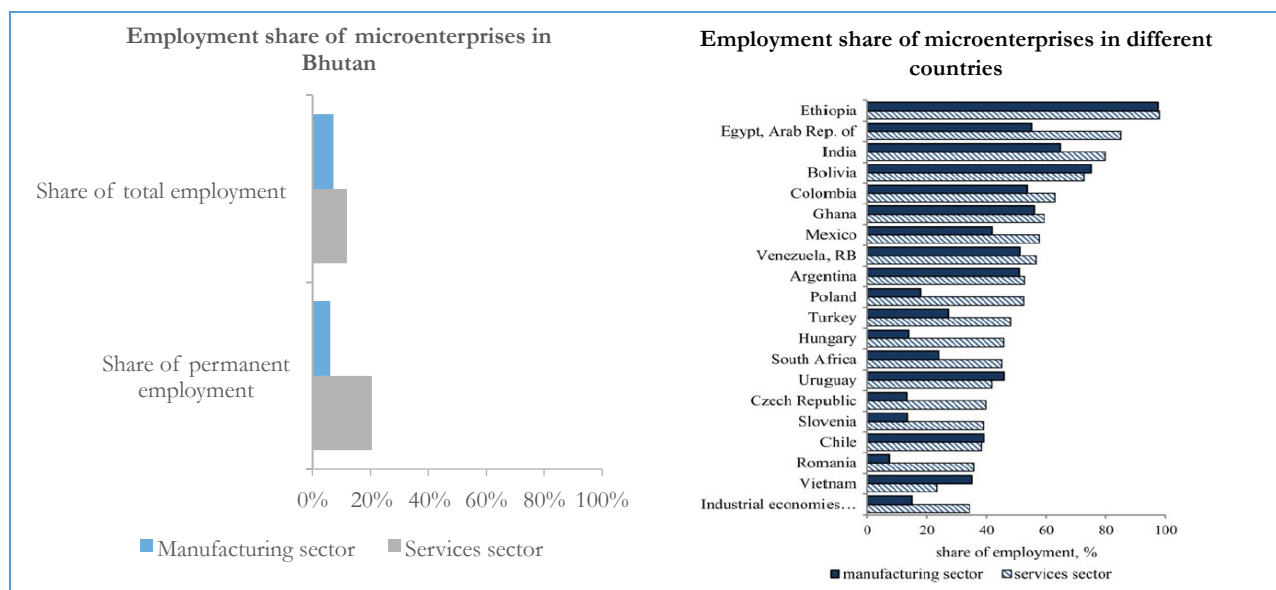
Source: World Bank staff estimates based on BES 2015.

Notes: Private nonfarm enterprises only.

63. The employment share of microenterprises in Bhutan is unusually low for a developing country. In Bhutan, the employment share of microenterprises is six percent in the manufacturing industry and 20 percent in the service industry. These numbers are much lower than those in a wide range of other developing countries surveyed by Li and Rama (2015).¹³ Bhutan’s share of microenterprises is especially low for the services industry, where even in developed economies the contribution of microenterprises to employment is often at least 20 to 30 percent (Li and Rama 2015). The small share of people employed by microenterprises in Bhutan is not in itself negative. Its economic impact ultimately depends on the percentage of microenterprises that represent subsistence entrepreneurship and also on how fast small companies grow and on how productive they are. As detailed below, numbers on the growth of microenterprises in Bhutan are not particularly encouraging (Figure 3.3).

¹³ Li and Rama (2015) stress that when using enterprise surveys to estimate the employment share of different segments of the private sector it is important to properly account for the existence of microenterprises. Given that the BES 2015 contains data on microenterprises and that according to World Bank (2009) almost 100 percent of firms in the nonfarm economy in Bhutan are registered at start-up, the BES 2015 takes account of the full contribution of microenterprises to employment levels.

Figure 3.3—Employment Share of Microenterprises in Different Countries



Source: World Bank staff estimates based on BES 2015 and Li and Rama 2015

Notes: Private nonfarm enterprises only.

64. Bhutan has a very high percentage of temporary employment. In the average Bhutanese firm, 12 percent of workers have a temporary contract. Thus, temporary employment in Bhutan is more prevalent than in most other countries in South Asia. For instance, in an average firm in Nepal and Pakistan, 5 and 7 percent of workers, respectively, are employed under a temporary contract, (Afram and Del Pero, 2012, and World Bank, 2013c). Moreover, the distribution of temporary workers across firms is very uneven: Close to 50 percent of those employed in the private sector are employed temporarily. The discrepancy between 12 percent of workers in an average firm having a temporary contract and 50 percent of workers in the private sector being employed through such a contract is due to the fact that while only 30 percent of all firms employ temporary workers and the median firm employs no temporary workers at all, those firms that do employ temporary workers tend to employ a lot of them and also tend to be relatively large (Figure 3.4)

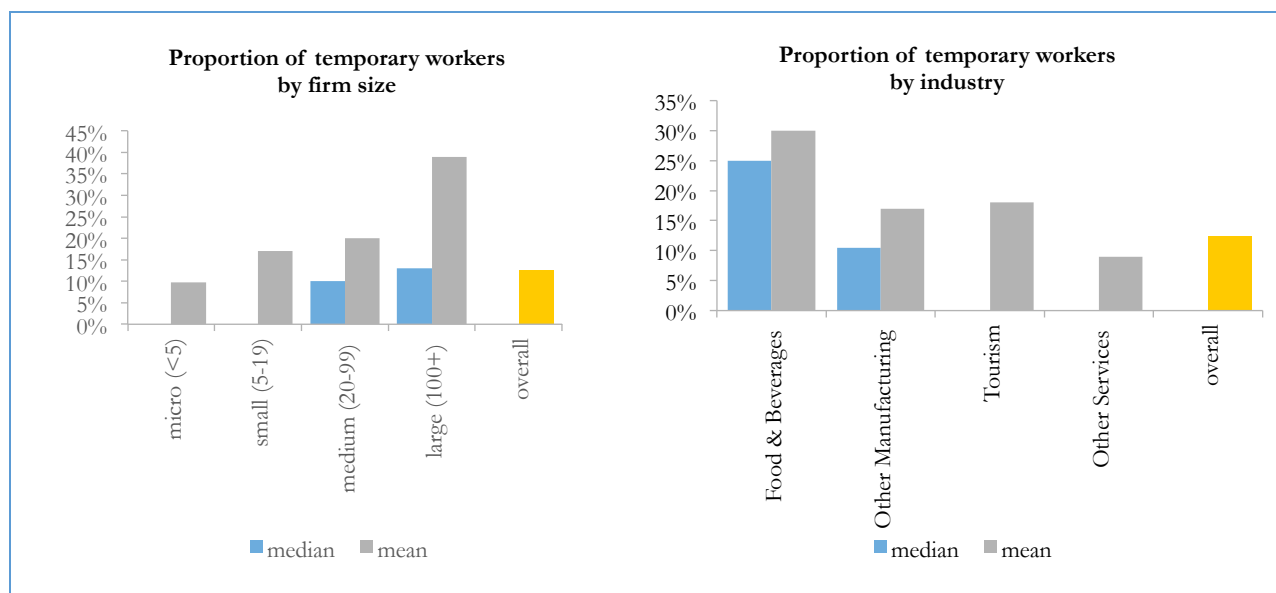
65. The proportion of temporary workers is highest in large firms and in the manufacturing and tourism sectors—areas of the economy that often depend on temporary and seasonal workers. The share of workers with temporary contracts increases with the size of the firm and is as high as 40 percent on average for large firms. Furthermore, for larger firms there is also a larger disparity between the mean and the median proportion of temporary employment. This is again due to the fact that the largest firms have the largest share of temporary workers. Industry-wise, temporary employment is most prevalent in the food and beverage industry and least prevalent in services.¹⁴ Large firms that tend to be the main employers of temporary workers are more likely to be in the manufacturing, construction, and food and beverage industries which are usually characterized by higher needs for temporary and seasonal workers.¹⁵ This suggests that

¹⁴ However, due to the very small number of firms in the food and beverages industry captured in the BES 2015, the number that indicates the very high proportion of temporary workers in the industry has to be interpreted with caution.

¹⁵ A third explanation might be that a lack of adequate available local skills requires large firms to hire non-Bhutanese workers on short-term contracts. However, the idea that non-Bhutanese workers are mostly hired for short-term projects finds little support in the BES 2015 data as non-Bhutanese workers are no more likely to hold a temporary employment contract than Bhutanese ones.

Bhutan’s rather liberal regulations on temporary employment contracts provides firms with fluctuating demand the needed flexibility to continuously adjust their workforces (Figure 3.4).

Figure 3.4—Proportion of Temporary Workers by Firm Size and Industry



Source: World Bank staff estimates based on BES 2015.

Note: Private nonfarm enterprises only.

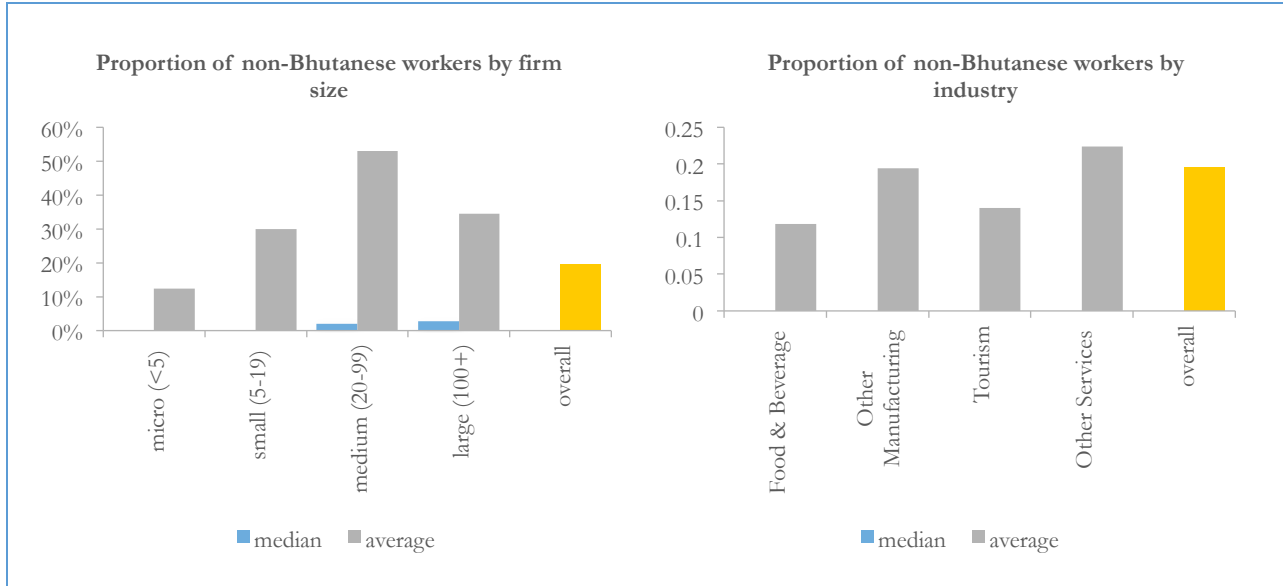
66. Approximately 30 percent of those employed in the nonfarm private sector in Bhutan are not Bhutanese citizens. However, on average just 19 percent of a company’s employees are non-Bhutanese, the median firm in Bhutan has no non-Bhutanese employees and only 30 percent of firms have any non-Bhutanese employees. The proportion of non-Bhutanese workers is highest among medium-sized enterprises and lowest among microenterprises. There is no strong pattern in terms of non-Bhutanese workers being significantly more likely to be present in one industry or the other (Figure 3.5).

67. According to the BES 2015, non-Bhutanese workers tend to earn lower wages than Bhutanese workers, both on average and across the wage distribution. Data from the BES 2015 show that non-Bhutanese workers are present across the entire skills spectrum but for the most part active in jobs that require little education and pay relatively low wages. In the nonfarm private sector, Bhutanese workers on average earn significantly higher wages than non-Bhutanese workers. The difference in average wages between Bhutanese and non-Bhutanese workers remains significant when one controls for workers’ education level and gender as well as firm size, industry and location. In addition, only about 20 percent of non-Bhutanese workers have more than a high school education compared with more than 40 percent of Bhutanese workers, as captured in the BES 2015. Similarly, close to 60 percent of non-Bhutanese workers and less than 40 percent of Bhutanese workers have less than secondary education. Overall, while some highly-skilled foreigners might fill gaps in providing specialized skills that may not be available locally, the majority of non-Bhutanese workers in the nonfarm private sector are hired for jobs that require only relatively basic skills and are not particularly sought after by Bhutanese workers (Figure 3.6).

68. The findings from the BES 2015 indicate that Bhutanese and non-Bhutanese workers tend to be employed in very different jobs and to have very different skills profiles. This is evidence that immigrant workers are not perfect substitutes for natives but might in fact complement Bhutanese workers. Such complementarities have important policy implications because immigration may then be shown to

improve the employment prospects and raise the wages of many native-born workers. For instance, if Bhutanese and non-Bhutanese workers are complements, an increasing number of low-skilled immigrant workers in the construction industry might stimulate construction activities and in the process lead to more jobs for relatively well-qualified Bhutanese citizens as supervisors or administrators in the same industry.

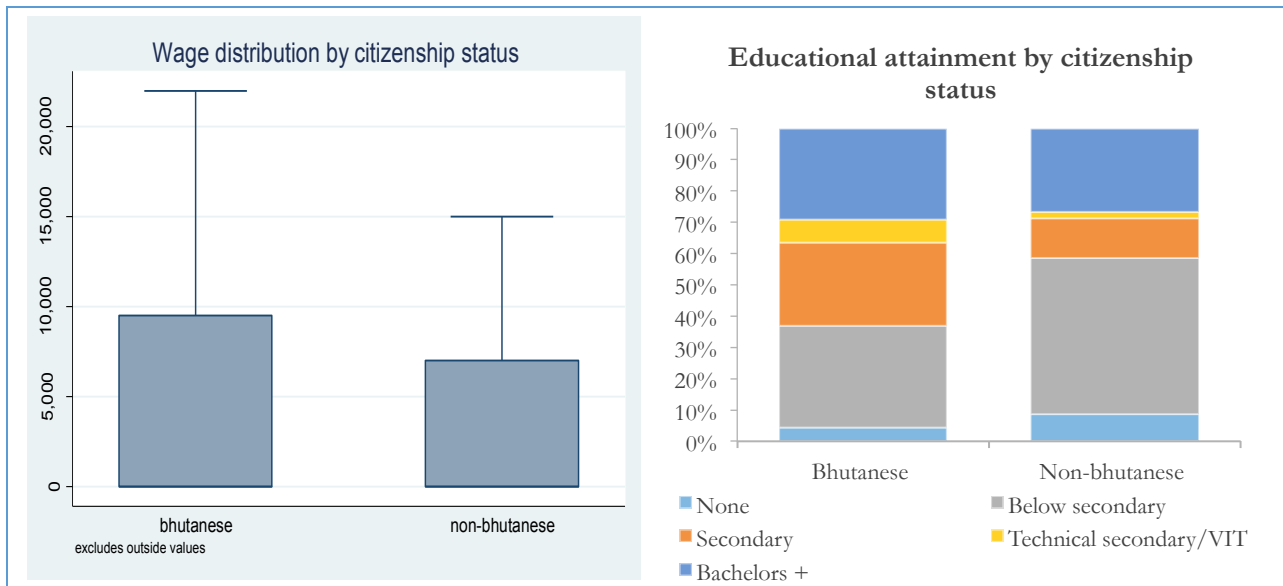
Figure 3.5—Proportion of Non-Bhutanese Workers by Firm Size and Industry



Source: World Bank staff estimates based on BES 2015.

Note: Private nonfarm enterprises only.

Figure 3.6—Wage Distribution and Educational Attainment, by Citizenship Status



Source: World Bank staff estimates based on BES 2015.

Notes: Private nonfarm enterprises only. Data on the wage distribution by citizenship status are from the employee module of the BES 2015. As item non-response in this module is high, these data should be interpreted with caution.

69. In recent years, sales and employment in existing nonfarm private sector firms have grown at a slower pace than previously. An analysis of BES 2009 data found that the private sector in Bhutan was developing quite rapidly. Excluding microenterprises, which were not covered by the BES 2009, the median firm that existed both in 2006 and 2008 was found to have sales growth of 36 percent and employment growth of 25 percent between the two years. The BES 2009 also found that about 24 percent of enterprises surveyed were less than five years old (World Bank, 2009). According to the BES 2015, private sector growth in sales and employment has continued in recent years, but more slowly. Again excluding microenterprises for the sake of consistency, the median enterprise in Bhutan experienced sales growth of 33 percent and employment growth of 20 percent between 2012 and 2014. If microenterprises are included, employment growth was 37 percent over that period (Table 3.1).

Table 3.1—Job Creation by Firm Size and Industry

Overall nonfarm private sector employment							
Total number of jobs in 2012		18,776					
Total number of jobs in 2014		25,805					
Growth in total number of jobs between 2012 and 2014		37%					
Employment by firm size and industry							
Type of firm	Number of jobs in 2012	Number of jobs in 2014	Growth in number of jobs between 2012 and 2014	Contribution to growth in number of jobs between 2012 and 2014	Median employment growth	Median sales growth	Share of firms created between 2012 and 2014
Micro (<5)	3,821	4,579	20%	11%	0%	20%	21%
Small (5–19)	5,142	6,134	19%	14%	20%	33%	1%
Medium (20–99)	6,973	9,011	29%	29%	15%	25%	0%
Large (≥100)	2,840	6,081	114%	46%	6%	13%	2%
Food and beverages	294	367	26%	1%	0%	22%	31%
Other manufacturing	4,049	4,631	14%	8%	0%	30%	3%
Tourism	5,208	7,105	36%	27%	0%	25%	10%
Other services	9,255	13,700	49%	64%	0%	20%	18%

Source: World Bank staff estimates based on BES 2015.

Notes: Private nonfarm enterprises only. Jobs for permanent full-time workers only. Calculations take into account only those firms that either existed in 2012 and survived between 2012 and 2014 or were created between 2012 and 2014 and survived until 2014.

70. The percentage of new firms created between 2012 and 2014 was highest among microenterprises, but this was largely due to churning. About a fifth, 21 percent, of microenterprises that existed in 2014 were created between 2012 and 2014. Such a high percentage of newly created microenterprises within the span of two years could be either a positive sign of high dynamism and firm creation or a negative sign of churning. Churning in this case refers to the process where a large number of firms are created but most do not survive or do not grow. So firms close only to be replaced by new firms that will also follow the same fate. In Bhutan's case, there is strong evidence that the seemingly large

dynamism in terms of the creation of new microenterprise was due to churning. This is because the median microenterprise that existed in 2012 did not grow in subsequent years.¹⁶ Thus, while it is relatively easy to start a firm in Bhutan, many obstacles still prevent micro-firms from either growing or becoming stable and sustainable microenterprises that provide more than a subsistence income to their owner. Other than microenterprises, very few firms were created between 2012 and 2014. Overall employment growth during this period was largely driven by the growth of enterprises that existed at the beginning of the period (Table 3.1).

71. Most employment growth between 2012 and 2014 was driven by medium-sized and large enterprises. According to the BES 2015, close to 7,000 jobs were created by these firms between 2012 and 2014. Large enterprises created 45 percent of these jobs; the services industry created 60 percent of them. While microenterprises dominate Bhutan’s private sector in terms of sheer numbers, between 2012 and 2014 they contributed little to job creation. The median firm in Bhutan—a microenterprise with two employees—did not add any jobs at all between 2012 and 2014. The employment growth rate of the median microenterprise also stood at zero percent, which means very few of Bhutan’s microenterprises turn from “mice” (small firms that never grow much) into “gazelles” (small but fast-growing enterprises). At the same time, there was positive employment growth in the median small, medium-sized and large enterprises. The highest employment growth rate, 20 percent, was observed among small enterprises (Table 3.1).

72. Bhutan’s job creation dynamic is rather peculiar for a developing country and suggests that Bhutan’s microenterprises face particular challenges to their viability or productivity. According to Li and Rama (2015), microenterprises account for over 60 percent of job creation in most developing countries. While larger enterprises everywhere tend to be more productive than smaller ones, the particularly low job creation dynamic among Bhutan’s microenterprises points to particularly significant differences in productivity between large and micro firms. In effect, the most productive firms are the most likely to grow and thus to be categorized as large in 2014. While this explanation is consistent with the findings in the literature on productivity and firm growth in developed countries (e.g., Ayyagari, Demircuc-Kunt, and Maksimovic, 2011) no direct evidence on the productivity of large versus small enterprises in Bhutan exists. In addition to low productivity, external factors (for example, taxes or access to finance) might also prevent Bhutan’s small firms from growing and thus hamper their ability to contribute to job creation.¹⁷

3.2 CHALLENGES AND CURRENT GOVERNMENT APPROACH

73. All sizes of enterprises in Bhutan—large firms most of all—perceive labor regulations to be one of the three biggest obstacles to operations. According to the BES 2015, close to 20 percent of all firms cite labor regulations as the main obstacle to their operations. This makes labor regulations the second most pressing obstacle to firms’ operations after access to finance. Moreover, for firms of all sizes, in all industries, and across all locations, labor regulations are at least one of the top three most pressing obstacles. Large firms seem to be most concerned about labor regulations. Overall, 14 percent of firms perceive labor regulations as the biggest obstacle to their operations, while 22 percent of medium-sized firms and 26 percent of large firms feel that way (Supplementary Table 3.2 below).

¹⁶ The calculations are based on the recall data of full-time permanent employment in 2012. This results in two main limitations: (i) temporary jobs are not accounted for due to a lack of recall data; (ii) calculations represent only surviving firms and therefore do not allow to account for job destruction associated with firms going out of business.

¹⁷ As already mentioned above, almost 100 percent of firms in the nonfarm economy in Bhutan are registered at start-up. Therefore, the BES 2015 takes account of the full contribution of microenterprises to employment growth. If anything, the contribution of these enterprises to job creation as captured in the BES 2015 may be overstated, given the high likelihood of microenterprises to exit the market and thus destroy jobs.

74. A major reason for the constraint labor regulations place on employers are the stringent requirements governing employment of non-Bhutanese workers. 30 percent of firms with non-Bhutanese workers cite labor regulations as the biggest obstacles to their operations while 34 percent of these firms report that the restrictiveness of immigration rules are a moderate, major or very severe obstacle to their operations. In statistical terms, a t-test shows that firms that consider labor regulations the biggest obstacle have a significantly higher proportion of non-Bhutanese workers than those that do not see labor regulations as a problem. Firms with temporary workers are also particularly likely to cite labor regulations, especially immigration rules, as obstacles to their operations. Relaxing these constraints could lead to higher productivity and growth in Bhutanese firms that employ foreign workers. In addition, given the complementary skills of Bhutanese and non-Bhutanese workers, this move could increase private sector employment, not only for migrant workers but also for Bhutanese, who would likely be employed in supervisory positions. (Supplementary Tables 3.2 and 3.3 below).

75. Many firms that would like to hire non-Bhutanese workers are unable to do so due to restrictive or opaque immigration regulations. More than 40 percent of firms that perceive immigration rules as at least a moderate obstacle to their operations do not employ any non-Bhutanese workers. This indicates that firms already employing non-Bhutanese workers have found ways to deal with immigration constraints but that other firms which would like to employ non-Bhutanese workers are unable to do so, thus hampering their growth and development (Supplementary Table 3.3 below).

76. Many firms see high salary costs as an obstacle to their operations. Across all sizes and categories of employers, a minimum of 20 to 30 percent of firms report that high salary costs pose at least a moderate obstacle to them. Among large firms, the salary complaint rate reaches a high of 47 percent. What makes matters worse from the perspective of these companies is that even though they perceive their salary costs as high, many workers perceive the salaries they offer as low. As a result, the perceived unattractiveness of wages is cited consistently across almost all types of firms as one of the three biggest reasons that it is difficult to retain workers (Supplementary Tables 3.3 and 3.4 below).

77. Almost one-fourth of the firms in Bhutan's nonfarm private sector has trouble retaining workers. The issue of worker retention appears most pressing in the food and beverage industry and among large firms. According to the BES 2015, 45 percent of firms in the food and beverage industry and 47 percent of large firms report difficulty in retaining workers. Together with what workers consider unattractive wages, lack of interest in the type of work and competition from other employers, these constitute the reasons it is hard to keep workers. The last point may indicate that there are other characteristics of a job besides its salary, location and other variables explicitly included in the BES 2015 questionnaire that might make it unattractive (Supplementary Table 3.4 below).

78. Competition from the public sector is by far the most important reason that large firms find it difficult to retain workers. Fully 42 percent of large companies indicate that competition from the public sector is the biggest reason they cannot retain employees. Competition from the public sector is also one of the top three reasons that medium-sized companies believe they cannot retain workers. The numbers indicate that many workers now employed in the public sector or hunting for such jobs used to work in the private sector but quit to pursue a public career. In many economies, large firms are generally more productive than smaller ones. Therefore, the finding that many large private firms indicate that competition from the public sector is the most significant reason for their difficulty in retaining employees is particularly worrisome. It once again confirms the overwhelming reach of the public sector in important segments of Bhutan's labor market that was already documented in Chapter 2 (Supplementary Table 3.4 below).

79. A significant portion of Bhutan's workers do not have the skills, knowledge or aptitude required by private employers. Almost half of all firms, 41 percent, report that the unavailability of skilled

manpower is at least a moderate obstacle to their operations. Lack of skilled labor is an even more pressing issue in the manufacturing industry, where 58 percent of all firms indicate that it is at least a moderate obstacle. More than a third of firms—35 percent—see a lack of available workers with previous industry experience as a significant constraint. Again, manufacturing firms are most affected: 58 percent of them report that they face this constraint (Supplementary Table 3.5 below).

80. Among workers in Bhutan, technical skills, computer skills and soft skills are all in short supply. Overall, close to 40 percent of firms regard their employees' job-specific skills as lower than required. The employees themselves are more upbeat: only 10 percent of them think that their job-specific skills are inadequate. Even more worrisome, even though uptake of ICT is generally thought to be low among nonfarm private sector firms in Bhutan (especially among those of modest size) close to 60 percent of employers say their workers have insufficient computer skills. Only 23 percent of employees think this is the case. Furthermore, from the perspective of employers, employees often have insufficient soft skills such as leadership and teamwork skills. According to the nonfarm private sector firms surveyed in the BES 2015, workers at 35 to 40 percent of firms have insufficient problem solving, critical thinking or leadership skills. Additionally, employees at one-fourth of firms have teamwork skills that are below their employers' requirements. Lack of English language, mathematical or management skills seems to be less of an issue. These skills are mentioned as inadequate by only 23 percent, 15 percent and 13 percent of firms, respectively (Supplementary Tables 3.6 and 3.7 below).¹⁸

81. Few firms offer training, even those that regard their workers' insufficient skills as a constraint on operations. Overall, only 14 percent of firms in Bhutan offer training for their workers, significantly below the regional average.¹⁹ Nearly 80 percent of firms that do not offer training say this is because there is no need for it. The finding is somewhat puzzling, given that many firms simultaneously complain about their employees' lack of skills. The answer might lie in companies' perception that returns on (formal) training are low, but no data on this point exists. Large firms are the only exception to this contradictory finding: 23 percent of large firms report that their operations are negatively affected by a lack of skilled manpower, and 86 percent of this group offers training (overall, 73 percent of large firms offer training) and none say there is no need to offer training. Furthermore, large firms are the only category where the most prevalent reason for not providing training is a lack of external training providers (Figure 3.7).

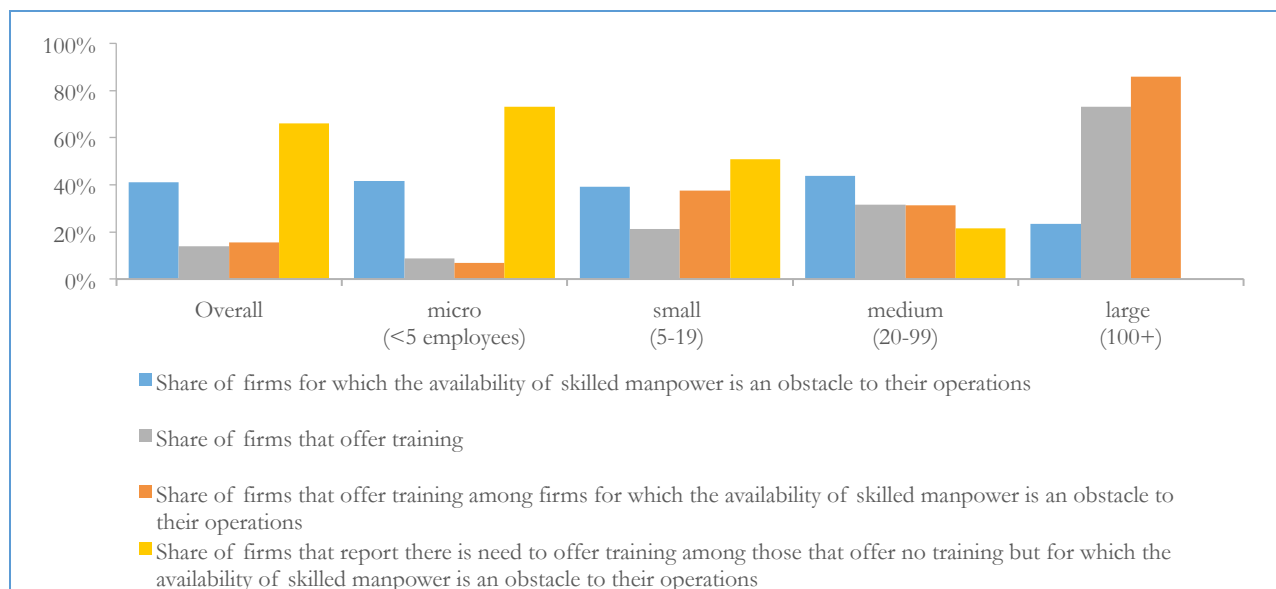
82. The RGoB has recognized the private sector's important role in job creation and has taken significant steps to foster the sector's growth and development. The Eleventh Five-Year Plan calls for the creation of 82,000 jobs by 2020. In contrast to earlier plans, it also explicitly shifts the focus away from hydropower development alone and instead emphasizes achieving economic diversification through the development of other industries. It identifies six industries as most promising for the employment of young workers: (i) tourism, (ii) arts and crafts, (iii) construction, (iv) agriculture, (v) health, and (vi) information and communication technology (ICT). This list of promising industries is consistent with the key strategies to achieve economic self-reliance and full employment in 2020 as outlined in the Economic Development Policy (launched by the government in 2010), which include: (i) diversifying the economic base, while leaving a minimal ecological footprint, (ii) harnessing and adding value to natural resources in a sustainable manner, (iii)

¹⁸ The relatively positive rating of employees' language or mathematics skills might in part be due to the fact that BES 2015 respondents interpret skill levels relative to relevant comparison groups, such as workers in other South Asian countries. LaPrairie (2016, p. 121) notes in the context of a case study of English-medium education in Bhutan that in spite of "graduates of Bhutan's education system having a tenuous mastery of English grammar, structure and vocabulary, leaving many unable to engage easily in conversation in English," employers and other stakeholders often positively assess the English language skills of these graduates because they are better than the even more tenuous English language skills of students in other South Asian countries.

¹⁹For reasons of data availability, any regional comparison has to be based on data that do not include microenterprises. Hence, the appropriate comparison is 26 percent in Bhutan versus 28.2 percent in the South Asia region according to World Bank Enterprise Surveys from across the region.

increasing and diversifying exports, (iv) promoting Bhutan as an “organic brand,” (v) promoting industries that build the Brand Bhutan image, and (vi) reducing dependence on fossil fuel in the transport industry. In line with this policy of diversifying the economy and also diversifying some industries, the RGoB has also taken active steps in engaging with the World Bank, the Asian Development Bank and other development partners in various projects focused on the development of the ICT industry, agricultural value chains, and small and medium-sized enterprises, as well as on the improvement of the investment climate.

Figure 3.7—Share of Firms that Offer Training or See Lack of Skilled Manpower as an Obstacle, by Firm Size



Source: World Bank staff estimates based on BES 2015.

Notes: Private nonfarm enterprises only.

83. The government has also recognized that there is a substantial mismatch between the skills supplied by job seekers and those demanded by the private sector. While the Eleventh Five-Year Plan explicitly acknowledges the challenges posed by an acute shortage of certain skills, in particular in the tourism industry, it also notes that “an increasing numbers of students, including graduates from vocational and tertiary institutions, are inadequately prepared to enter the workforce. On the other hand, Bhutan continues to face an acute shortage of skilled and highly specialized manpower such as doctors, engineers, ICT experts and teachers. This has resulted in a paradoxical situation of relatively high levels of youth unemployment and a critical skills shortage at the same time.”

84. At the same time, the Eleventh Five-Year Plan and a number of other important policy documents offer little detail on how the skills shortages and mismatches should be addressed. Instead, policy documents often shift to the topic of incentivizing businesses and industries that give priority to the employment of Bhutanese citizens. To the extent to which employment of non-Bhutanese workers happens as a result of shortages of specialized skills that may not be available locally or because Bhutanese workers are reluctant to engage in certain types of activities (such as jobs that do not pay high salaries and might be deemed dirty, dangerous or difficult), this threatens to constrain the development of some

potentially promising industries as well as to hamper the productivity of firms that currently employ migrant workers in reaction to the shortage of relevant labor supply among the native-born population.²⁰

3.3 POLICY RECOMMENDATIONS

85. The analysis of labor demand with the help of the BES 2015 has identified a number of barriers to the growth of employment in Bhutan's private sector. Barriers to private sector employment in Bhutan include (i) restrictions on the employment of non-Bhutanese workers, (ii) a lack of workers with the necessary technical, computer and soft skills, (iii) high wage expectations and competition from the public sector, and (iv) workers' lack of interest in the employment opportunities provided by the private sector. Many of these obstacles are similar to those faced by various other resource-rich countries like Oman and other oil-rich economies around the Persian Gulf (Malik and Awadallah 2013; World Bank 2012c).

86. Expanded access to better quality education would improve private sector employment creation in the long run. As mentioned in Chapter 2, in Bhutan two-thirds of workers with tertiary education are employed in the public sector. At the same time, the country's private sector suffers from skills shortages and mismatches. This situation limits the development of a vibrant private sector and the creation of more well-paying and otherwise desirable private sector jobs. Heavy investment in further expansion of access to education (specifically at the preschool level and beyond grade ten), and even more importantly in increased quality of education, would improve workers' jobs prospects and productivity and ultimately stimulate private sector employment. This recommendation is in line with the emphasis of access and quality of education in both the Eleventh Five-Year Plan and the Bhutan Education Blueprint 2014–2024 (Ministry of Education MoE 2014). The Bhutan Education Blueprint 2014–2024 also lays out a comprehensive roadmap for how to transform the education system to ensure that students in Bhutan receive the best of indigenous wisdom and global competence.

87. Bhutan's training and education system could benefit from providing more opportunities for on-the-job training. For those who are already out of school opportunities for mid-career retraining could be expanded and training curricula revised with the objective of (i) incorporating on-the-job training or internship components to provide trainees with practical experiences, and (ii) aligning training content more closely with the needs of the private sector. Nepal's Employment Fund is one example of a successful short-term training program that combines many international best practices. Each year, the Employment Fund issues a call for proposals for various short term-trainings. Interested training providers complete a Rapid Market Assessment outlining potential employment opportunities for trainees. The Employment Fund selects providers according to their capacity, track record, the demand for their proposed trainings, and the proposed costs. Training includes classroom-based learning but also job placement services. The Employment Fund verifies trainees' employment status three months and six months after they complete training, and the payment for training providers is outcome-based. This creates strong incentives for training providers to provide placement assistance (Chakravarty et al. 2015).

88. More intensive computer and soft skills training could increase the relevance of the educational and training system. For the population that is still in school or university, the introduction and facilitation of internships to gain industry experience and to acquire necessary work ethics could be

²⁰ It should be mentioned that for a number of sectors more detailed strategies for how to address skills shortages and mismatches have been developed. For instance, for the ICT sector a strategy has been proposed to establish industry-academia linkages. According to the strategy, institutions of higher education will collaborate with enterprises to resolve the mismatch between labor supply and demand. Various specific activities such as internships, guest lectures and research collaboration are all part of the strategy. The government will also play a critical role in terms of institutionalizing the linkages between academia and the private sector.

helpful. Furthermore, given the widespread lack of soft skills, the introduction of soft-skill specific training modules in education and training curricula could be useful. Since computer literacy is relatively low, it would be advisable to identify the exact computer skills that are missing as well as lessons learned from existing ICT training programs such as the three-tiered skills program for promoting the ICT/ICT-enabled services industry introduced as part of the World-Bank-supported Private Sector Development Project. Based on these existing experiences and whenever possible and appropriate, ICT training modules could be introduced and strengthened in both general education and vocational training programs.

89. Clearer and simpler regulations associated with the employment of foreign labor could ease constraints to firms' operations. To a large extent, the sentiment that labor regulations are an important constraint to doing business in Bhutan can be traced back to specific constraints related to the employment of non-Bhutanese workers. The revision, clarification and simplification of regulations associated with the employment of foreign labor would improve the business climate in Bhutan and promote the growth of the private sector. In this context, Bhutan could learn from international best practices for managing labor migration. Models worth studying might, for instance, include those of South Korea or Malaysia. As detailed in World Bank (2013b), since 2004 South Korea has managed the migration of low-skilled workers through the Employment Permit System. The core principles of the system are complementarity (between native and foreign workers), transparency, alignment with firms' needs, and a focus on temporary migration and non-discrimination (foreign workers have access to social insurance and receive lump-sum pension payouts at the end of their contracts). In Malaysia, while some challenges still need to be addressed with respect to migration management, the country has taken many steps to improve the system's efficiency and effectiveness. These steps include the introduction of online processing portals for all immigrants and the deployment of new technologies and policies to streamline migration management processes (World Bank 2015c).

90. To address the widespread lack of interest in private sector jobs among Bhutan's workforce, a number of interventions could potentially be helpful. An information, education and communication (IEC) campaign to increase the prestige and desirability of private sector jobs could be mounted. Today, IEC campaigns are predominantly used in the area of public health to promote healthier lifestyles or to limit the spread of epidemics. There is a growing body evidence of evidence that IEC campaigns in these areas have had a significant impact. IEC campaigns have also increasingly been used in social protection or human development programs to change the behaviors of beneficiaries or their families and communities in order to create an environment that enables productive participation and human capital accumulation.

91. Reinforced efforts to foster broad-based private sector development and productivity could increase the attractiveness of the private sector to highly educated workers, and strengthen its capacity to absorb job seekers. As mentioned above, the RGoB has recognized that Bhutan's future development depends on a strong private sector and has launched a number of laudable initiatives to strengthen the private sector. As jobs are a product of labor demand, only reinforced efforts to foster broad-based private sector development and productivity can ultimately increase the attractiveness of the private sector as an employer of choice for highly qualified job seekers and reduce the existing imbalances between the public and the private sector. Moreover, they can contribute to the creation of a dynamic economic environment in Bhutan's cities. Such efforts can therefore play a big part in confronting the policy challenges that Bhutan faces as an agrarian and resource-rich economy (Box 3.1).²¹

²¹ Renewed efforts to foster broad-based private sector development, expanded access to better quality education, and clearer, simpler regulations on foreign labor would all serve the same objective: to increase the productivity of private sector workers in Bhutan and thereby improve the number and quality of jobs in the sector. If pursued together, all three policy directions could be mutually reinforcing.

92. Efforts to foster business productivity and profitability could be particularly helpful for microenterprises. On average, microenterprises struggle more than larger firms when it comes to retaining workers. The main reasons that microenterprises cite for not being able to retain workers are unrealistically high salary expectations and competition from other firms. Almost 50 percent of microenterprises cite high salary costs as an obstacle to retaining workers, compared to an average of 20 to 30 percent of firms of other sizes. Microenterprises also seem to be more likely to lose workers because the jobs they offer are not desirable. On the other hand, microenterprise have less trouble finding workers with the right skills. This might be explained by the fact that their business model builds on the skills available in the labor market and that they would thus be less likely to demand a high level of skills. Therefore, the most beneficial interventions for microenterprises would be those that would allow them to increase their profitability and productivity, ultimately enabling them to pay higher wages.

3.4 SUPPLEMENTARY TABLES

Table 3.2—Main Obstacles to Firms' Operations

Obstacle	Total	Food & beverages	Manufacturing	Tourism	Services	Micro (<5 employees)	Small (5–19 employees)	Medium (20–99 employees)	Large (≥100 employees)	Without temporary workers	With temporary workers	Without foreign workers	With foreign workers
Access to finance	38%	8%	26%	35%	42%	45%	22%	22%	11%	44%	22%	45%	19%
Access to land	2%	3%	5%	0%	2%	2%	1%	9%	0%	2%	2%	2%	2%
Business licensing and permits	2%	0%	7%	0%	2%	2%	1%	2%	10%	2%	2%	2%	1%
Corruption	0%	0%	0%	0%	0%	0%	0%	2%	0%	0%	1%	0%	1%
Courts	0%	0%	0%	0%	0%	0%	1%	0%	0%	0%	0%	0%	0%
Crime, theft and disorder	3%	0%	5%	0%	4%	3%	2%	0%	2%	1%	7%	1%	7%
Customs and trade regulations	4%	4%	3%	6%	3%	5%	1%	4%	12%	4%	4%	3%	7%
Electricity	4%	3%	4%	11%	0%	3%	7%	5%	0%	4%	5%	5%	1%
Inadequately educated workforce	1%	0%	12%	1%	0%	1%	2%	7%	5%	0%	4%	1%	3%
Labor regulations	14%	18%	16%	21%	10%	11%	20%	22%	26%	7%	30%	8%	29%
Political instability	1%	0%	2%	0%	2%	1%	1%	3%	8%	1%	2%	2%	0%
Practices of competitors in the informal sector	4%	16%	4%	7%	2%	2%	8%	12%	3%	2%	9%	5%	3%
Tax administration	0%	0%	2%	0%	0%	0%	1%	1%	0%	0%	1%	0%	0%
Tax rates	13%	39%	3%	12%	15%	14%	13%	4%	16%	17%	4%	18%	3%
Transport	2%	0%	5%	2%	2%	0%	9%	3%	5%	1%	4%	2%	3%
Don't know	2%	4%	1%	3%	2%	1%	4%	2%	0%	2%	1%	2%	3%
Does not apply	8%	6%	4%	1%	12%	9%	8%	2%	2%	11%	1%	3%	19%

Source: World Bank staff estimates based on BES 2015.

Note: Answers to the question “Which of the elements of the business environment included in the list, if any, currently represents the biggest obstacle faced by this establishment?” Multiple answers not allowed. Blue font indicates an element of the business environment was mentioned as the main obstacle by between 15 and 29 percent of firms, orange font that is was singled out by 30 percent or more of firms.

Table 3.3—Labor-related Obstacles to Firms' Operations

Obstacle	Total	Food & beverages	Manufacturing	Tourism	Services	Micro (<5 employees)	Small (5–19 employees)	Medium (20–99 employees)	Large (≥100 employees)	Without temporary workers	With temporary workers	Without foreign workers	With foreign workers
Employment Protection Legislation													
At most a minor obstacle	89%	100%	89%	86%	91%	91%	87%	79%	84%	91%	84%	88%	92%
At least a moderate obstacle	11%	0%	11%	14%	9%	9%	13%	21%	16%	9%	16%	12%	8%
Salary costs													
At most a minor obstacle	78%	49%	73%	67%	84%	81%	71%	68%	53%	86%	56%	76%	81%
At least a moderate obstacle	22%	51%	27%	33%	16%	19%	29%	32%	47%	14%	44%	24%	19%
Restrictiveness of immigration rules													
At most a minor obstacle	83%	87%	76%	83%	83%	88%	78%	51%	46%	87%	72%	90%	66%
At least a moderate obstacle	17%	13%	25%	17%	17%	12%	22%	49%	54%	13%	28%	10%	34%
Inadequately educated workforce													
At most a minor obstacle	79%	97%	69%	76%	81%	80%	78%	72%	81%	82%	70%	76%	86%
At least a moderate obstacle	20%	3%	31%	24%	17%	19%	23%	28%	19%	16%	30%	23%	14%

Source: World Bank staff estimates based on BES 2015.

Note: Answers to the question “To what degree are the following factors an obstacle to the current operations of this establishment?” Blue font indicates a labor-related element of the business environment was mentioned as at least a moderate obstacle by between 15 and 29 percent of firms, orange font that is was singled out by 30 percent or more of firms.

Table 3.4—Main Reasons for Firms' Difficulties in Retaining Workers

Reason for difficulties	Total	Food & beverages	Manufacturing	Tourism	Services	Micro (<5 employees)	Small (5–19 employees)	Medium (20–99 employees)	Large (≥100 employees)	Without temporary workers	With temporary workers	Without foreign workers	With foreign workers
Wages offered are lower than those of other firms	36%	5%	31%	24%	47%	44%	29%	10%	18%	43%	27%	49%	10%
Unattractive conditions of employment	2%	0%	0%	0%	4%	0%	7%	0%	0%	3%	0%	3%	0%
Geographic location of firm	3%	0%	1%	5%	3%	3%	2%	7%	19%	1%	7%	3%	5%
Lack of career progression	1%	7%	9%	0%	1%	0%	2%	6%	6%	1%	2%	2%	0%
Long/Unsocial hours	1%	0%	1%	0%	2%	0%	3%	4%	5%	0%	3%	2%	0%
Workers prefer public sector jobs	9%	7%	7%	3%	14%	6%	10%	16%	42%	11%	7%	10%	7%
Too much competition from other employers	11%	55%	7%	20%	4%	13%	2%	23%	11%	3%	22%	2%	29%
Not enough people interested in this type of work	27%	0%	34%	35%	21%	28%	27%	27%	0%	34%	18%	27%	28%
Staff don't want long term commitment	8%	25%	9%	13%	4%	6%	16%	6%	0%	3%	16%	3%	19%
Training is not being provided	-	-	-	-	-	-	-	-	-	-	-	-	-
Disputes and lack of teamwork amongst employees	1%	0%	0%	0%	1%	0%	3%	0%	0%	1%	0%	0%	2%

Source: World Bank staff estimates based on BES 2015.

Note: Answers to the question “What is the most important reason for why it is difficult to retain staff?” Multiple answers not allowed. Blue font indicates a reason for why it is difficult to retain workers was mentioned by between 15 and 29 percent of firms, orange font that is was singled out by 30 percent or more of firms.

Table 3.5—Inadequate Skill Supply as an Obstacle to Firms' Operations

Types of skills	Overall	Food & beverages	Manufacturing	Tourism	Services	Micro (<5 employees)	Small (5–19 employees)	Medium (20–99 employees)	Large (≥100 employees)	Without temporary workers	With temporary workers	Firms without foreign workers	Firms with foreign workers
Availability of skilled manpower													
At most a minor obstacle	59%	43%	42%	54%	64%	58%	61%	56%	77%	65%	44%	57%	62%
At least a moderate obstacle	41%	57%	58%	46%	36%	42%	39%	44%	23%	35%	56%	43%	38%
Availability of unskilled manpower													
At most a minor obstacle	83%	71%	80%	90%	80%	85%	81%	70%	78%	86%	75%	80%	90%
At least a moderate obstacle	17%	29%	20%	10%	20%	15%	19%	30%	22%	14%	25%	20%	10%
General education													
At most a minor obstacle	80%	73%	81%	79%	80%	82%	74%	75%	97%	83%	71%	74%	93%
At least a moderate obstacle	20%	27%	19%	21%	20%	18%	26%	25%	3%	17%	29%	26%	7%
Technical education/vocational training of workers													
At most a minor obstacle	87%	71%	68%	88%	89%	93%	76%	64%	68%	93%	73%	87%	86%
At least a moderate obstacle	13%	29%	32%	12%	11%	7%	24%	36%	32%	8%	27%	13%	14%
Finding workers with previous industry specific experience													
At most a minor obstacle	65%	58%	42%	54%	73%	67%	60%	59%	62%	71%	48%	69%	54%
At least a moderate obstacle	35%	42%	58%	46%	27%	33%	40%	41%	38%	29%	52%	31%	46%

Source: World Bank staff estimates based on BES 2015.

Note: Answers to the question “To what degree are the following factors an obstacle to the current operations of this establishment?” Blue font indicates a factor was mentioned as at least a moderate obstacle by between 15 and 29 percent of firms, orange font that is was singled out by 30 percent or more of firms.

Table 3.6—Employees’ Skills: Rating by Employers and by Employees Themselves

Types of skills	Ratings by firms									Ratings by workers
	Overall	Food & beverages	Manufacturing	Tourism	Services	Micro (<5 employees)	Small (5–19 employees)	Medium (20–99 employees)	Large (≥100 employees)	Overall
Employees’ ability to read and write in English										
Below required	23%	3%	22%	22%	23%	28%	15%	3%	13%	12%
As required and above	77%	97%	78%	78%	77%	72%	85%	97%	87%	88%
Employee’s mathematical skills										
Below required	15%	18%	23%	15%	14%	13%	19%	16%	14%	14%
As required and above	85%	82%	77%	85%	86%	87%	81%	84%	86%	86%
Employees’ computer skills										
Below required	56%	57%	50%	52%	58%	63%	48%	17%	24%	23%
As required and above	44%	31%	50%	48%	42%	37%	52%	81%	76%	77%
Employees’ job specific technical skills										
Below required	38%	38%	19%	29%	46%	47%	17%	20%	5%	10%
As required and above	62%	62%	81%	71%	54%	53%	83%	80%	95%	90%
Employees’ communication skills										
Below required	7%	9%	7%	8%	7%	6%	12%	3%	14%	5%
As required and above	93%	91%	93%	92%	93%	94%	88%	97%	86%	95%
Employees’ leadership skills										
Below required	35%	25%	32%	31%	37%	39%	26%	21%	11%	16%
As required and above	65%	75%	68%	69%	62%	60%	74%	79%	89%	84%

Source: World Bank staff estimates based on BES 2015.

Notes: Answers to the question “Using the response options on the card, how do you rate the skill level of the establishment’s skilled full-time permanent employees trained compared to what the establishment needs for the following types of skills?” for employers and “On a scale of 1 to 5 how do you rate your skill level compared to what you need for your job for the following types of skills?” for employees. Blue font indicates a type of skill was mentioned as less than that required by between 15 and 29 percent of firms or employees, orange font as one that was singled out by 30 percent or more of firms or employees.

Table 3.7—Employees’ Soft Skills: Ratings by Employers

Types of skills	Overall	Food & beverages	Manufacturing	Tourism	Services	Micro (<5 employees)	Small (5–19 employees)	Medium (20–99 employees)	Large (≥100 employees)
Employees’ teamwork skills									
Below required	25%	3%	19%	16%	31%	32%	8%	12%	3%
As required and above	75%	97%	81%	84%	69%	68%	92%	88%	97%
Employees’ creative and critical thinking skills									
Below required	39%	23%	35%	29%	45%	43%	33%	30%	5%
As required and above	90%	91%	77%	92%	91%	57%	65%	70%	95%
Employees’ problem solving skills									
Below required	34%	12%	28%	17%	43%	37%	27%	27%	11%
As required and above	66%	85%	72%	83%	56%	62%	73%	72%	89%
Employees’ ability to work independently									
Below required	21%	7%	13%	23%	21%	25%	10%	12%	16%
As required and above	79%	80%	87%	77%	79%	75%	89%	88%	84%
Employees’ time management skills									
Below required	13%	10%	12%	14%	13%	14%	11%	12%	11%
As required and above	87%	88%	88%	86%	87%	86%	89%	87%	89%

Source: World Bank staff estimates based on BES 2015.

Notes: Answers to the question “Using the response options on the card, how do you rate the skill level of the establishment’s skilled full-time permanent employees trained compared to what the establishment needs for the following types of skills?” for employers. Blue font indicates a type of skill was mentioned as less than required by between 15 and 29 percent of firms, orange font as one that was singled out by 30 percent or more of firms.

BOX 3.1 PROMOTING PRIVATE SECTOR DEVELOPMENT

According to the 2015 edition of the Statistical Yearbook of Bhutan, the size of the private sector in 2014 was over 42,000 businesses. About 69 percent of businesses are classified as cottage, micro or small businesses where cottage or micro businesses are defined as those with up to four employees and a total investment of less than Nu 1,000,000 (about \$15,000 at current exchange rates). Small businesses have five to 19 employees and total investment of Nu 1,000,000 to 10,000,000 (\$15,000 to \$150,000). Another 34 percent of businesses are classified as contract businesses. Since the great majority of contract businesses are micro businesses as well, together micro and small businesses are 99 percent of the private sector (NSB 2015). There are about 350 limited liability companies (LLCs), and a handful of joint-stock companies and partnerships. The remaining businesses are essentially sole proprietorships, with or without employees. The stock market is small, with about 20 listed companies.²²

Specific factors hurt the competitiveness of private firms operating in Bhutan, including a difficult investment climate and low productivity levels. In the World Bank's Doing Business Report 2016 (World Bank 2015b), Bhutan, represented by its capital Thimphu, ranked 71st out of 189 countries in the ease of doing business. This made it the best-performing country in South Asia, placing it behind only a handful of other lower-middle income countries including Armenia, Georgia, Kosovo, Kyrgyz Republic and Mongolia. Bhutan performed best in the area of trading across borders, where it is ranked 28th. Its weakest areas are starting a business (91), protecting minority investors (115), and resolving insolvency (189).

Over the past few years, the RGoB has taken important steps to improve Bhutan's investment climate. In the area of business registration, it eliminated two procedures that required name approval and location clearance. In the area of property registration, in 2008 it created a Land Commission to handle cases involving the transfer of property. In 2009, it improved its credit information system by launching a public credit registry. In 2013, the Royal Monetary Authority opened a collateral registry for movable collateral. More recently, Bhutan made getting electricity easier by speeding up the process for obtaining a new connection and also made transferring property easier by introducing a computerized land information system.

The World Bank Group is supporting the RGoB's efforts to further improve its business environment as part of a broader technical assistance engagement on investment climate reform. In some reform areas, like the improvement of business registration procedures, improvements in e-government and e-services, or revision of the Bankruptcy Act, the RGoB's efforts are also supported by the World Bank through the Second Development Policy Credit.

Source: "Improving the Investment Climate in Bhutan." Reform Memorandum delivered by the World Bank to the RGoB in December 2013.

²² As the BES 2015 relies on a sample of the private nonfarm sector it is subject to sampling error and numbers provided in this box are not necessarily identical to those discussed in the remainder of the chapter.

4 LABOR MARKET POLICIES

4.1 COUNTRY CONTEXT AND RECENT DEVELOPMENTS

93. This chapter analyzes Bhutan’s labor market policies to determine where there is room for improvement. The analysis encompasses Bhutan’s labor market regulations (such as its minimum wage, employment protection, provisions against child labor and occupational safety and health standards), labor market interventions (active and passive labor market policies) and industrial relations both from a legal and an empirical point of view. Special emphasis is put on the implementation of labor market regulations on the ground and on policies regulating the movement of people into and out of Bhutan. Regulations on the movement of people are particularly significant because they are directly related to Bhutan’s stated goal of achieving economic self-reliance by 2020 (Box 4.1).

94. Labor regulations in Bhutan are administered through the Labor and Employment Act of 2007. The Act covers hiring conditions, minimum wages, working hours, leave policies, employment and income protection, the hiring of foreign labor and industrial relations. In addition to the Labor and Employment Act, the MoLHR has adopted directives on labor market interventions as well as 21 rules and regulations supporting the Labor and Employment Act. Twelve of these rules and regulations refer to employment conditions (like the Rules on Hours of Work of 2009, the Leave Regulations of 2009 and the National Wage Order of 2014). The other nine cover occupational safety and health. The rules and regulations on occupational safety and health encompass both preventive and protective measures that are to be observed and implemented by workers and employers.

95. While Bhutan is neither a member of the ILO nor a signatory to any ILO convention, the country’s Labor and Employment Act is in compliance with most of the core ILO conventions. Eight fundamental ILO Conventions—on forced labor, child labor, freedom of association and the right to organize, and non-discrimination—are binding upon all the organization’s member countries. Bhutan is neither a member of the ILO nor a signatory to any ILO convention. Nevertheless, Article 6 of the Labor and Employment Act prohibits forced or compulsory labor, Article 9 prohibits the worst forms of child labor and Articles 11 to 13 prohibit discrimination against employees and job seekers and mandate equal pay for equal work. In addition, Article 170 sets 18 as the minimum age of employment and limits employment of youth aged 13–17 to certain workplaces and categories of work. Finally, according to Article 176 of the Act, the workers of an enterprise that has 12 or more workers with an employment contract may form a workers’ association. While workers’ associations are permitted to engage in collective bargaining, failure to ratify the core ILO conventions related to freedom of association and the right to organize might be the biggest obstacle to Bhutan joining the organization.²³

96. In practice, only the minority of workers in Bhutan who are regularly paid employees with a contract of employment with a duration of one year or more are covered by the provisions of the Labor and Employment Act. As detailed in Chapter 1, informal work is widespread among Bhutan’s population and endemic among certain groups, such as individuals with low education and those from rural areas and poor households. Moreover, according to the Labor and Employment Act, the rules regarding

²³ It should be noted that Bhutan has ratified the following international treaties that concern the welfare, rights and protection of its citizens: the Charter of the United Nations; the International Convention on the Elimination of All Forms of Racial Discrimination; the International Convention on the Elimination of All Forms of Discrimination against Women; the United Nations Convention on the Rights of the Child; the SAARC Convention on Regional Arrangements for the Promotion of Child Welfare in South Asia; the Convention on the Rights of Persons with Disabilities; and the two CRC Optional Protocols on the Sale of Children, Child Prostitution and Child Pornography, and on the Involvement of Children in Armed Conflict (cf. MoF, 2014).

employment contracts apply only to employment relationships with a duration of one year or more.²⁴ Many provisions of the Labor and Employment Act do not apply to temporary employment contracts and there are no restrictions in the Act governing the length or renewal of temporary employment contracts, or their use for permanent tasks. Given this lenient regulatory environment, it should probably come as no surprise that a large proportion of Bhutan's private sector workers are on temporary employment contracts (as explained in more detail in Chapter 3, nearly 50 percent of all those employed in Bhutan's nonfarm private sector are in fact on temporary contracts).

97. Compared to other lower-middle income countries, Bhutan's statutory minimum wage is relatively low and does not pose a threat to job creation. On August 1, 2011, Bhutan introduced a national minimum wage of Nu 100 per day or Nu 3,000 per month applicable to all workers irrespective of age, sex, disability or skills. On the same day, a separate (and higher) minimum wage was introduced for the National Work Force: those Bhutanese employed by government agencies for their projects or works. On February 1, 2014, Bhutan's general minimum wage was revised to Nu 125 per day or Nu 3,750 per month. This is equivalent to \$61 per month at current exchange rates. According to the BLFS 2014, a Bhutanese worker aged 15 years or older earns Nu 14,199 (\$233) a month on average. Bhutan's minimum wage thus amounts to approximately 26 percent of average earnings. According to the World Bank's Doing Business Report the ratio of the minimum wage to value added per worker in 2015 was 0.21 (World Bank 2015b). Both the ratio of the minimum wage to average earnings and its ratio to value added are lower in Bhutan than in most other lower-middle income countries. As a result, few job seekers in Bhutan would accept job offers at the statutory minimum wage level. Among the unemployed surveyed in the BLFS 2014, less than half a percent say they would be willing to take up a job that paid at or below the minimum wage.

98. Bhutan's leave provisions correspond to international norms, while the country's standard working hours are comparatively long. In Bhutan, an employee is legally entitled to sick leave, annual leave, casual leave, and maternity or paternity leave (see Chapter 2 for effective coverage rates in the public and private sectors). Additionally, employees are legally entitled to be absent from work during a minimum of nine public holidays each year. The mandatory minimum amount of paid annual leave is one and a half days of annual leave for each month of work. Accrual begins after six months of employment, and annual leave can only be taken after twelve months of continuous employment. This equates to international norms, but working hours are longer. A standard workday is hours, and a standard work week lasts six days. As a result, many workers in Bhutan are engaged in comparatively long working hours. According to the BLFS 2014, the average work week in the country (including overtime) comprises more than 50 hours.

99. The rules and regulations for terminating a contract for economic reasons are more flexible in Bhutan than in most neighboring or otherwise comparable countries. In Bhutan, a party to a contract of employment may at any time give notice to the other party, in writing, of the intention to terminate the contract. By paying a sum equal to the basic pay that the employee would have earned during the notice period, either party may terminate the contract without waiting for the end of the notice period. If an employer terminates an employment contract under redundancy provisions, the employer is obliged to (i) consult with the workers' association or if there is no such association—with the employees, advising them of the number of employees likely to be made redundant and the period over which redundancies may occur; (ii) give notice of not less than 30 days and additional notice of seven days for every year of continuous employment, up to a maximum of 42 days; and (iii) notify the Chief Labor Administrator (the head of the MoLHR's Secretariat) about the redundancy proposal.

²⁴ The employment and working conditions of the uniformed members of the Royal Body Guards, the Royal Bhutan Army and the Royal Bhutan Police are also formally outside the scope of the Act.

100. The Labor and Employment Act does not stipulate severance pay, and there is also no unemployment insurance scheme. However, if an employer terminates an employment contract unlawfully, the employee may initiate dispute resolution procedures. In the case of wrongful dismissal the courts may do one or more of the following: (i) with consent of the employee and employer, order that the employee be reinstated to his or her employment to the same or an equivalent position, and that the employee be treated as if he or she had never been dismissed; (ii) order the employer to pay compensation to the worker equal to one month’s pay for each year of continuous employment up, to a maximum of six months’ pay; and (iii) order costs to be paid in such sums as the courts consider just.

101. Bhutan’s legal minimum age of employment, 18, would seem to protect children but nevertheless some children are employed. Based on data from the Child Labor Indicators compiled by the Understanding Children’s Work inter-agency research cooperation program, in Bhutan 3.8 percent of children aged five to 14—or about 6,000 children—are employed. About 1.1 percent of five-to-14-year-olds are employed and not attending school, and 2.7 percent of this age group are employed while also attending school. Both numbers are lower than the corresponding average figures for lower-middle income countries. In the mean, in lower-middle income countries 2.8 percent of children aged five to 14 work without attending school and 12.8 percent of children of the same age range combine school and work. At the same time, at 14.1 percent the proportion of five-to-14-year-olds who are neither in school nor working is higher in Bhutan than in other lower-middle income countries (12.8 percent). This discrepancy can largely be explained by the comparatively low proportion of children aged five or six in Bhutan who are in kindergarten, preschool or school (Table 4.1).

Table 4.1—Children’s Work and Education in Bhutan v. Other Lower-middle Income Countries

Indicator	Age	Bhutan	International average
Proportion of children in economic activity only	5–14 years	1.1%	2.8%
Proportion of children in school only	5–14 years	82.0%	71.6%
Proportion of children combining school and economic activity	5–14 years	2.7%	12.8%
Proportion of children neither in school nor in economic activity	5–14 years	14.1%	12.8%
Primary school completion rate		98.4%	90.6%

Sources: Understanding Children’s Work Child Labor Indicators and World Development Indicators.

Notes: Data for primary completion rates are for 2012, data on child activity breakdowns for different years. International averages are unweighted averages for lower-middle income countries.

102. Bhutan’s policy for the enforcement of labor regulations is in line with international best practices. According to the Labor and Employment Act, the main functions of Bhutan’s labor inspectors are (i) to advise employees and employers about their legal rights and obligations, (ii) to facilitate the implementation of the Act by providing information, advice and guidance to employers and employees as well as to the self-employed and (iii) to investigate and, when necessary, take action in accordance with the Act and other applicable regulations to deal with alleged infringements. This is in line with international best practices for modern labor inspectorates. Internationally, labor inspectorates aspire to 60 percent proactive inspections and 40 percent reactive inspections (in response to accidents or complaints), and to apply risk prioritization toward workplaces with the highest risks of occupational safety and health infringements (TNO, 2008).

103. Only a fraction of workplace accidents and incidents are reported to the authorities, who visit a minority of workplaces liable for inspections each year. Between July 2013 and June 2014, the MoLHR’s Department of Labor received 106 complaints, including 53 associated with non-payment of wages, 18 related to non-payment of benefits, and 13 associated with termination without notice. During the same time

period, 55 workplace accidents and incidents were reported to the Department (MoLHR 2013). However, the Annual Health Bulletin for the year 2013 lists 28,705 work-related injuries (MoH 2013). This indicates that most workplace accidents are not reported to the MoLHR. Also, while 4,975 workplaces are liable for inspection visits, according to the annual report of the MoLHR's Department of Labor for July 2013 and June 2014, inspectors visited only 1,202.

104. Strict rules regulate the employment of non-Bhutanese workers. Bhutan's Labor and Employment Act requires that no person shall employ a foreigner unless the employer has obtained prior approval from the Chief Labor Administrator. Moreover, quotas have been established for the maximum number of foreigners who may work in Bhutan, including quotas for specified industries and occupations. The Labor and Employment Act also stipulates that no employer shall terminate a Bhutanese worker's employment contract for the purpose of employing a foreigner. An employer also may not terminate Bhutanese workers' employment unless the employer has first terminated the employment contracts of all foreigners working in a capacity similar to that of the Bhutanese citizen or resident.

105. Bhutan's active labor market programs stress training, entrepreneurship support, and employment opportunities abroad. While no rigorous evidence on the effectiveness and cost-effectiveness of Bhutan's labor market programs exists, the country generally focuses on programs with relatively high unit costs and a small number of beneficiaries. For example, the Guaranteed Employment Program (GEP) aims to support 5,000 youth during the period of the Eleventh Five-Year Plan. Under the GEP the MoLHR pays a monthly allowance to program participants. Employers are required to top up the allowance by an amount specified in the program guidelines. In terms of entrepreneurship support, a prominent program is the Skills for Employment and Entrepreneur Development (SEED) initiative, which provides vocational skills to aspiring entrepreneurs. The SEED initiative aims to provide skills to young, ambitious individuals interested in setting up their own businesses. It offers practical experience in entrepreneurship, technical skills and soft skills (such as communication, marketing, and resource management). The objective is to train 500 individuals during the Eleventh Five-Year Plan. Another employment support program is the small-scale but high-profile Overseas Employment Program. The Overseas Employment Program gives Bhutanese citizens a structured way to take up employment abroad.

Table 4.2—Taxes in Selected Countries as a Percentage of Commercial Profits

Country/Area	Profit taxes	Labor taxes and contributions	Other taxes	Total tax rate
South Asia	13.2%	7.2%	16.9%	38.9%
Bangladesh	27.7%	0.0%	3.9%	31.6%
Bhutan	33.9%	0.0%	1.4%	35.3%
India	24.9%	20.0%	15.7%	60.6%
Nepal	17.7%	11.0 %	0.5%	29.5%

Source: World Bank 2015b

Notes: Data are for 2015. Tabulated are taxes and contributions payable by a medium-sized company in the second year of operation, expressed as a share of commercial profits. Profit tax gives the amount of taxes on profits paid by the business, labor taxes and contributions the amount of taxes and mandatory contributions on labor paid by the business and other taxes the amount of taxes and mandatory contributions paid by the business that are not already included in the categories of profit or labor taxes.

106. Taxes on profits are in line with the regional average; employers pay no specific labor taxes. The *Doing Business Report* measures labor and other taxes as a share of commercial profit. It finds that in Bhutan, businesses pay an average of 33.9 percent of commercial profits in taxes. This is broadly similar to most comparable countries in South Asia. At the same time, a key difference between Bhutan and other

South Asian countries is that employers in Bhutan pay no labor taxes. The only other South Asian country that doesn't impose labor taxes on employers is Bangladesh (Table 4.2).²⁵

107. While workers' associations are regulated through the Labor and Employment Act, social partnerships generally play only a limited role in shaping labor relations in Bhutan. Social partnerships can be defined as tri- or multi-party arrangements that may involve employers, trade unions, the government and other stakeholders. Bhutan's constitution states, “[a] Bhutanese citizen shall have the right of freedom of association, other than membership to associations that are harmful to the peace and unity of the country, and shall have the right not to be compelled to belong to any association.” As already mentioned above, the Labor and Employment Act also explicitly allows workers in an enterprise with 12 or more employees with an employment contract to form a workers' association. Nevertheless, there are only few organized interest groups in Bhutan, and these are of minor importance. Trade unions spanning multiple enterprises or entire industries do not exist. On the employers' side, there are some influential business organizations such as the Association of Bhutanese Tour Operators or the Bhutan Chamber of Commerce and Industry. Non-governmental organizations (NGOs) are few in number and mostly focus on issues such as the environment and women's and children's welfare. Overall, the government remains dominant in designing and implementing labor market policies (Bertelsmann Stiftung 2014).

4.2 CHALLENGES AND CURRENT GOVERNMENT APPROACH

108. Labor market policies, in particular labor regulations, are an important component of a country's business environment. As argued in the World Development Report 2013 on Jobs, labor regulations should avoid both over- and under-regulation. For instance, overly strict employment protection laws may discourage hiring and reduce economic growth by creating disincentives for workers to move from lower- to higher-productivity jobs. At the same time, under-regulation can also have adverse effects. For example, health and productivity can decline if workers are constantly asked to work long hours with no weekly rest days or are not allowed to take sick leave. According to the World Development Report, between these two extremes there is a plateau where appropriate regulations can alleviate market failures, protect workers, and contribute to shared prosperity, without imposing unreasonable costs on firms.

109. With the notable exception of limits on the employment of foreign labor, labor regulations in Bhutan are rather flexible and the country seems to be on the plateau that avoids both over- and under-regulation. Apart from stringent rules and regulations on the employment of non-Bhutanese workers, the Labor and Employment Act stipulates few restrictions in hiring and firing of workers. For example, there are no limits on fixed-term contracts and few restrictions on terminating employees for economic reasons. In addition, minimum wages are low compared to average wages.²⁶ Therefore, with the notable exception of regulations on the employment of foreign labor, labor regulations are not a major impediment to job creation. At the same time, the Labor and Employment Law regulates work hours, annual leave and occupational safety and health in ways that are in line with international standards. For employees covered by the Act—and under the condition that rules are enforced in practice—workers are generally offered adequate protection.

110. The only overly stringent aspect of labor regulations concerns the employment of non-Bhutanese workers. Bhutan's enterprises are heavily dependent on foreign labor. In 2013, Bhutan's

²⁵ Although employers in Bhutan pay no labor taxes, employees pay personal income tax on their labor earnings and an additional 1 percent of their gross salaries as health insurance contributions.

²⁶ As mentioned above the statutory minimum wage amounts to approximately one-quarter of average earnings, lower than the ratio in most other lower-middle income countries.

enterprises employed 41,400 non-Bhutanese workers, according to the MoLHR. As detailed in Chapter 3, non-Bhutanese workers account for a fifth or more of all workers in half of the enterprises covered by the BES 2015, and dominate employment in about 10 percent of nonfarm private sector firms. Overall, demand is highest for workers from abroad who possess specific skills that are in short supply in Bhutan, although most foreign workers actually have relatively low qualifications (Chapter 3). In spite of the high demand for foreign labor, regulations concerning the employment of non-Bhutanese workers are very restrictive. In the future, the government plans to introduce a foreign workers fee system to streamline recruitment and to decentralize approval procedures for employment of foreign worker. Other steps that have been undertaken to streamline the access to non-Bhutanese workers include the establishment of an online system to apply for employment permits.

111. Even though protections against the worst forms of child labor form an integral part of the Labor and Employment Act and the government is committed to strengthening the child protection system, some children are still working rather than attending school. Child labor is less prevalent in Bhutan than in other South Asian countries (Khan and Lyon 2015). Nevertheless, as cited above about 1.1 percent of five-to-14-year-olds work rather than going to school, and another 2.7 percent of children this age work while also attending school. These numbers make it clear that child labor is an issue that deserves considerable attention.

112. The capacity of the government to oversee labor regulations and occupational safety and health standards is limited. The availability of resources, including inspection officers and dedicated vehicles, dictates the pace of labor inspection visits. There are only 23 inspectors in the Department of Labor of the MoLHR. In order to compensate for the shortage of inspectors, the Department of Labor has prioritized the formation of health and safety committees in companies in heavy industries that employ more than 50 workers. A health and safety committee enables management and worker representatives to meet regularly and work cooperatively to develop policies and procedures that improve occupational safety and health.

113. Active labor market programs have two basic objectives: economic (making it more likely that the unemployed find jobs) and social (improve inclusion and participation rates for productive employment). If well-designed, properly targeted and correctly implemented, such programs have the potential to significantly improve labor market performance. At the same time, various reviews of active labor market programs indicate that such programs are not a panacea for resolving large-scale unemployment problems, and that expectations must be realistic. Active labor market programs cannot substitute for structural labor market reforms (Kuddo 2013).

Table 4.3—Evidence on the Effectiveness and Cost-effectiveness of Active Labor Market Programs

Type of Program	Costs	Effectiveness	Strength of evidence
Public employment services “job brokerage”	Relatively cheap	Highly effective	Unanimous
Training programs	Relatively very expensive	Effective	Mixed
Employment incentives / start-up incentives	Relatively expensive	Effective	Mixed
Direct job creation / public sector employment	Relatively expensive	Ineffective	Unanimous

Source: Lehmann 2011.

Note: “Effective” means that the average employment or reemployment probability of a person participating in the indicated measure is increased, “unanimous” means that virtually all studies show the indicated effect, “mixed” means that some studies show the indicated effect but other studies do not.

114. No rigorous evidence exists on the effectiveness or efficiency of Bhutan’s existing active labor market programs; however, it can be observed that the country generally focuses on programs with relatively high unit costs and a small number of beneficiaries. Bhutan places a lot of emphasis on training and entrepreneurship assistance programs. While international evidence suggests that these types of active labor market programs can be helpful in improving labor market outcomes, international experience also shows that public employment services (including career guidance services, job and vocational counseling, and various job search assistance programs such as job search skills training programs, job clubs, and vacancy and job fairs) are often more effective and cost-effective, provided that a reasonable number of job vacancies is available (Table 4.3; Kluve 2006; Betcherman et al. 2007 Lehmann and Kluve 2008).

115. Strengthening public employment services is a key element of the RGoB’s Eleventh Five-Year Plan. The Eleventh Five-Year Plan emphasizes the need to strengthen the capacity of regional employment and labor offices to effectively deliver services related to labor administration and intermediation. This includes revamping the job portal system to improve delivery of employment facilitation services, conducting periodic market surveys, and commissioning studies to provide relevant, up-to-date information on employment (GNHC 2013).

116. Labor taxes, which discourage labor demand by raising labor costs for employers and reduce labor supply by lowering the disposable income of wage workers, are not an acute problem in Bhutan. Labor taxes create a “tax wedge” between labor costs to the employer and the worker’s take-home pay, thereby reducing both employment and economic growth. International evidence suggests that high payroll taxes can be associated with higher unemployment rates and lower formality rates (Elmeskov, Martin and Scarpetta 1998). It is estimated that a ten-percentage-point increase in the labor tax wedge can reduce formal employment from 1 to 5 percentage points, with the biggest effect on youth and low-skilled workers (Lehmann and Muravyev 2014). As Bhutan has comparatively low labor taxes, a tax wedge between labor costs and workers’ take-home pay is not a priority challenge.

4.3 POLICY RECOMMENDATIONS

117. The government could consider revising, clarifying and simplifying regulations associated with foreign workers. As mentioned in Chapter 3, business constraints related to labor regulations rank high on employers’ list of impediments to doing business in Bhutan. In the BES 2015, 22.6 percent of employers considered labor regulations the single biggest obstacle to the operation of their firm. To a large extent, the sentiment that labor regulations are a major constraint on business can be traced to specific constraints on the employment of non-Bhutanese workers.²⁷ The revision, clarification and simplification of regulations associated with the employment of foreign labor would improve the business climate in Bhutan and promote the growth of the private sector. Moreover, in many cases the skills of Bhutanese and non-Bhutanese workers are complementary. Many foreign workers either have specialized qualifications that Bhutanese workers lack or are willing to perform tasks that Bhutanese workers are reluctant to engage in. This means smarter regulations concerning the employment of non-Bhutanese workers would not only improve the business climate but would also increase the employment prospects of Bhutanese workers.

²⁷ As noted by Rutkowski (2007), employers’ subjective perceptions of labor regulations are not necessarily correlated with indices of labor market rigidity because they are formed relative to other obstacles to firm activity.

118. Regulations on foreign labor could be designed to promote knowledge transfer between foreign and local workers and the hiring of foreign workers whose skills complement Bhutanese labor. One possibility of realizing both knowledge transfers and complementarities within the confines of a single firm would be to issue permits for hiring non-Bhutanese workers to firms based on the recruitment or on-the-job training of Bhutanese workers. As discussed in World Bank (2013a), in many Arab states of the Persian Gulf, similar administrative requirements require firms to employ a threshold share of nationals in their workforces (so-called Bahrainization, Emiratization, Kuwaitization, Omanization, Qatarization, and Saudization policies).

119. The capacity of the government to oversee labor regulations and occupational safety and health standards could benefit from strengthening. Because only a fraction of workplace accidents and incidents are reported, more awareness and advocacy on occupational safety, health, and accident reporting procedures is needed for all workplaces in Bhutan. Although the extent of child labor is limited in scale compared to other countries in South Asia, it also needs constant monitoring. The Department of Labor may need more labor inspectors and more resources to conduct labor inspections, especially in remote areas. Greater capacity to enforce the Labor and Employment Act will increase compliance and ensure that workers are paid, work reasonable hours and receive all legally mandated benefits (coverage of which is often underwhelming, as noted in Chapter 2). While the enforcement of Bhutan's Labor and Employment Act has had some unintended consequences it has also had the desirable effect of increasing paid employment and reducing hours worked (Box 4.2).

120. Bhutan could systematize monitoring and evaluation of active labor market programs, and complement training and entrepreneurship support programs by more thorough, more tailored employment services. More systematic monitoring and evaluation of existing active labor market programs could improve understanding of their effectiveness and cost-effectiveness. In addition, it might be possible to complement existing programs focused largely on training, support for entrepreneurship and employment opportunities abroad by introducing or enhancing basic employment services. These services could include but would not need to be limited to (i) job search assistance services and job search skills training programs, (ii) job cafes or clubs, (iii) job and vacancy fairs, (iv) employer-focused intermediation services, (v) small business advisory meetings, (vi) events providing information on the labor market and the availability of jobs, and (vii) career, job, and vocational counseling (either individual or group-based). The facilitation of work opportunities outside of Bhutan, such as through the continuation or scale-up of the Overseas Employment Program, could also help Bhutanese citizens whose skills are not in demand in the domestic labor market. In this context, it would be important to emphasize effective measures to protect the overseas workers' well-being, safety and security.

121. Bhutan could also consider establishing a labor market observatory (LMO). Currently, little pertinent, up-to-date and granular information on Bhutan's labor market is available. To rectify this deficit, a LMO could (i) compile and disseminate information on the state of the labor market and important trends, (ii) conduct comparative research, and (iii) evaluate the effectiveness and cost-effectiveness of active labor market programs (see, for example, Martín, 2011). A well-managed LMO can improve the functioning of a labor market by providing information that allows different stakeholders to make rational, evidence-based decisions. In particular, it can be helpful for groups with scant access to information about labor supply and demand, and could thus, for instance, help integrate rural-to-urban migrants into the urban economy (something that is particularly crucial for urbanizing countries such as Bhutan, per the discussion in Chapter 1).

122. Finally, deeper social dialogue could play an important role in framing collective or firm-level solutions to labor market challenges. Social dialogue between employers and employees can enable workers to more successfully transition between different employment situations while also helping

businesses respond more flexibly to the shifting demands of an economy and to changes in the competitive landscape. In this context, employment protection legislation could continue to be an instrument for safeguarding core labor standards, and over time workers' and employers' associations could play a greater role in determining employment relations through collective bargaining, with the aim of finding the right balance between flexibility and security. Ultimately, deeper social dialogue could help create a dynamic economic environment, especially in Bhutan's cities, and thus respond to one of the priority policy challenges that Bhutan faces as an agrarian economy.

BOX 4.1 INTERNATIONAL MIGRATION AND ECONOMIC SELF-RELIANCE

Bhutan aims to achieve economic self-reliance by 2020. In a working paper published in 2015, the Ministry of Finance notes that self-reliance is defined as “relying on oneself or one’s own effort and abilities rather than those exerted or supplied by other people.” The paper goes on to argue that while in the narrowest sense of the word self-reliance might be understood to mean producing everything you need from within the country “this strict definition is irrelevant in this present interconnected world and particularly for Bhutan, a landlocked with limited resource endowment nation.” It also asks what economic self-reliance could mean for Bhutan’s labor force and mentions the high prevalence of non-Bhutanese workers in some industries in Bhutan today (MoF 2015).

Research on immigration’s impact on Bhutanese workers is very limited. Fortunately, the BES 2015 offers a unique opportunity to examine the presence of foreign workers in different parts of Bhutan’s private nonfarm economy. As detailed in Chapter 3, the prevalence of foreign workers is rather high among medium-sized and large firms in this sector. As again detailed in Chapter 3, the BES 2015 indicates that immigrant workers are present across the entire skills spectrum but are for the most part active in jobs that require little education and pay low wages. As noted in Chapter 2, outside agriculture most Bhutanese workers—especially younger ones entering the labor market—are generally at least moderately well-educated and have relatively high wage demands. This suggests that the majority of immigrant and native workers in the nonfarm private sector complement each other.²⁸

Complementarities between native and immigrant workers have important policy implications. In particular, they imply that the employment of foreign workers improves the employment prospects and raises the wage levels of many native-born workers. For instance, assume that Bhutanese and immigrant workers in the construction industry are in fact complements. Assume further that while Bhutanese workers are generally well-educated and interested in white-collar jobs, non-Bhutanese workers have less formal education but are more willing to work in blue-collar jobs. In this scenario, an increasing number of immigrant blue-collar workers in the industry will stimulate construction activity and in the process lead to a higher number of white-collar jobs for Bhutanese citizens as supervisors or administrators.

The apparent complementarity between Bhutanese and immigrant workers suggests that the strict definition of economic self-reliance as “producing everything you need from within the country” would not be appropriate with regard to Bhutan’s labor force. Instead, a broader definition of economic self-reliance would be more appropriate. This broader definition would stress that Bhutan wants to rely on itself and its own effort and abilities with regard to labor and skills. But it would also recognize that the country can benefit from international interconnectedness and labor mobility.

²⁸ In many countries, the question of whether most immigrants and native workers are complements or substitutes remains controversial; with presently available data, it cannot be answered 100 percent conclusively for Bhutan. At the same time, as discussed in Peri (2014), complementarities between immigrants and native groups of workers have been documented for many countries. Similarly, there are strong indications that most immigrants and native workers in Bhutan complement each other.

A broader definition of economic self-reliance could include three elements. First would be the expectation that the majority of Bhutanese workers will find work in Bhutan and that the majority of jobs in Bhutan will be filled by Bhutanese workers. For this expectation to be realized the coverage, quality and relevance of Bhutan's education and training system will need to be continuously improved. Second would be the understanding that some Bhutanese citizens may have skills that are less in demand in Bhutan than elsewhere, and that others could improve their skills through work experience abroad. These groups of citizens will benefit from government support of work opportunities outside the country in an orderly, secure way (e.g. through the expansion of initiatives such as the Overseas Employment Program). Third would be an appreciation that a certain amount of economic immigration can be beneficial for Bhutan. This appreciation will ideally lead to the development of an orderly and well-regulated process to manage economic immigration.

Based on international best practices, three broad principles can guide policymakers in Bhutan to develop an orderly and well-regulated process to manage work-related immigration:

The process should be **market-driven**: Immigration flows should be aligned with labor market demands as well as with Bhutan's overall economic, social and cultural objectives.

It should be **comprehensive**: A comprehensive immigration system is a system that recognizes the need for immigrants of different types but also differentiates among these types.

It should be **balanced**. It should seek to maximize the employment of Bhutanese citizens and minimize any negative impact of immigration on Bhutanese workers, while also protecting immigrant workers from abuse and avoiding different employment and social protection rules for Bhutanese and non-Bhutanese workers.

Sources: Ministry of Finance 2015; World Bank 2015c; World Bank staff calculations based on the BES 2015.

BOX 4.2 ECONOMIC EFFECTS OF BHUTAN'S LABOR INSPECTIONS

Most countries around the world have introduced labor regulations that, for instance, establish minimum wages, regulate overtime work, mandate leave, stipulate pension plans and prohibit child labor. Such regulations are meant to protect workers' rights, improve their living standards and rein in abuses by employers. In practice, written legislation is not always implemented as intended. Instead, enforcement of labor regulations is often lax. This means that employers are sometimes able to avoid regulatory compliance without fear of consequences.

In many low- and middle-income countries, the informal segment of the economy, which is beyond the reach of the authorities, is used as a way to sidestep labor regulations and avoid the costs associated with compliance. In this context, enforcement of labor regulations may have the unintended consequence of increasing the relative cost of operating in the formal economy. Therefore, it may drive firms either to employ workers in the informal economy or to not hire them in the first place.

Ultimately, whether labor regulations really improve working conditions or lead to the replacement of formal jobs by informal employment can only be answered empirically. A recent rigorous investigation of the topic for Bhutan using quasi-experimental methods exploits the introduction of random labor inspections to firms in the country to examine the impact of enforcing labor regulations on formal and informal employment, earnings, hours of work and other outcomes. The investigation relies on the fact that most businesses were initially unaware that labor regulations had been established through the Labor and Employment Act of 2007.

To increase awareness and compliance, the government set up regional labor offices and began sending labor inspectors on visits throughout the country.

Empirical investigation of the economic effects of these visits finds that labor inspections had the desirable impact of increasing paid employment and reducing hours worked. However, at the same time inspections also had adverse impacts on new hires and total employment. Thus, while enforcement certainly helped to improve working conditions for workers whose employment continued after enforcement was intensified, it also had negative consequences. In effect, the results suggest that firms found it costlier to hire workers after labor regulations had been introduced and enforced.

Source: Fandl et al. 2011

5 SOCIAL PROTECTION FOR WORKERS

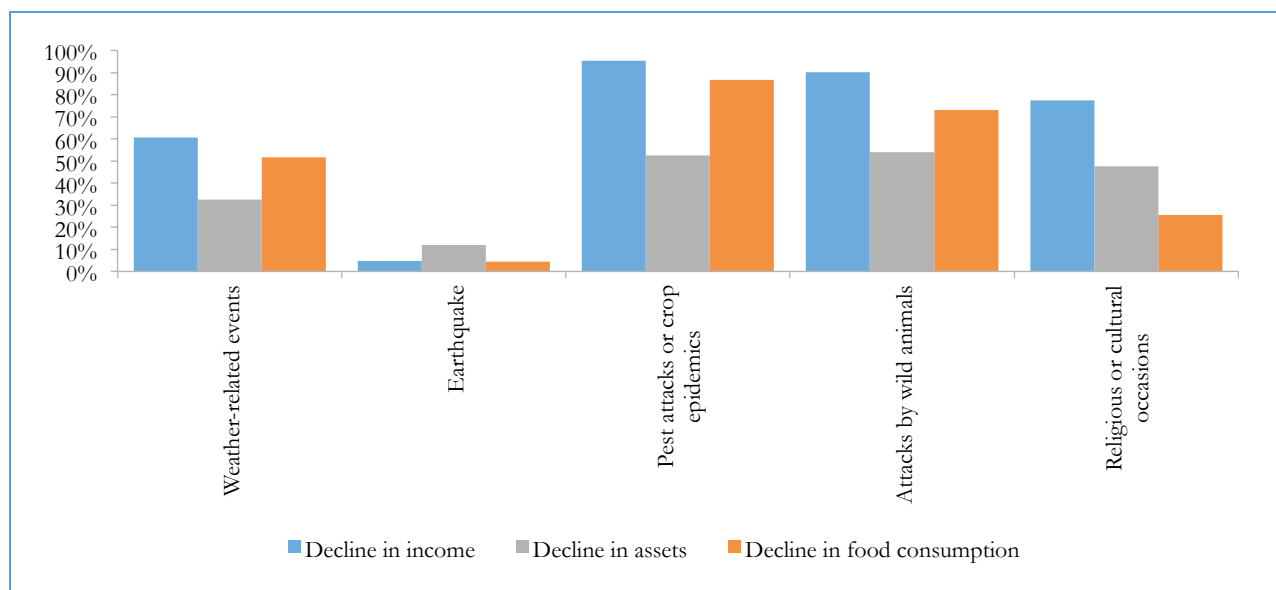
5.1 COUNTRY CONTEXT AND RECENT DEVELOPMENTS

124. This chapter analyses households' vulnerability to shocks and the adequacy of existing social protection measures, in terms of both the measures themselves and their actual implementation. The chapter identifies specific groups of workers that are vulnerable and suggests possible responses the government could provide. The chapter also explores the relationship between vulnerabilities and individuals' job preferences and choices. In order to identify patterns particular to a specific group, parts of the analysis are disaggregated by variables such as gender, location, age and sector of employment.

125. In spite of the rapid decline in Bhutan's poverty rate in recent years, pockets of poverty remain (especially in rural areas) as do other specific vulnerabilities. As mentioned in Chapter 1, between 2007 and 2012 Bhutan's poverty rate decreased from 23 percent to twelve percent, with most of the reduction coming from rural households. However, as Chapter 1 also noted, Bhutan remains an agrarian economy, and pockets of poverty persist in rural areas and among households engaged in small-scale and subsistence agriculture. In addition to poverty, an urban-rural gap exists in food security and access to services.

126. The agrarian nature of Bhutan's economy determines the nature of the most prevalent shocks and vulnerabilities. According to the BLFS 2104, around 11 percent of households—and 16 percent of rural households—were affected by wild animal attacks on crops and settlements in the year preceding the survey. Other frequent shocks included religious and cultural occasions (6 percent of households experienced this type of shock in the 12 months preceding the survey), earthquakes (5 percent), rains, floods or windstorms (5 percent), and pest attacks or crop epidemics (4 percent).

Figure 5.1—Proportion of Households Affected by Major Shocks that Experience Declines in Income, Assets or Food Consumption



Source: World Bank staff estimates based on BLFS 2014.

Note: The results on the effects of shock, are time sensitive, and only reflect the shocks that occurred during 2014. Only 5 percent of households reported having faced small earthquakes during this period, which may be the cause of earthquakes' supposedly limited affects.

127. In Bhutan, the effects of a shock on households' income, assets and food consumption often depend on the nature of the shock. Different shocks have different effects on household income, assets, food consumption or other variables. For instance, attacks by wild animals can lead to the death or injury of farmers or—more commonly—their livestock. They can also result in a loss of crops. For many rural households, livestock and crops are key assets. Moreover, many rural households engaged in small-scale and subsistence farming get most of their food from their own livestock and crops. Therefore, attacks by wild animals can result in large losses in rural households' assets and subsequently lead to large income losses reduced food consumption. According to the BLFS 2014, the actual effects of different shocks on households' income, assets and food consumption varied. But with the exception of wild animal attacks and earthquakes—which obviously may destroy physical assets—major shocks most frequently resulted in a decline in income (Figure 5.1).

128. Poor and rural households more frequently experience shocks and are more prone to suffer declines in assets, income and food consumption as a result. In order to assess the effect of shocks on different population groups it is helpful to divide all households in Bhutan into quintiles according to their household income. About a third, 33.7 percent, of households in the first (poorest) income quintile experienced a decline in income induced by some type of shock in the year prior to the BLFS 2014. However, over the same period, only 3.1 percent of households in the fifth (richest) income quintile experienced a decline in income due to a shock. The same pattern is evident for assets (2.5 percent decline for the top quintile v. 20.4 percent for the bottom) and food (0.4 percent decline for the top quintile v. 27.1 percent for the bottom).

129. Households and individuals cope with shocks by drawing on their own savings, seeking help from the government or working longer hours. Responses to shocks tend to depend on the nature of the shock, in particular whether a shock is anticipated, idiosyncratic or systematic. In general, the three most common coping strategies are to draw on savings, to seek help from the government and to work longer hours. Some people also seek help from NGOs, increase informal borrowing, reduce food consumption or take riskier jobs in response to shocks. For shocks that can at least partly be anticipated (like religious or cultural occasions), households are more prone to rely on their savings. In response to more idiosyncratic shocks (such as attacks by pests or wild animals) households tend to change their own behaviors: they work longer hours, reduce food consumption, and rely on informal borrowing. Finally, for systemic shocks like earthquakes, households tend to have no response. This may be because the entire community is affected or because of an expectation that the government will make provisions to help households cope with the shock (Figure 5.2).²⁹

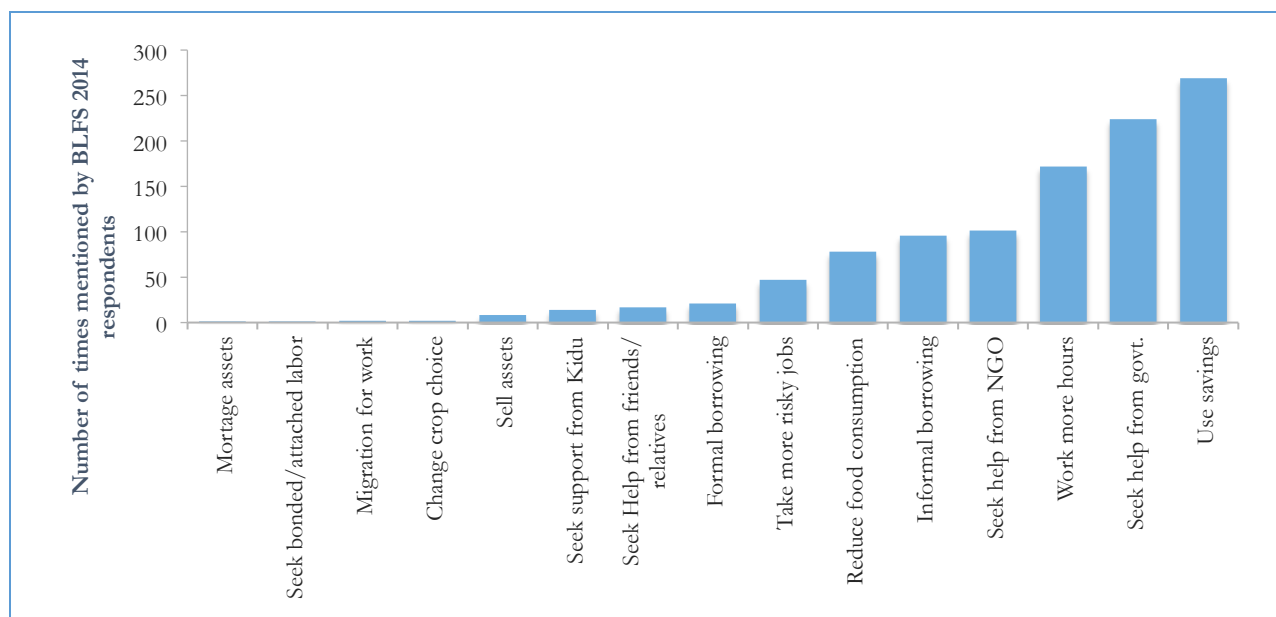
130. While Bhutan has long relied on social programs in health and education, there are few government social protection programs to support individuals and households vulnerable to shocks. In Bhutan, large social programs such as free health and education services have existed for over 40 years. Today, such social programs continue to exist in parallel with social protection programs like social safety nets and social insurance. The RGoB has several social protection programs implemented by a range of government agencies, including the GNHC, the MoE, the Ministry of Health (MoH) and the MoLHR as well as by His Majesty the Fifth King of Bhutan's Secretariat through the Office of the Gyalpoi Zimpon. Other social protection agencies include the Electricity Authority (which makes provisions or subsidies), the Loden Foundation and other NGOs that fund scholarships, and the National Pension and Provident Fund. Social

²⁹ One oft-quoted anecdotal example of the supposed (over-)reliance by some households on government support is a large fire in Bumthang that was followed by very efficient provisioning for affected households by the RGoB. After a second fire in the same area, the local population then expected the same efficient government response.

insurance is provided through private institutions. Not counting social programs like free health care and education, the RGoB spends 0.9 percent of GDP on social protection.

131. Bhutan has a mix of universal and targeted social protection programs. Social protection can be provided to all (universal) or targeted to specific groups based on their need or vulnerability.³⁰ In Bhutan, some programs are geographically targeted to households in rural areas, for instance the provision of free electricity. Other social protection programs and related social programs are universal, such as free health care. As a result, despite some out-of-pocket expenditure, health-related costs or illnesses are not among the most frequent or severe shocks that households in Bhutan face.

Figure 5.2—Coping Strategies in Response to Major Shocks



Source: World Bank staff estimates based on BLFS 2014.

Notes: Numbers are not weighted. Multiple answers allowed.

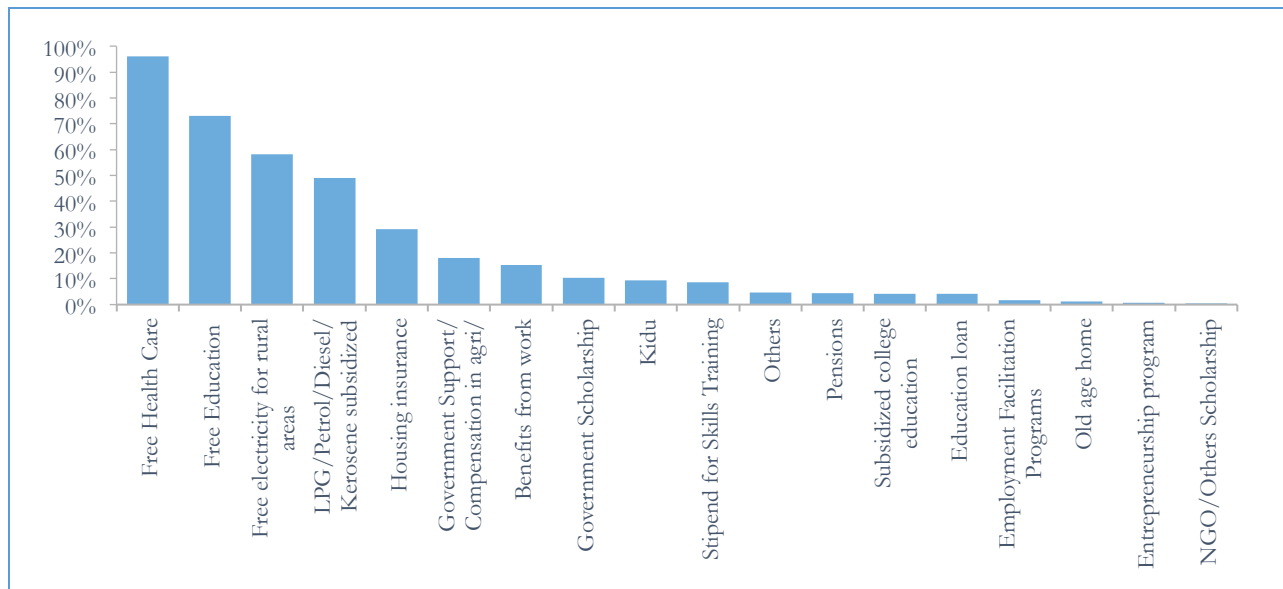
132. Among all of Bhutan’s social programs, free education and free healthcare reach the most households, followed by free electricity and subsidized fuel. In Bhutan, universal social programs like free education and healthcare generally reach more households than the smaller targeted social protection programs. For example, in the year prior to the BLFS 2014 survey, 94 percent of households benefitted from free health care, while the *kidu* (welfare) program provided by the Office of the Gyalpoi Zimpon (described in more detail below) reached 9 percent of household. Only 1 percent of households benefitted from the existence of old-age homes (Figure 5.3).

133. Contributory pensions for civil servants, employees of state-owned enterprises and members of the armed forces cover less than 9 percent of the population. This is in addition to a mandatory retirement scheme that was introduced in 2002 in order to provide income security during old age. Both employees and employers make monthly contributions of equal size to two schemes. The schemes provide

³⁰ Under a universal approach everybody receives the same government-provided benefits while targeting proposes that the provision of benefits differs based on an individual or household circumstances. Targeting can be based on individual or household characteristics (such as demographics or poverty) or on geographic locations. Many countries choose to target social protection programs to increase program efficiency but actual efficiency gains depend on program characteristics like needs, gains and costs.

retirees with a monthly income through the National Pension Plan as well as a lump sum payment upon retirement through the National Provident Fund Plan, a fully funded defined contribution scheme. The National Pension Plan is a partially funded pay-as-you-go system with a defined benefit scheme. That is, it is a social insurance scheme that obtains contributions from workers through their careers and provides benefits after retirement to its members and their spouses. The civil and armed forces old-age retirement plans are managed and administered by the National Pension and Provident Fund (NPPF), an autonomous organization created in 2000.

Figure 5.3—Proportion of Households Receiving Benefits from Various Social and Social Protection Programs



Source: World Bank staff estimates based on BLFS 2014.

134. A total of 50,728 civil servants, employees of state-owned enterprises and members of the armed forces are members of the NPPF. Of these, 4,296 are pension beneficiaries (NPPF 2014). The NPPF delivers services to employees of 445 government agencies, state-owned enterprises and agencies of the armed forces. In addition to pension and provident fund services, the organization provides housing, education and student loan services to its members. Housing is provided to 799 tenants in 92 residential buildings in four *dzongkhags* (Thimphu, Chhukha, Samdrup Jongkhar and Samtse). Annual contributions to NPPF accounts constitute an estimated 5.2 percent of Bhutan’s Gross Domestic Savings (NPPF 2014). According to the Bhutan Living Standards Survey (BLSS) 2012, pension income represents about 1.3 percent of overall household income.

135. Civil servants benefit from a pension scheme as well as from housing for low-income civil servants in Thimpu and Phuentsholing. The pension scheme includes (i) post service retirement benefits for NPPFP members; (ii) income security in the event of permanent disability; (iii) social support to surviving family of a deceased member; and (iv) a compulsory savings plan for the salaried employees. This is made available when they reach 56 years of age. Since 2009, housing has been provided to low income civil servants in Bhutan’s two biggest cities, Thimphu and Phuentsholing. The National Housing Development Corporation was established in 2009 with the mandate to provide housing to low-income civil servants. Currently, 2,000 civil servants benefit from the low-cost housing scheme in Thimphu and Phuentsholing.

136. Crop, rural, life and general insurance are available largely through the Royal Insurance Corporation of Bhutan The Royal Insurance Corporation of Bhutan was established in 1975 under the

Charter of His Majesty the Fourth King of Bhutan to meet the insurance needs of Bhutan's citizens and to participate in the economic development of the nation. It functions as a financial institution as well as an insurance company. Its life insurance scheme provides security against unforeseen calamities. Its general insurance schemes covers fixed and movable assets by providing indemnity in the case of natural hazards. Its group savings-cum-insurance scheme covers employees in the civil service and the public sector against untimely death and permanent disability, and also provides security to salaried employees after their retirement. The Royal Insurance Corporation of Bhutan has also been entrusted by the RGoB to implement the Rural House Insurance Scheme to indemnify the rural population against damages to homes caused by fire, floods or earthquake. Finally, the Royal Insurance Corporation provides both short-term and long-term loans to accelerate Bhutan's development. The RGoB owns 33 percent of its shares. Recently, a few other insurance companies have been established.

137. The prices of both Liquid Petroleum Gas (LPG) and kerosene are subsidized to households through a grant from the Government of India. Depending on the location, subsidies lower the retail price of LPG and kerosene by 55 to 70 percent. The BLSS 2012 indicates that 61 percent of all households in Bhutan use LPG for cooking. In urban areas, LPG is the most important source of cooking fuel. Again according to the BLSS 2012, more than 92 percent of urban households rely on LPG for cooking.³¹ Annually, the fuel subsidies are estimated to amount to about Nu 500 million (\$8,000,000 at current exchange rates; National Council of Bhutan, 2014).

138. Since 2013, all rural domestic households have received up to 100 units of free electricity per month. This accords with the government's pledge to provide free electricity to the rural households for three years. Prior to the 2013, low voltage rural households paid 85 Nu per 100 units. The subsidy was initiated to encourage the rural community to use electricity to cut down on their dependency on firewood and other fuel sources. The subsidy is also expected to prevent rural-urban migration and provide support to the rural poor.

139. Households in Bhutan have long relied on the Royal prerogative of granting *kidu* as a last-resort assistance during times of adversity. Even today social policies and initiatives of the government are reinforced by His Majesty the Fifth King of Bhutan's continuing tradition of granting *kidu* to people in hardship situations. The granting of *kidu* is managed through the Office of the Gyalpoi Zimpon (Office for People's Welfare and Wellbeing). It covers thousands of vulnerable citizens—the elderly, disabled, destitute, landless, alcohol- or drug-addicted and sick—as well as children who lack the income to attend school. The social protection benefits administered by the Office of the Gyalpoi Zimpon include the areas of education, scholarships, medical support, citizenship, land grants, disaster relief and amnesty. Support can also include cremation and funeral services for the poor. For the most part, the Office of the Gyalpoi Zimpon relies on a three-pronged approach, which consists of cash transfers, land grants and scholarships.

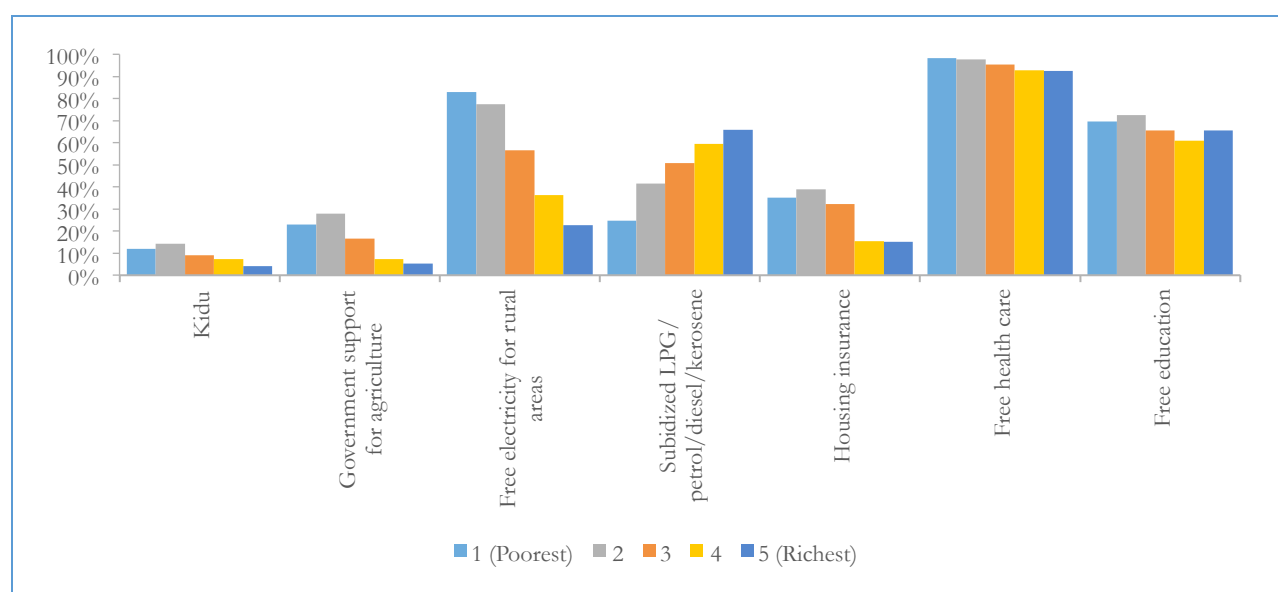
140. While none of Bhutan's social protection programs are explicitly designed to be poverty-targeted, most of them are progressive. Social assistance programs such as *kidu* and government support for agriculture, livestock, farming, and free electricity cover a much higher proportion of households in the first quintile of the income distribution than in the fifth quintile. For some programs, households in the second quintile of the income distribution have a higher coverage than those in the first quintile. This is likely

³¹ Also in the context of LPG and kerosene subsidies, the Ministry of Economic Affairs estimates that in 2014 only 40,000 LPG cylinders were in circulation even though 200,000 had been distributed. These numbers imply that there had either been illegal exports of subsidized LPG out of Bhutan or that households were hoarding many cylinders inside the country (cf. National Council of Bhutan, 2014)

due to disparities concerning access and information between the poorest households and those that are slightly better off (Figure 5.4).³²

141. The coverage of employment-related social protection benefits is highest among non-poor households. The coverage of pensions and a range of other work-related benefits is generally higher for households with higher income. The wealthiest households also benefit the most from government scholarships. The reason might be that government scholarships are largely focused on individuals pursuing higher education. In most countries, the cost of higher education is much higher than that of primary and secondary education, and many less wealthy households are unable to afford it even if they are supported by government scholarships. Bhutan seems to follow a similar pattern, as free education is provided by the RGoB only until grade ten.

Figure 5.4—Proportion of Households Covered by Various Social Programs, by Income Quintile



Source: World Bank staff estimates based on BLFS 2014.

142. Households headed by an agricultural worker benefit relatively more from universal social protection programs, social protection programs targeted at the rural population and the *kidu* program. Households headed by a self-employed or family agricultural worker also tend to benefit more from the *kidu* program, housing insurance, free electricity, and government support in agriculture than households headed by nonfarm self-employed or family workers. Households headed by an agricultural worker tend to benefit less from subsidized fuel and employment-related programs.³³

143. Households headed by an armed forces employee are more likely to benefit from some but not all social protection programs. Whereas coverage of some social protection programs varies little between

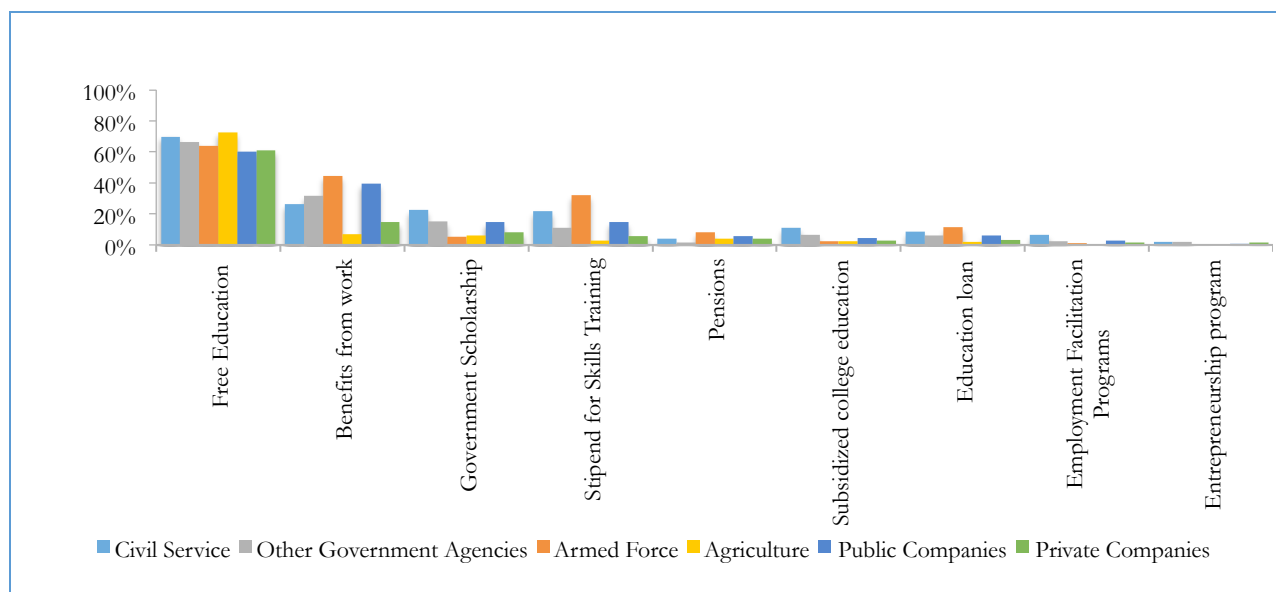
³² Universal social programs (i.e., free education and free health care) cover the rich and poor almost evenly across income quintiles. As LPG, kerosene and other fuels are used more frequently and more intensively by richer households, Bhutan’s fuel subsidy program is the one social protection program that is highly regressive.

³³ The analysis of this and the following paragraphs is based on the occupation of a household’s head as recorded in the BLFS 2014. 46 percent of household heads are active in agriculture, 25 percent are in private businesses or companies, ten percent in the civil service, six percent in other government agencies, seven percent in the armed forces and five percent in state-owned enterprises. Of course, while the head of a household may be engaged in a specific sector other members of the same household may work in different sectors or be inactive.

households headed by employees in different sectors, there are some significant differences. Households headed by someone in the armed forces have relatively high coverage from some social protection programs such as benefits from work, stipends for skills training, education loans and fuel subsidies. This finding could potentially be linked to the provision of social protection programs either within or specifically for the armed forces—a topic that deserves further exploration (Figure 5.5).

144. Social protection programs related to expanding opportunities—such as work-related benefits, scholarships and subsidized college education—mostly go to households headed by regular paid employees. In contrast, households headed by family workers benefit the least from these kinds of benefits. Less than 1 percent of household headed by a family worker are able to take advantage of employment facilitation or entrepreneurship programs. A slightly higher proportion of these households (4 percent) are covered by stipends for skills training. In effect, in addition to having no access to pensions, households headed by family workers also have access to few programs that could help them develop their human capital.

Figure 5.5—Proportion of Households Covered by Education and Labor Social Programs and Social Protection Programs, By Household Head Occupation



Source: World Bank staff estimates based on BLFS 2014.

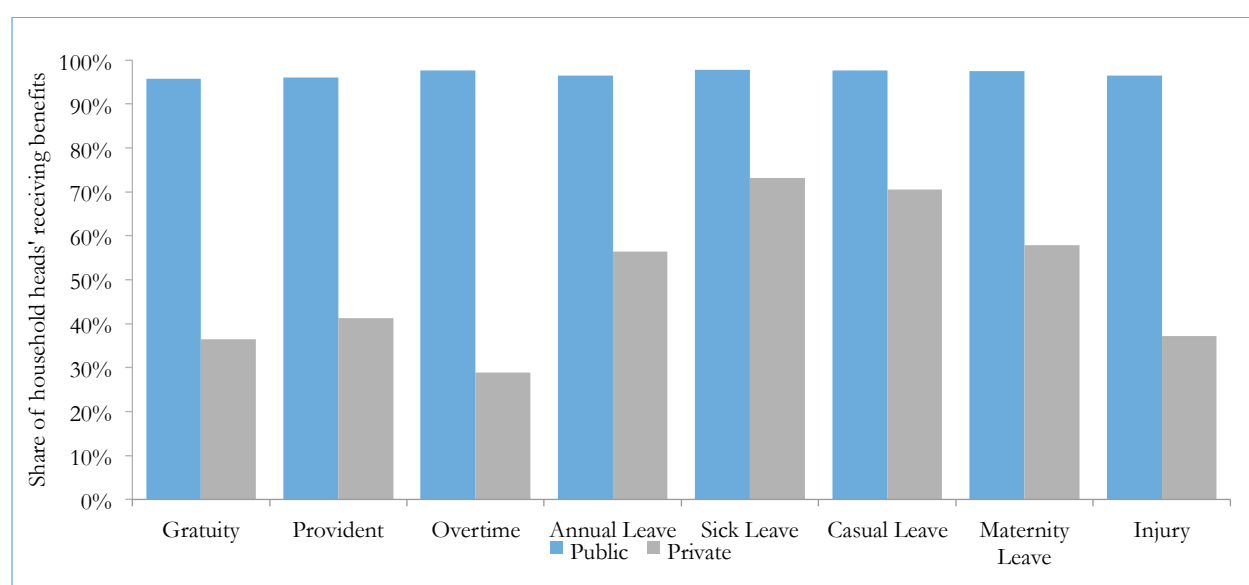
145. Workers in urban areas are more likely to be covered by work-related fringe benefits. In a comparison of work-related benefits (injury, maternity leave, casual leave, sick leave, annual leave, overtime, provident fund and gratuity), it is clear that a larger number of workers in urban than in rural areas receive these benefits. Across all types of fringe benefits, the share of workers covered in urban areas (between 53 percent and 82 percent) is consistently higher than in rural areas (33 percent to 61 percent). However, as causality cannot be specifically attributed to location, this finding may ultimately be a result of the workers' location, sector, industry or type of occupation.

146. Almost without exception, coverage of social protection programs in urban areas skews toward households headed by a public sector employee. This is true for all social assistance programs as well as for labor-related programs and work-related fringe benefits (the one exception is housing insurance). Over 95 percent of households headed by public sector workers receive work-related benefits. Across all types of work-related benefits, households headed by public sector workers have far higher coverage rates than households headed by private sector workers. The most pronounced differences exist with regard to overtime, followed by provident fund pensions and gratuity. At 40 percent, the coverage of work-related

injury benefits is low among households headed by someone in the private sector. This particular finding needs to be further explored, since the Labor and Employment Act mandates work-related injury benefits across all sectors of employment (Figure 5.6).

147. Within urban households, the coverage rates of education, skills and active labor market programs also differ between households headed by public sector workers and households headed by private sector workers. Across a wide range of social protection and labor programs—including work benefits, free education, government scholarships, stipends for skills training, subsidized college education, education loans, and employment facilitation programs—the share of urban households led by public sector workers that receive these benefits is far greater than those led by a private sector employee. Only entrepreneurship support programs are more widely accessed by households headed by private sector workers.

Figure 5.6—Proportion of Urban Households Covered by Work-Related Fringe Benefits, by Household Head Employment Sector



Source: World Bank staff estimates based on BLFS 2014.

Note: Urban households only

5.2 CHALLENGES AND CURRENT GOVERNMENT APPROACH

148. In addition to social programs like free health and education services, the RGoB has in recent years introduced a range of social protection programs. Today, the RGoB’s portfolio of social protection programs includes both large universal programs and a few smaller targeted ones. The largest targeted programs are the civil service pensions and the *kidu* program administered by the Office of the Gyalpo Zimpon. Civil society organizations such as Tarayana also provide social services to the elderly, the disabled, the destitute, and other poor or vulnerable groups. As mentioned above, 0.9 percent of Bhutan’s GDP is spent on social protection.

149. Despite the RGoB’s efforts, some groups are largely untouched by certain social protection provisions. As can be seen in Figure 5.3 and Figure 5.4, the coverage of social protection provisions ranges from less than 1 percent (entrepreneur support and old age homes) to 58 percent (rural electrification subsidy), depending on the scheme. More than 85 percent of the country’s labor forces are outside the

existing retirement benefit scheme (NPPF 2015). As previously noted, Bhutan is still an agrarian country: most of the population resides in rural areas and a majority of workers engage in agriculture, often small-scale and subsistence agriculture. A majority of Bhutanese are thus frequently affected by climate- and nature-related shocks.³⁴ However, existing formal social protection support mechanisms offer only limited support for such shocks. As a result, many shocks trigger high losses in income, assets and food consumption that can be catastrophic.

150. While social protection coverage cuts across a range of categories, it is neither equitable nor needs-based. Instead it is most available to a number of already privileged groups. In Bhutan, the type of a worker's contract as well as his or her location, gender and level of education determine his or her access to social protection. Workers who are men, have regular contracts, live in urban areas, and have a high level of education have better access to social protection than other workers. Coverage of work-related fringe benefits and social assistance benefits is particularly good for public sector employees and their households. As already mentioned in Chapter 3, this has to be one of the main factors so many queue for public sector jobs in Bhutan. And social protection provisions and benefits for public sector workers have expanded in recent years. For example, in December 2015 the RGoB approved new parental benefits for the civil service including the extension of maternity and paternity leave, the introduction of breast-feeding breaks for mothers and the establishments of *crèches* for young children.

151. In the private sector, the implementation of work-related social protection programs is often lacking. Since 2007 the MoLHR has introduced a range regulations meant to improve the access of private sector workers to social protection programs and benefits. Newly-introduced benefits include access to different types of leave and the requirement for employers to contribute to a provident fund. However, the implementation of these regulations has been lagging and has not been closely monitored. As a result, many employers have, for instance, not deducted the contributions for the provident fund from their workers' salaries or have not matched their employees' contributions to the fund.

152. Social protection for those in the informal economy (including small-scale and subsistence agriculture) is inadequate, leaving the workers who are most vulnerable most at risk. Workers in the informal economy often have less education and lower earnings. In addition, they are also likely to lack private protection against risks such as ill health, accidents, death and old age. The provision of public social protection programs for workers in the informal economy thus presents a complex challenge.

153. The RGoB has been drafting a social protection framework for workers, which attempts to equalize options and opportunities for workers in different segments of the private sector, including informal work. These efforts are in addition to those aimed at improving social protection for workers in the formal economy and employees of private companies. Among other things, the draft social protection framework suggests the introduction of pensions that are easily portable across different types of work and greater use of existing insurance schemes (like those offered by the Royal Insurance Corporation of Bhutan) that are in principle open to all but in practice used mostly by specific groups.

154. Opportunities to develop human capital and connect people to productive employment have been expanded as part of the RGoB's efforts to lower unemployment. Social protection programs closely linked to the labor market—such as training, scholarships and enterprise development grants—mostly reach beneficiaries who live in urban areas, are well-educated, and from households with at least one public sector worker. This pattern aligns closely with the group of people who are unemployed in Bhutan, (as mentioned in Chapter 1, unemployment is for the most part concentrated among urban, well-educated

³⁴ The types of shocks faced by households in Bhutan are somewhat different to most other countries in South Asia where health and economic shocks usually play a greater role than natural calamities.

youth). Although the new opportunities to develop human capital and connect people to productive employment have reached this group and certain others that struggle to find their place in the labor market, they do not reach individuals from poorer households or those who engage in relatively unproductive, unprotected employment in small-scale and subsistence agriculture and other segments of the informal economy.

5.3 POLICY RECOMMENDATIONS

155. If Bhutan wants to deliver more equitable social protection to all its workers, it could improve the balance between the types of support it provides. The World Bank Social Protection Strategy 2012–2022 (World Bank 2012a) recommends that governments use social insurance to support resilience, and apply social safety nets to support equity and promote the building of human capital and access to jobs. Bhutan needs to consider the balance between these different social protection programs. The country has several social protection programs already in place, but to date the bulk of support seems to have been provided to those who perhaps need it the least—public sector workers and, to a lesser extent, those in formal private sector jobs. Recently, government efforts have focused on opportunities related to education and jobs. While this is commendable, these newest programs seem to have again been accessed largely by households headed by public sector workers.

156. Improvement and expansion of existing social protection programs could support the rebalancing of program types. Vulnerabilities in urban and rural areas and among population groups differ. As such, Bhutan would benefit from targeted social safety net interventions to complement existing universal social programs. Targeting of existing social protection programs, such as fuel subsidies and higher education scholarships, could be improved to reach a higher number of poor and vulnerable households. This could be a first step toward a comprehensive national social assistance system.

157. Ensuring protection of all workers would require a renewed focus on those in the informal economy, particularly in small-scale and subsistence agriculture. As a large majority of the risks identified for rural households is climate- or weather-related, the expansion of measures that encourage savings among agricultural households as well as the introduction and scale-up of agricultural insurance, including crop insurance and livestock insurance, would be critical. It would be equally critical to ensure that those who are no longer able to work in agriculture for physical reasons should receive income support allowing them to live at a minimum standard. Moreover, in response to Bhutan’s priority policy challenges as an agrarian economy, the RGoB may also need to implement complementary measures to increase farming productivity (Box. 5.1).

158. Narrowing the gap in social protection coverage between public and private sector workers would not only result in more equitable provision of services, but would also encourage some youth to shift to private sector jobs. Coherence between social protection policies, employment policies and labor market and wage policies is important for equity purposes. Improved coherence in such policies would also help level the playing field between the public and the private sector. The RGoB has recently approved additional benefits for women with young children and the expansion of child care benefits for public sector workers. While this is a decision that gives mothers more flexibility to arrange for their children’s care, it also further widens the benefits gap between private and public sector workers. As a result, the RGoB might consider amending the Labor and Employment Act to expand these newly-available benefits to workers in the private sector. However, implementation and monitoring of existing rules and regulation is already limited (as mentioned in Chapter 2). Ensuring proper implementation of existing rules would likely deliver an even greater payoff than additional rules.

159. The overly generous pension scheme is a major factor skewing the compensation balance towards employment in the public sector. Previous studies have found that the pension wealth that accumulates over a full career is equivalent to roughly 14 times the workers' wage. (In South Asia, only Sri Lanka showed a higher figure). Were this to be taken into account as an annual flow of deferred compensation it would result in a significant public-private wage differential. Moreover, the defined benefit scheme will eventually run deficits if not reformed. Parametric reforms to reduce the mismatch between long run revenues and expenditures would also reduce the gap between public and private sector compensation.

160. Expanding pension coverage is an important long run objective but expanding the public sector scheme to private sector workers will simply create a larger tax wedge and may promote informality. One alternative would be to promote voluntary participation in defined contribution scheme through matching contributions aimed to benefit lower income workers in particular. Matching contributions (as opposed to tax deductions) have been introduced in a number of countries including China and India and have the potential for reaching both formal and informal private sector workers with some capacity to save.

161. In light of the fundamental change in the revenue outlook since the inception of the pension scheme in 2001, the government may want to reconsider the current contribution rate model for both public and private sector workers. After decades of low coverage, many countries are moving away from the traditional Bismarckian social insurance model and delinking pensions and health insurance from employment status. A broad social pension scheme would not only ensure coverage but would also encourage the demand and supply of labor in the formal private sector relative to an expanded payroll tax-financed scheme.

162. The introduction of an income support scheme for jobless private sector workers should be considered. Income support schemes for jobless workers come in many different varieties, including mandatory severance payments financed by employers laying off a worker, unemployment insurance systems financed through contributions by workers or firms, or support schemes financed through general government resources. Unemployment insurance is better suited to protect workers' income than, for instance, severance payments, because financial risks are pooled across all participants in the unemployment insurance scheme instead of only the workers of one firm. However, Bhutan's labor market has features that would make the introduction of an unemployment insurance scheme challenging. In particular, the population of the unemployed is rather small and scattered across the country and informality continues to be widespread. These factors would increase the administrative costs of an unemployment insurance scheme. In addition, an insurance scheme financed through contributions by employers or employees could discourage formalization. Therefore, an income support scheme financed through general government revenues appears more viable. The design and fiscal sustainability of such a scheme would need to be carefully considered prior to introduction.³⁵

163. The consolidation of social protection programs and modernization of social protection systems could improve equity and efficiency. The GNHC has recently introduced the Targeted Household Poverty Programme (THPP), Bhutan's first social assistance program specifically targeted at poor households. The THPP provides a unique opportunity to improve the coverage of social assistance benefits for the poorest households. Additionally, if implemented in a systematic and scientific way, THPP can provide the database and consolidated monitoring of beneficiaries and impacts needed to modernize Bhutan's

³⁵ Moreover, establishing a provident scheme for private workers could provide an alternative retirement scheme for those in the private sector and the extension of maternity and flexible leave policies recently introduced for those in the civil service, to the private sector could further reduce imbalances for women (alluded to in Chapter 1 and discussed in more detail in NCWC, 2013). As with income support for jobless workers, the appropriateness of the design and fiscal sustainability issues need to be carefully considered, prior to introduction of such schemes.

entire social protection system. As an example, the GNHC could provide the profiles and information of the poorest households collected through the THPP to other social protection programs, and the agencies can coordinate on which benefits or services are provided to specific households on the list. The introduction of management information systems that are interoperable between different implementing agencies could also facilitate the integration and coherence of Bhutan's social protection programs.

164. Finally, ensuring evidence-based decision making on social protection policies requires an increased level of monitoring and evaluation of existing social protection programs and their impacts. At present, program-level monitoring in Bhutan is very limited. There is also no national-level monitoring of social protection programs. Recommendations already mentioned above such as the introduction of an integrated management information system could facilitate the monitoring of programs. In addition, independent impact evaluations of key programs could provide evidence on the effectiveness and efficiency of various programs and guide the improvement of Bhutan's social protection policies and programs.

BOX 5.1 INCREASING PRODUCTIVITY IN THE AGRICULTURAL INDUSTRY

The development of Bhutan's renewable natural resources industry (which comprises agriculture, livestock and forestry) has been slow. Key reasons are low levels of technology adoption, the predominance of subsistence farming, a large number of fallow tracts and lack of market access. Moreover, the relatively small proportion of land suitable for cultivation and the significant flow of migrants from rural areas to urban centers have contributed to the industry's slow development as well as its growing trade deficit.

A range of ongoing challenges remain to be addressed to improve agricultural productivity and the quality of life in rural areas. First, physical access to rural areas and markets needs to be improved. Second, more access is needed to quality inputs and seeds, as well as more widespread adoption of good agricultural practices. Third, greater access to credit, technology and farm mechanization is required, as are sustainable approaches to managing pests and wildlife. Finally, Bhutan must address the loss of agricultural land for other developments and the impacts of climate change and natural disasters.

The shortage of farm labor is widely viewed as a constraint on agricultural production. Increased farm mechanization is needed to offset it. In the agricultural census of 2008, approximately 16 percent of respondents listed labor shortages as a key constraint on agriculture. In addition, efforts to enhance agricultural production and marketing have lacked adequate coordination. Marketing has mostly focused on providing infrastructure (for example, farm roads, irrigation schemes and market sheds). This has resulted in a lack of sustainability and limited income increases for farmers.

In light of these constraints, the RGoB has accorded high priority to the development of agriculture in the Eleventh Five-Year Plan. Moreover, agriculture is one of Bhutan's "Five Jewels" frequently cited by government officials. A number of concrete projects have also been undertaken or are being prepared to improve the productivity of Bhutan's agricultural industry. For instance, the Food Security and Agriculture Productivity Project implemented by the Ministry of Agriculture and Forests and supported by the World Bank aims to increase agricultural productivity and enhance market linkages in selected rural *dzongkhags* in southwest Bhutan. These objectives are to be achieved in three ways: (i) the strengthening of farmers groups (ii), crop diversification and the provision of irrigation, climate-smart technologies and farming practices, improved agricultural inputs, and mechanization in a packaged approach, (iii) the adoption of value chain approaches, and (iv) support for production, accessibility, and demand for nutrient-rich foods.

Source: Unpublished World Bank project documents for the Food Security and Agriculture Productivity Project.

6 CONCLUSION

165. Bhutan’s hydropower generation potential raises the prospect of tremendous development opportunities in the future but this opportunity will need to be managed with an eye to its impact on labor and jobs. Over the coming years, the development of Bhutan’s hydropower generation capacity will have a direct impact on several key macroeconomic indicators. It is expected to lead to an increase in export revenues, sustained economic growth and continued rapid poverty reduction. It is also expected to provide a window of opportunity for realizing the MoLHR’s vision of “a Nation where all its citizen have the opportunity for a gainful and quality employment characterized by harmonious and productive relationship in the workplace and the broader community.” At the same time, hydropower development can also be expected to create or exacerbate a number of significant challenges, including labor market challenges.

166. Against this backdrop, this report analyzed select key issues for Bhutan’s labor market that deserve particular attention now and in the coming years. In particular, the report focused on four issues: imbalances between the public and private sectors, barriers to private sector employment, labor market policies and social protection for workers. Throughout, the analysis was guided by an investigation of Bhutan’s current situation and future prospects, the state of key labor market indicators and an assessment of priority policy challenges according to the systematic classification of countries by the *World Development Report 2013*. This chapter reiterates some main policy options for realizing gainful quality employment for all.

167. The report highlighted the desire of many workers in Bhutan to obtain public sector jobs; queuing for such jobs is widespread and a major reason for the relatively high unemployment rate among young, well-educated, and well-off city dwellers. If Bhutan wants to avoid the plight of other resource-rich countries that rely on the public sector to provide jobs for their citizens, a comprehensive approach to sectoral rebalancing is needed—not to weaken the public sector but to allow private sector jobs to emerge and prosper. This rebalancing could include a commitment that growth in the public sector workforce will be subdued for the foreseeable future. Further, in order to gradually align public and private sector compensation packages, adjustments to public sector wages would need to be modest, in line with or below private sector wage growth. In the medium term, fringe benefits offered to private sector workers would need to be brought more in line with those of the public sector.

168. Bhutan’s private nonfarm economy remains underdeveloped; in recent years, sales and employment in existing private sectors firms have grown at a slower pace than previously. To address the lack of interest in private sector jobs, an information, education and communication campaign to increase the prestige and desirability of private sector jobs could be undertaken. More fundamentally, Bhutan could expand access to education, improve educational quality, focus education and training interventions on the development of a core set of technical as well as soft skills demanded by the country’s private sector and ensure that training content is in line with labor demand. More generally, reinforced efforts to foster broad-based private sector development and productivity could increase the attractiveness of the private sector as an employer of highly educated workers and strengthen its capacity to absorb job seekers.

169. While labor regulations in Bhutan are generally rather flexible, the country’s rules and regulations governing the employment of non-Bhutanese workers are stringent, and the government’s capacity to oversee labor regulations and occupational safety and health standards is limited. Bhutan could consider revising, clarifying and simplifying the regulations on foreign labor, drawing on international good practices for managing labor migration (models might be South Korea or Malaysia). Moreover, measures could be taken to enhance government capacity to oversee labor regulations and occupational safety and health standards and to strengthen the capabilities of regional employment and labor offices. Finally, as far as active labor market programs are concerned, Bhutan could improve monitoring and

evaluation arrangements and complement existing training and entrepreneurship support programs by more systematic and tailored employment services geared toward both employers and job seekers.

170. The RGoB has in recent years introduced a range of social protection programs; despite these efforts, many informally employed workers (particularly in agriculture) are not covered by social protection programs. Ensuring the protection of all workers would require a renewed focus on the poorest households (who often work in the informal economy, in particular in small-scale and subsistence agriculture). A first step to more effective and cost-effective social assistance could be an expansion of the THPP implemented by the GNHC and a link between its data base and that of other social protection programs to assure complementarity in coverage. In addition, narrowing the gap between compensation packages for public and private sector workers would require the gradual alignment of social insurance coverage between workers in both sectors and the introduction of carefully considered income support schemes for private sector workers. Finally, expansion of the evidence base around impacts of existing social protection programs through increased monitoring, evaluation and impact assessments could guide the improvement and consolidation of social protection programs for workers.

171. While this report provides recent, robust evidence on a range of topics, deeper analysis of select issues might be called for, including the management of labor migration, the reform of social insurance and income support schemes, and barriers to private sector employment. A deeper analysis of the management of labor migration could uncover more precisely how between Bhutanese and non-Bhutanese workers complement each other, and guide policymakers in Bhutan to develop an orderly, well-regulated process to manage economic immigration. Expanded pension coverage for all workers as well as an income support scheme for jobless workers—both financed through general government revenues—would help mitigate imbalances between the public and the private sector but the design and fiscal sustainability of such schemes would need to be carefully considered prior to their introduction. With regard to mitigating barriers to private sector employment, further analyses could use the BES 2015 to look at the issue in more detail and aim to offer practical solutions.

REFERENCES

- Afram, Gabi and Angelica Salvi Del Pero. 2012. *Nepal's Investment Climate: Leveraging the Private Sector for Job Creation and Growth*. World Washington, DC: World Bank.
- Ayyagari, Meghana, Asli Demirgüç-Kunt and Vojislav Maksimovic. 2011. "Small versus Young Firms across the World: Contribution to Employment, Job Creation, and Growth." World Bank Policy Research Working Paper 5631.
- Bertelsmann Stiftung. 2014. *BTI 2014: Bhutan Country Report*. Gütersloh: Bertelsmann Stiftung.
- Betcherman, Gordon, Martin Godfrey, Susana Puerto, Friederike Rother and Antoneta Stavreska. 2007. "A Review of Interventions to Support Young Workers: Findings of the Youth Employment Inventory." *Social Protection and Labor Policy and Technical Notes 41412*. Washington, DC: World Bank.
- Chakravarty, Shubha, Mattias Lundberg, Plamen Nikolov and Juliane Zenker. 2015. *The Role of Training Programs for Youth Employment in Nepal: Impact Evaluation Report on the Employment Fund*. Unpublished manuscript. Washington, DC: World Bank.
- Christofides, Louis and Maria Michael. 2013. "Exploring the Public-Private Sector Wage Gap in European Countries." *IZA Journal of European Labor Studies* 2: 1–53.
- Elmeskov, Jorgen, John P. Martin and Stefano Scarpetta. 1998. Key Lessons for Labour Market Reforms: Evidence from OECD Countries' Experiences. *Swedish Economic Policy Review* 5:205–252.
- Elsby, Michael. 2009. "Evaluating the Economic Significance of Downward Nominal Wage Rigidity." *Journal of Monetary Economics* 56: 154–169.
- Fandl, Kevon, Adriana Kugler, Milan Vodopivec and Michael Weber. 2011. "Is Enforcement of Labor Market Regulations Beneficial for Workers? Evidence from Surprise Inspections in Bhutan." Unpublished manuscript. Washington, DC: World Bank.
- Fogel, Walter and David Lewin. 1974. "Wage Determination in the Public Sector." *Industrial and Labor Relations Review* 27: 410–431.
- Gross National Happiness Commission (GNHC). 2013. *Eleventh Five Year Plan Document*. Thimphu: GNHC.
- International Labour Office (ILO). 1999. *Statistics on Public Sector Employment: Methodology, Structures and Trends*. Geneva: ILO.
- . 2011. *Key Indicators of the Labour Market, 8th Edition*. Geneva: ILO.
- . 2013. *Measuring informality: A statistical manual on the informal sector and informal employment*. Geneva: ILO.
- Kahn, Shulamit. 1997. "Evidence of Nominal Wage Stickiness from Microdata." *American Economic Review* 87:993–1008.
- Khan, Sherin and Scott Lyon. 2015. *Measuring Children's Work in South Asia: Perspectives from National Household Surveys*. Geneva: ILO.
- Kluge, Jochen. 2006. "The Effectiveness of European Active Labor Market Policy." IZA Discussion Paper 2018. Bonn: Institute for Study of Labor (IZA).
- Kuddo, Arvo. 2013. *Public Employment Services, and Activation Policies*. Saarbrücken: Lambert Academic Publishing.

- LaPrairie, Mark. 2016. *A Case Study of English-Medium Education in Bhutan*. EdD International Dissertation. London: University College London.
- Lehmann, Hartmut. 2011. “Active Labor Market Policies: An Introduction into their Rationale and Evaluation (with an Emphasis on Transition Countries).” Lecture at World Bank Workshop in Sarajevo.
- Lehmann, Hartmut and Jochen Kluve. 2008. “Assessing Active Labor Market Policies in Transition Economies.” Working Papers 646, Dipartimento Scienze Economiche. Bologna: Università di Bologna.
- Lehmann, Hartmut and Alexander Muravyev. 2014. Labor Market Institutions and Informality in Transition and Latin American Countries. In: *Social Insurance, Informality, and Labor Markets: How to Protect Workers while Creating New Jobs*, edited by M. Frölich, D. Kaplan, C. Pagés, J. Rigolini and D. Robalino. Oxford: Oxford University Press.
- Li, Yue and Martín Rama. 2015. “Firm Dynamics, Productivity Growth, and Job Creation in Developing Countries: The Role of Micro-and Small Enterprises.” *The World Bank Research Observer* 30: 3–38.
- Malik, Adeel and Bassem Awadallah. 2013. “The Economics of the Arab Spring.” *World Development* 45: 296–313.
- Martín, Iván. 2011. *Labour Market Information Systems and Labour Migration Information in Six Developing Countries: the Challenge of Integration. A comparative Study of Colombia, Costa Rica, Ghana, Nicaragua, Senegal and Tunisia*. Brussels: International Organization for Migration (IOM).
- Ministry of Education (MoE). 2014. “Bhutan Education Blueprint 2014–2024.” Thimphu: MoE.
- Ministry of Finance (MoF). 2014. “Achievement of Economic Self-Reliance by 2020.” Working paper. Thimphu: MoF.
- Ministry of Health (MoH). 2013. *Annual Health Bulletin*. Thimphu: MoH.
- Ministry of Labour and Human Resources (MoLHR). 2014a. *A New Approach to Skills Training Program in 11th FYP. Skilling Youth for Work and Life*. Thimphu: MoLHR.
- . 2014b. *Annual Report of the Department of Labor* (July 2013—June 2014). Thimphu: MoLHR.
- . 2015. *Labour Force Survey Report 2014*. Thimphu: MoLHR.
- Ministry of Labour and Human Resources (MoLHR) and United Nations Development Programme (UNDP). 2013. *Millennium Development Goals (MDG) Acceleration Framework. Youth Employment in Bhutan*. Thimphu: MoLHR and UNDP.
- Mizala, Alejandra, Pilar Romaguera and Sebastián Gallegos. 2011. “Public-Private Wage Gap in Latin America (1992–2007): A Matching Approach.” *Labour Economics* 18: S115–S131.
- National Commission for Women and Children (NCWC). 2013. *Bhutan Gender Policy Note*. Thimphu: NCWC.
- National Council of Bhutan. 2014. *A Review of Issues Pertaining to Distribution of Liquefied Petroleum Gas and Superior Kerosene Oil in Bhutan. Prepared and Presented by the Economic Affairs Committee at the 13th Session of the National Council*. Thimphu: National Council of Bhutan.
- National Pension and Provident Fund (NPPF). 2014. *Annual Report 2013–2014*. Thimphu: NPPF.
- National Statistics Bureau (NSB). 2015. *Statistical Yearbook of Bhutan 2015*. Thimphu: NSB.
- National Statistics Bureau (NSB) and World Bank. 2014. *Bhutan Poverty Assessment*. Thimphu: NSB.

- Peri, Giovanni, 2014. “Do immigrant workers depress the wages of native workers?” *IZA World of Labor* 42. Bonn: Institute for Study of Labor (IZA).
- Rutkowski, Jan. 2007. “From the Shortage of Jobs to the Shortage of Skilled Workers: Labor Markets in the EU New Member States.” IZA Discussion Paper 3202. Bonn: Institute for Study of Labor (IZA).
- Schmillen, Achim. 2016. “The Public/Private Wage Differential in the Land of Gross National Happiness.” Unpublished manuscript. Washington, DC: World Bank.
- Schmillen, Achim and Umkehrer, Matthias, 2013. “The Scars of Youth: Effects of Early-Career Unemployment on Future Unemployment Experience.” IAB Discussion Paper 201306, Nuremberg: Institute for Employment Research (IAB).
- TNO. 2008. *Occupational Safety and Capacity of the State Labor Inspectorate to Enforce Relevant Legislation in Azerbaijan*. Baku: TNO.
- United Nations Development Programme (UNDP). 2015. *From Old Public Administration to the New Public Service—Implications for Public Sector Reform in Developing Countries*. UNDP: Singapore.
- World Bank. 2003. *Measuring Living Standards: Household Consumption and Wealth Indices*. Washington, DC: World Bank.
- . 2009. *Bhutan Country Profile 2009—Enterprise Surveys*. Washington, DC: World Bank.
- . 2012a. *In from the Shadow: Integrating Europe’s Informal Labor*. The World Bank: Washington DC
- . 2012b. *More and Better Jobs in South Asia*. The World Bank: Washington DC
- . 2012c. *Resilience, Equity, and Opportunity—The World Bank 2012–2022 Social Protection and Labor Strategy*. The World Bank: Washington DC
- . 2012d. *World Development Report 2013: Jobs*. Washington, DC: World Bank.
- . 2013a. *Jobs for Shared Prosperity: Time for Action in the Middle East and North Africa*. Washington, DC: World Bank.
- . 2013b. *Low-skilled labor migration: Korea’s Employment Permit System*. Washington, DC: World Bank.
- . 2013c. *Pakistan Country Profile 2013—Enterprise Surveys*. Washington, DC: World Bank.
- . 2014a. *East Asia Pacific at Work: Employment, Enterprise, and Well-being*. Washington, DC: World Bank.
- . 2014b. *Student Learning in South Asia: Challenges, Opportunities, and Policy Priorities*. Washington, DC: World Bank.
- . 2015a. *Bhutan—Public Finance Reforms towards Economic Self-Reliance*. Washington, DC: World Bank.
- . 2015b. *Doing Business 2016: Measuring Regulatory Quality and Efficiency*. Washington, DC: World Bank.
- . 2015c. *Malaysia Economic Monitor December 2015: Immigrant Labour*. Washington, DC: World Bank.
- . 2015d. *The Bhutan 2015 Enterprise Surveys Data Set*. Washington, DC: World Bank.

APPENDIX

BHUTAN LABOUR FORCE SURVEY 2014 AND BHUTAN ENTERPRISE SURVEY 2015

The Bhutan Labour Force Survey (BLFS) is a household survey that is conducted annually by the Department of Employment of Bhutan's Ministry of Labour and Human Resources (MoLHR). It covers a nationally representative sample of around 6,000 households in all 20 *dzongkhags* (districts) of Bhutan. As Bhutan's urban residents are more heterogeneous than its rural population and economic activities in urban centers are more diverse, urban households are oversampled. In 2014, the BLFS covered 1,479 rural and 4,440 urban households for a total sample of 5,919 households. On average, sampled households contained about four household members resulting in a total sample size of 23,587 individuals. The 2014 edition of the BLFS is described in detail in MoLHR (2015).

In each household covered in the BLFS, all questions are answered by one respondent, often the household head. Respondents are questioned about variables concerning the household as a whole and about socio-demographic and work-related characteristics of all household members. Together with items on labor force participation, the core of the BLFS questionnaire encompasses questions related to the household members' current work status and employment history. An additional module covers housing and asset ownership, risks and coping mechanisms, and coverage of social protection programs on the household level. Among other variables, the BLFS contains information on household members' monthly earnings and weekly hours. Both variables are available for dependent as well as self-employed workers. This makes it possible to construct a measure for hourly wages.

The survey also ascertains whether a worker is employed in the civil service, other government agencies, the armed forces or state-owned enterprises (which following ILO, 1999, together constitute the public sector), in agriculture or private enterprises (i.e., the private sector) or by a non-governmental organization, international non-governmental organization or community service organization. Additionally, the 2014 edition of the BLFS questions respondents about a wide range of household members' individual characteristics. These include information on labor market characteristics such as whether an individual is a regular paid employee, casually paid employee, contract worker, self-employed worker or unpaid family worker.³⁶ Comprehensive information on the industry of employment is also available in the BLFS. Information on socio-demographic characteristics, such as individuals' age and education are included in the BLFS as well. Information on an individual's location (*dzongkhag* and urban or rural area) and his or her gender and nationality (Bhutanese or not) can also be used. Lastly, the questionnaire contains a series of questions on households' wealth and exact demographic composition.

Field work for the BLFS 2014 was done in December 2014 and January 2015. For the first time for a large-scale household survey in Bhutan, tablet-based computer-assisted personal interviews were conducted. The objective was to improve data quality and streamline data analysis. As another measure to assure high data quality, all respondents were asked for their cellphone numbers and during a meticulous data cleaning exercise these numbers were used to reach out to respondents in case any inconsistencies or missing values had been discovered in the raw BLFS data.

³⁶ The BLFS 2014 uses the following definitions for regular wage workers, casual wage workers, contract workers and self-employed workers: A regular wage worker is an "individual performing any kind of work for wage or salary, in cash or in kind", a casual wage worker an "individual working as and when they find a job for which they get paid, in cash or in kind", a contract worker an "individual who has a temporary contract to do a particular piece of work but is not an employee of the company he/she is working for" and a self-employed worker an "individual operating his own enterprise neither employing anybody to operate his/her enterprise nor being employed by anybody."

An Enterprise Survey is a firm-level survey of a representative sample of an economy's private sector. Enterprise Surveys are routinely conducted by the World Bank in a wide range of countries. They are usually answered by business owners or relevant top executives and cover a broad range of business environment topics including access to finance, corruption, infrastructure, crime, competition, and performance measures. Formal (i.e., formally registered) companies are targeted for interviews and broken down into four categories according to their size: (i) micro (less than five employees); (ii) small (five to 19 employees); (iii) medium-sized (20 to 99 employees); and (iv) large (more than 100 employees) companies. The manufacturing and service industries constitute the core of the survey.³⁷ Occasionally, for a few surveyed countries, other industries are included or certain industries are oversampled to provide better suited data for a particular country context or to reflect country-specific questions.

The Bhutan Enterprise Survey (BES) 2015 is used as the basis for many analyses of this report, in particular those of Chapter 3. For the BES 2015, firms in the food and beverages industry and in the tourism industry were oversampled. This resulted in the breakdown of all numbers for firms in the following four industries: (i) food and beverages; (ii) other manufacturing; (iii) tourism; and (iv) other services. Besides, almost 100 percent of firms in the nonfarm economy in Bhutan are registered at start-up which makes it possible for the BES 2015 to contain data on microenterprises. The BES 2015 directly covers data collected through interviews with representatives from 367 firms. 114 of these firms are microenterprises, 146 small firms, 84 medium-sized firms and 23 large firms. In addition to the interviews with business owners or relevant top executives, interviews were also conducted with 659 employees of firms covered by the BES 2015.

Importantly, weights can be applied to all data collected through the BES that reflect the situation in the whole economy. This means the BES 2015 is representative for the entire nonfarm private sector in Bhutan. The previous round of the BES happened in 2009.

³⁷ In all World Bank Enterprise Surveys the manufacturing and service industries are defined according to version 3.1 of the United Nation's International Standard Industrial Classification of All Economic Activities (ISIC). The manufacturing industry corresponds to ISIC codes 15 to 37 while the service industry encompasses ISIC codes 45, 50 to 52, 55, 60 to 64, and 72.

