NATIONAL COUNCIL OF BHUTAN

Review of the Foreign Direct Investment Policy 2010 and impact of Foreign Land Ownership

Issues and Concerns

DRAFT

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This document contains a review of the FDI Policy 2010 and detailed study on the impact of foreign land ownership. Since the FDI Policy 2010 was adopted as a supporting policy for the Economic Development Policy (EDP) 2010, it is would be important to read the National Council's review of the EDP 2010 first to get a holistic perspective of this review of the FDI Policy.

Background

The Economic Affairs Committee of the National Council is pleased to provide a review of the Foreign Direct Investment Policy 2010 with emphasis on impact of foreign land ownership. The review is based on the mandate provided for in the Constitution of Bhutan and the National Council Act under the following articles:

Article 10.2 of the Constitution provides the basis for parliamentary review of executive functions when it says: *"Parliament shall ensure that the Government safeguards the interests of the nation and fulfils the aspirations of the people through public review of policies and issues, Bills and other legislations, and scrutiny of State functions."*

The Constitution in Article 11.2 also confers specific additional powers on the National Council to *"act as the House of review on matters affecting the security and sovereignty of the country and the interests of the nation and the people that need to be brought to the notice of the Druk Gyalpo, the Prime Minister and the National Assembly*".

The Article 7 of the National Council Act states that:

"The National Council shall ensure that the Government safeguards the interests of the nation and fulfills the aspirations of the people through public review of policies and issues, Bills and other legislation, and scrutiny of State functions."

Further Article 10 of the National Council Act highlights the review function of the National Council as follows:

"In exercising its review function, the National Council shall:

a) Review and comment on the policies, plans and programmes of the government;
b) Review performance of the government;
c) Review implementation of resolutions and laws; and
d) Review issues of national importance."

This FDI Policy review with special and specific emphasis on land ownership for foreign companies is undertaken in as per Article 10 sections a and d of the National Council Act.

Contents

Summary

The FDI Policy 2010 is a significant departure from the FDI Policy 2002, as it provides more liberal conditions for entry of foreign investors. The highlights of the new policy are: 100 percent foreign ownership in priority sectors; the "negative list" approach, which provides the possibility for foreigners to invest in all except for 16 areas (see Annexure I); allowing FDI land ownership; liberal issuance of work permits for expatriates, etc,.

The FDI Policy 2010 is an indication of the government's growing confidence to liberalize the economy as well as the need to supplement the development efforts of the government with international private sector participation. Foreign investment steered in the right direction can be beneficial to the economy as a purveyor of capital, technology and skills and it can stimulate growth, employment and social development. However, FDI is not a panacea for all development challenges because if it is not aligned to the country's development priorities and if not managed properly, it can also create irreversible social, economic and environmental problems.

In the past, Bhutan has not been able to attract FDI. For example, a press report in May 2008 indicated that since 2002 about eleven projects worth US$ 57.595 million (Nu 2,298.41 million), mostly in the manufacturing sector, had been approved.[1] However, another report in September 2008 showed that of the eleven only four FDI businesses were operational [2] indicating that, in general Bhutan has not been successful in attracting FDI. Likewise, the benefits of FDI are also not very clear. Government officials have admitted that there has been weak monitoring of the benefits of FDI, whether in terms of quality of employment or convertible currency generation or creating domestic business linkages.[3]

It would be worthwhile to determine if this lack of success in the past had to do with the restrictive policies of the past or whether it was due to weakness in the fundamental economic conditions that are not conducive to business growth in general. If the latter, the solutions to the problem of attracting FDI do not lie only in proposing a highly liberal FDI regime but also require a separate set of solutions that are within the domestic policy realm.

As the nation embarks on a bold new FDI policy, it is important to reflect on the past experience and also outline clear objectives for the FDI policy including its link to economic development and poverty alleviation aligned closely to the existing Bhutanese context.

This document seeks to review the FDI Policy 2010 and comprises two main sections, as follows:

Part I. Review of the FDI Policy 2010

Part II. Review of the Impact of Foreign Landownership on Bhutan.

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[1] Kuensel, FDI projects in Bhutan, *Foreign shareholdings double those of locals,* 5 May, 2008,
[2] Kuensel, The benefits of FDI, *Consultant commissioned to study impact of foreign investment*
6 September, 2008.
[3] Ibid..

Part I. Review of the FDI Policy 2010

Introduction

To ensure that FDI is beneficial for Bhutan there must be very clear linkages between FDI Policy and the development objectives and economic constraints and challenges that Bhutan faces. A comprehensive FDI policy must take into account Bhutan's factor endowments (skills, natural resources, capital) and its development objectives (poverty reduction, growth, job creation, balance of payments, currency reserves, etc,).

This section assesses if the FDI policy is indeed consonant with Bhutan's development objectives and highlights some issues of concern followed by a set of recommendations.

A. FDI Policy and National Development Objectives Linkages

A policy document such as the FDI policy 2010 must articulate clear objectives for inviting FDI into Bhutan. The objectives must be aligned to the broader development needs and objectives of the country to ensure that the beneficial effects of FDI are maximized and the negative socio-economic and environmental consequences are minimized. Without outlining clear objectives, the current policy assumes a rather narrow and uni-dimensional view of FDI as mere capital flows and does not acknowledge the possible accompanying benefits which include technology and skills transfer, employment potential, etc.

The FDI Policy 2002 clearly articulated a set of objectives that included, among others, private sector development, employment generation, skills development, enhance convertible currency earnings, etc,. A set of clear objectives will be useful to develop indicators to see if the policy is aiding the attainment of the objectives. For example an objective such as employment generation can be measured by indicators such as jobs created, similarly convertible currency earnings can be measured by net capital inflow and skills development by trainings conducted.

However, the FDI Policy 2010 does not have a set of objectives that it seeks to attain nor does it state how FDI will contribute to economic development. For example, Section 1., on Policy Statement of the FDI policy broadly states that:

"The nation's long term development is guided by the concept of maximizing Gross National Happiness. The spirit and intent of this concept as articulated in the Bhutan Vision 2020 document is to "maximise the happiness of all Bhutanese and to enable them to achieve their full and innate potential as human beings." This is envisaged through the adoption of policies and programs that operationalizes the four pillars of GNH namely sustainable socio-economic development, conservation of natural environment, preservation of culture and good governance.

In pursuance of the above, the Royal Government adopts the FDI Policy 2010 to achieve the objectives as set out in the Economic Development Policy 2010."

The Objectives set out in the Economic Development Policy (EDP) 2010, stated in Section 5.a, are as follows:

> *5.1 Achieve economic self-reliance by the year 2020.*
> *5.2 Full employment (97.5%).*

The review findings of the EDP 2010, conducted by the Economic Affairs Committee of the National Council, show that the above objectives set out in the EDP are very broad and contextually removed from Bhutan's current reality. For example, the EDP review recommends a clearer and precise definition of economic self-reliance. Further, the objective of full employment has already been statistically achieved in Bhutan and this measure does not help in addressing the unemployment issue. Therefore, a more relevant objective of the FDI policy would be to provide gainful employment in skilled and semi-skilled sectors and opportunities to earn higher wages from improved productivity.

A reliance on the EDP objectives may not be helpful as the EDP is a comprehensive document whose objectives can only be attained through the collective attainment of many other policies. Hence there is every possibility that reasons for not attaining the objectives of the FDI policy could be attributed to failure of other policies. This could hamper monitoring and accountability.

In the FDI Policy, section 2. on FDI Focus Areas states that:

The FDI shall be encouraged in areas that contribute to the following;

- *i) Development of green and sustainable economy*
- *ii) Promotion of socially responsible and ecologically sound industries*
- *iii) Promotion of culturally and spiritually sensitive industries*
- *iv) Investments in services that promote Brand Bhutan*
- *v) Creation of a knowledge society*

This section reads like the desired outcomes of the FDI policy and not the objectives of the policy. This is because there is every possibility that all the above could occur even with a loss of employment.

Therefore, for the purposes of monitoring and assessing the impact of FDI policy, it is important for the FDI policy to articulate a clear set of objectives that could have links with the EDP objectives but that could also stand by itself. Such clarity will help in setting targets and indicators to review and monitor the impact of FDI in the future.

B. Issues of Concern

This section highlights issues of concern pertaining to the FDI Policy 2010. Considering the negative impacts of the proposal in the FDI Policy to allow foreign companies to own land in Bhutan, the Committee has decided to present this issue in a separate section as it deserves greater attention. The following are some of the general concerns:

1. Allowing 100 percent ownership:

The FDI policy allows 100 percent foreign ownership in selected "priority" areas related to the services sector. This includes: education, health, 5 Star hotels and resorts, infrastructure, research and development etc. (See Annexure II for full list)

Full ownership is an important consideration for investors, but for Bhutan as the host country, it would be important to ensure that there are direct and measurable benefits for Bhutan as well. The need for joint venture arrangements enables domestic investors to have an equity stake in the FDI project, thereby widening benefits and ownership. It would be useful to know if the lack of success in attracting FDI to Bhutan has been determined by ownership restrictions under the previous policy regime.

In some countries, 100 percent ownership is often linked to performance conditions in order to ensure that FDI contributes meaningfully to economic development goals. For example, in Malaysia, 100 percent ownership is allowed for manufacturing companies which would export 80 percent of their output. The foreign equity ratio is directly related to the proportion of export[4]

2. Minimum Investment Size.

The FDI policy sets minimum project cost for priority areas in both manufacturing and services sector ranging from Nu. 5 million in Head Office Services to Nu. 200 million in health, education and infrastructure sectors. Similarly, the size ranges from Nu. 20 million in agro and forest based sectors to Nu. 50 million in other priority manufacturing sectors. (see Annexure II) For all other sectors the minimum project size stipulated is Nu 25 million for services and Nu. 50 million for the manufacturing sector.

The rationale for setting a minimum threshold on project size limits is to protect smaller size projects that can easily be taken up by local firms. As per the FDI policy, FDI companies which are allowed 100 percent ownership in sectors like health, education and infrastructure also have to bear high minimum project cost such as Nu. 200 million. This link ensures that companies with total ownership also have to bear higher project costs and have a greater stake in their investment in Bhutan.

[4] Investing in Malaysia: Current Rules, Incentives, Requirements, East Asian Executive Reports, Vol. 18 No. 7 (1996), pp. 13 – 21.

While this link is commendable, it would be useful to know if the project cost also includes cost of land and working capital. Otherwise, a large part of the cost will be sunk into the cost of buying land and could skew the investment pattern. Similarly, if working capital is included in the project cost, then in the manufacturing sector a sizable portion of the investment could be absorbed in the working capital. This would leave lesser amounts for actual investments in technology and training.

3. Crowding out effect.

Section 5.4 on Local borrowing states that:

"FDI company may borrow from financial institutions in the country and the debt-equity ratio shall be as per the provisions of the Royal Monetary Authority (RMA)'s prudential regulations. However, the investors may put in higher equity if they so desire."

This provision needs to be examined closely because in case of large volume borrowing by FDI companies, it could crowd out domestic businesses from the credit market. For example, in a small economy with a nascent financial sector like that of Bhutan, if foreign investors borrow from local financial institutions, this could lead to a rise in interest rates making borrowing more expensive for domestic firms. Due to such concerns, countries such as Chile, which have generally liberal FDI policies, do not allow domestic banks to lend to FDI.[5]

A liberal FDI regime can also crowd out domestic investment by partaking in business opportunities that would otherwise have been taken by domestic enterprises. A concern in this respect was expressed during the EDP consultations by the Hotels Association of Bhutan pertaining to allowing 100 percent ownership in 4 Star hotels in Bhutan.

Section 5.2 on Incentives and exemptions states that:

The FDI companies shall be entitled to the incentives and exemptions as provided by the Royal Government to similar domestic investments, unless specified otherwise in this Policy.

On one hand this looks like a justifiable proposition to provide level playing field to the foreign investor. On the other hand, it can lead to crowding out of domestic firms when they do not enjoy additional advantages compared to foreign investors.

In the long run there is also a concern about foreign companies using predatory pricing policies to force local competitors out of business. Hence the need for a strong competition policy and mechanisms to monitor such undesirable developments.

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[5] Xiaolun Sun, Foreign Direct Investment and Economic Development, What Do the States Need To Do? Foreign Investment Advisory Service, 2002

4. Exceptions Clause

One of the main purposes of a policy document is to provide transparency and predictability in government policies so that foreign investors and domestic partners/investors have confidence in the investment regime. However, this is undermined by the Exceptions clause in Section 12 which states that:

" The Royal Government reserves the right to permit FDI under terms and conditions that may be different from those specified herein. When such exceptions are made, the nature of the exceptions and the rationale for making them will be made public at the time they are granted."

The fact that such exceptions are permissible under the policy is sufficient to undermine the transparency of the investment regime and provides ample room for the development of a business-politics nexus and collusion among the elite. There are already growing concerns in the country about such decisions that are taken without a proper policy framework in place.

Further the fact that the rationale for such decisions is made public only at the time of granting the project does not help. Even if there is a public outcry and objection to such a project, it is a *fait accompli* and too late to annul the deal because by that time considerable investments would have been made in feasibility studies and other costs. In the broader interest of transparency and accountability, this clause should be revoked from the FDI Policy.

5. Need for uniform standards

The FDI policy clearly defines the negative list, the restrictive list and the priority list including stipulations on the minimum project cost and permissible equity holdings. However, Section 3.1 on "Sectors Open for FDI" states that:

"The Royal Government shall allow FDI in both manufacturing and service sectors. These shall be governed by project specific agreements (if any) and sector specific policies, standards and procedures."

This clause provides a high degree of discretion to the administering agencies and the government. It would be useful to set broad minimum standards and procedures that all FDI should meet in terms of employment generation, technology transfer, environment norms, etc. This is because sector specific policies could vary widely and may not necessarily be aligned to Bhutan's development realities or needs. For example, little is known about the Hazelnut project, and what sector specific policies were in place to allow such a project.

Experience of other countries has shown that high degree of policy discretion could also compromise transparency and lead to sector policies being framed at the behest of large Multi National Corporations or their local partners who are usually well connected with the domestic elite.

6. Access to Land.

Section 5.10 titled "Access to Land" seeks to allow foreign land ownership and for local partners to capitalize land as their equity contribution.

It states that:

"Land or space for establishing FDI business shall be available either on lease or ownership based on the provisions of the Land Act of Bhutan, 2007 and amendments thereto. Local partners shall be allowed to capitalize land as their equity contribution."

As this is a sensitive issue and deserves greater attention it is dealt separately in the next part. However, this section also states that:

"*Local partners shall be allowed to capitalize land as their equity contribution*."

If this is allowed, it will be important to ensure that the local partner has at least 51% ownership. For example, in the Philippines only Filipino citizens and corporations or partnerships that are at least 60% Philippine owned are entitled to acquire land in the Philippines."[6] Similarly in India a company with more than 50 percent local holdings and able to appoint a majority of its board members is now considered an Indian company following India's new FDI policies.[7] This is an important avenue through which FDI companies may own land to facilitate their businesses, but local partners have overall control of the company.

7. Bilateral currency arrangements

Section 3.5. on Currency of Investment states that:

"FDI shall be made in convertible currency, unless provided otherwise by bilateral arrangement. In cases where such exceptions are granted by bilateral arrangement, the foreign exchange requirement for the establishment and operation of the business must be met from the company's own sources of foreign exchange."

In this section it would be vital to clarify if the "bilateral arrangement" is made between the foreign investor and local investor, or the home country of the foreign investor and Host country Bhutan.

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[6] http://www.real-estate-ph.com/title_ownership.php

[7] http://www.india-briefing.com/news/oversight-body-enforce-fdi-ban-2818.html

8. Legislation

Section 15. states that" *The Royal Government* *may* *enact Foreign Investment Promotion Act based on this policy."*

This policy statement should be revised as follows:

"*The Royal Government* *shall submit to the Parliament* *to enact a Foreign Investment Promotion Act."*

This is a vital revision for the following reasons:

Firstly, it must be emphasized that according to Article 10.1 of the Constitution, all legislative powers under the Constitution are vested in the parliament and not the government.

Secondly, an Act pertaining to FDI is necessary because Article 14.15 of the Constitution states that : "*Trade and Commerce with foreign nations shall be regulated by law*."

Thirdly, a law related to FDI is necessary to ensure that the following provisions of the Constitution are respected"

Article 9.9. "The State shall endeavour to achieve economic self-reliance and promote open and progressive economy."

Article 9.10. "*The State shall encourage and foster private sector development through fair market competition and prevent commercial monopolies*."

Finally, legislation that will provide a legal basis for FDI is not only desirable but also necessary to give confidence to foreign investors that Bhutan is serious about attracting investment. An Act will also contain detailed legal frameworks which will cover areas beyond the scope of a policy document.

9. FDI in sensitive border areas

The FDI policy must articulate a clear stand on investments in sensitive border areas. Investments made close to border areas coupled with 100 percent ownership and the proposal to allow foreign land ownership would have a negative bearing on the security of the country. It would also impact on cross border population movements and lead to other undesirable social and political complications.

C. Recommendations

Based on the review of the FDI policy, the Committee would like to make the following recommendations:

1) The FDI policy must set clear objectives that are linked to the development needs and philosophy of Bhutan. Clarity of objectives will help to develop indicators and targets that will enable proper monitoring and review in the future.
2) The policy should consider setting some kind of performance requirement for FDI companies that are allowed to own 100 percent equity.
3) The policy should clarify if the minimum project cost includes the cost of land and working capital. It is recommended that these two not be included in the project size as the benefits of capital and technology inflow would be minimized considering the relatively high cost of land in parts of Bhutan and the need for large working capital outlays for many manufacturing sectors.
4) The policy should ensure that adequate provisions are made to avoid crowding out of local firms from access to finance and markets.
5) The government should consider submitting to the Parliament a Competition Bill to ensure that FDI does not lead to the emergence of monopolies in Bhutan.
6) Revoke section 12 of the Policy which provides a high level of discretion to administering authorities thereby undermining policy transparency and good governance.
7) The policy should set certain minimum performance requirements so that sector policies that are developed, as per Section 3.1, do not vary widely from each other and provide some degree of uniformity and predictability.
8) If local partners, for lack of adequate capital as equity, are allowed to provide land as equity, the policy should ensure that in this situation, the local partners have a majority control of the company.
9) The provisions of Section 3.5 on bilateral currency arrangements need to be clarified.
10) The government should consider submitting to the Parliament a Bill for Promotion of FDI to provide a sound legal basis for foreign investments.
11) The policy should take a clear stand on investments in sensitive border areas.
12) The policy should explicitly mandate the Gross National Happiness Commission to develop indicators and targets and monitor FDI performance against these parameters.

Part II. Review of the Impact of Foreign Landownership.

Introduction

Marking a major social, political and economic policy shift from the past, the Foreign Direct Investment Policy 2010 seeks to allow FDI businesses to own land in Bhutan.

Section 5.10 FDI Policy 2010 on Access to land states that:

> "*Land or space for establishing FDI business shall be available either on lease or ownership based on the provisions of the Land Act of Bhutan, 2007 and amendments thereto. Local partners shall be allowed to capitalize land as their equity contribution*."

The above statement is a further elaboration of the Economic Development Policy 2010, Section 7.1.17 states that:

> *"As provided in the Land Act 2007, businesses shall be allowed to register land in the name of the company. In case of FDI, this will enable the local investors /promoters to put land as equity component."*

The National Council recognizes that FDI could play a beneficial role in promoting private sector development. However, it is vital to ensure that the FDI policy is aligned to Bhutan's development needs and context and is not driven by large corporate interests, whether it is local or of foreign origin.

This paper seeks to analyze the Foreign Direct Investment Policy 2010 with a particular focus on the issues and concerns pertaining to allowing FDI businesses to own land in Bhutan.

This paper is divided into the following sections:

Section I	Importance of land in developing countries in predominantly agrarian economies with particular emphasis on Bhutan.
Section II:	Legal aspects of foreign land ownership.
Section III:	Is Landownership necessary to attract FDI?
Section IV:	Socio-economic and political consequence of Foreign land ownership
Section V:	Conclusion and recommendations

This study show serious socio-economic and political implications from foreign land ownership and urges the government to revoke the clause that allows foreign land ownership.

Section I: Significance of land ownership

From a conventional economics standpoint land, narrowly interpreted, is seen simply as a factor of production along with capital, labor and technology. However for developing countries, in particular agrarian societies like Bhutan, land is the single most valuable asset which provides food security, community and national identity, cultural inspiration and the basis for values and traditions.

From a global perspective land (defined in the wider sense of land and the immovable property fixed to land) is viewed as having the greatest proportion of natural capital in low income countries as shown below. Land also ranks as the highest asset across all three income brackets, underscoring the fundamental importance of land.

The Composition of Natural Capital (High Oil Exporters Excluded)

	Low income Countries	Middle-income Countries	High-income Countries
Land	75	61	50
Timber	8	8	10
Subsoil	17	31	40

Source: World Bank, World Development Report 1989, page 87, as cited in Tony Burns, Land Administration Reform: Indicators of Success and Future Challenges, World Bank, Washington DC 2007

Although Bhutan's economy has been transformed over the last half century, more than 65 percent of the population continues to depend on agriculture for its livelihood. A vast majority of the population living in urban areas continues to relate directly to the rural life of farms and as part of vibrant rural social and cultural communities that define the essence of what it means to be a Bhutanese.

In the context of a modern economy, land is also a source of collateral for obtaining loans and is perhaps the most important store of value, considering the appreciation of land value over the last two decades. Current estimates show that only about 7 percent of the country's total land area is arable, and this ratio is declining as more agriculture land is lost to urbanization, industrialization and infrastructure development.

As a vital and scarce resource, land ownership and land use continue to be major causes for some of the most intractable conflicts among family members, between communities or even between countries. Land and land-related cases are most common cases in the courts, and it is reported that "land issues are the single most pervasive problem for Bhutanese of all walks of life."[8]

[8] Kuensel His Majesty to visit East 4 March 2009, Thimphu, Bhutan

This socio-economic and political importance of land has been well recognized in Bhutan. One of the major initiatives undertaken by His Majesty the King has centered on people's access and ownership of land. The cardinal importance of land for the Bhutanese people was most appropriately stated by His Majesty in 2009:

> *"We must do everything to ensure that our limited arable land is of greatest benefit to the people and their children. Land must bring social, economic and political strength to the people. It must give them a stake in the building of a strong nation and a vibrant democracy. It must help build strong citizens because strong citizens mean a strong Bhutan."*
>
> *"My heart aches to learn that some parents are facing immense difficulties in sending their children to school. Use your land to educate your children, to nurture them and to build prosperous lives and a bright future for yourselves."*[9]

The importance of land for the people was further underscored by His Majesty the Fourth Druk Gyalpo during a public meeting in Mongar:

"*The land Kidu was granted because His Majesty felt that as an agrarian society, land is the primary asset of our people.*"[10]

The royal pronouncements indicate the importance of land not only to sustain livelihood but also to further foster social and economic progress for a strong, secure and sovereign country.

[9] Tshering Palden, A Promise kept, Kuensel, 14th March 2009, Thimphu, Bhutan
[10] Kuensel, Drukgyal Zhipa addresses the people of Mongar, 6 February 2010

Section II: Foreign Land Ownership and Laws of Bhutan.

The media in Bhutan have raised the point that the laws of Bhutan may permit foreign businesses to own land in Bhutan. This is largely based on the assumption that any business entity, foreign or local, that is incorporated under the Companies Act of Bhutan 2000 is automatically a Bhutanese legal entity.

This section briefly explores the question whether FDI land ownership is consonant with the laws of Bhutan. It also elucidates relevant provisions of the FDI Policy 2002.

<u>Foreign Direct Investment (FDI) Policy 2002, Section 7.f.</u>

"Land or space for establishing business premises by foreign investors will be made available on lease by the Royal Government or private sector promoters."

<u>Foreign Direct Investment (FDI) Policy 2010 Section 5.10</u>

"Land or space for establishing FDI business shall be available either on lease or ownership based on the provisions of the Land Act of Bhutan, 2007 and amendments thereto. Local partners shall be allowed to capitalize land as their equity contribution."

<u>Constitution of Bhutan, 2008, Article 7.9</u>

" A Bhutanese Citizen shall have the right to own property but shall not have the right to sell or transfer land or any immovable property to a person who is not a citizen of Bhutan, except in keeping with laws enacted by Parliament."

<u>Land Act of Bhutan 2007 Chapter 4.58:</u>

"*The Juristic Persons who are entitled to own land in the Kingdom of Bhutan are ……..*

(f) Corporations"

<u>Land Act of Bhutan 2007 Chapter 4.68:</u>

"*The land ceiling in Section 64 of this Act shall not apply to the land registered in the name of……(f) Industrial land beyond 25 acre ceiling, provided that the industrial land exceeding 25 acres is registered in the name of a Corporation*."

<u>What is industrial land?</u>

Land Act of Bhutan 2007: "*Industrial land means registered land for construction of industrial establishments, industrial areas, export processing and other concentrated production areas, and the land where mineral exploration and processing are located. These activities are subject to any law governing industries and mining*."

Land Act of Bhutan 2007 Chapter 5.75:
"*The land of a corporation shall be registered in the name of a corporation registered under the prevailing Company's Act of the Kingdom of Bhutan, or, in the name of the body corporate established under the relevant law*."

Companies Act of the Kingdom of Bhutan 2000

The Companies Act which was enacted in 2000, before the first FDI Policy was released in 2002. Therefore, there is no reference to foreign companies and it does not defines what a foreign company is compared to a local company. While assumptions are made that a foreign company registered under the Companies Act is a domestic legal entity, there are no provisions in the Companies Act that explicitly state so.

Assessment:

An assessment of prevailing laws and polices indicates that apart from an explicit statement in the FDI Policy 2010, the legal basis for FDI businesses to own land in Bhutan is fuzzy at best.

A sequential analysis of policies and laws including the Constitution shows that the present assumption that foreign businesses can own land is largely an unintended consequence of a lack of sequential and legal coherence.

For example, the Companies Act was passed in 2000 and the first FDI policy was adopted in 2002. The Land Act was amended in 2007, the Constitution signed in 2008 and the new FDI policy adopted by the Cabinet in 2010.

From this sequence of adopting policies, enacting and amending Acts, it is clear that the provisions pertaining to land ownership by corporations in the Land Act 2007 was based on the FDI Policy 2002 which did not allow foreign companies to own land. In view of the new developments on the FDI policy front, there is an urgent need to review and amend the Companies Act and the Land Act.

It would also be insightful to read the verbatim reports and proceedings of the National Assembly session 2007 and the parliamentary debate on the Constitution held in 2008 with reference to the clauses outlined above. This would provide a clear picture of the spirit and intent of the various provisions that pertain to land ownership and particularly foreign land ownership.

Section III: Is Foreign Landownership necessary to attract FDI?

One of the explanations given for FDI land ownership is that it is necessary to attract foreign investment. This section seeks to explore that assumption.

III. A. Foreign Land ownership and the Objectives of the FDI Policy

Section 2 of the FDI Policy states the objectives of the FDI policy as follows:

1. *Development of green and sustainable economy*
2. *Promotion of socially responsible and ecologically sound industries*
3. *Promotion of culturally and spiritually sensitive industries*
4. *Investments in services that promote Brand Bhutan*
5. *Creation of a knowledge society*

An examination of the objectives above shows that Bhutan seeks to promote environmentally friendly business sectors that are culturally sensitive and service oriented. A survey of existing literature shows that it is not necessary to allow foreign land ownership to meet Bhutan's FDI Policy objectives:

1) Studies by the World Bank have shown that land ownership is not a critical consideration for FDI attractiveness provided that the country has a strong rule of law and the law provides for foreign companies to operate their business on leased land.[11] For example, Thailand and Indonesia do not allow foreigners to own land. Thus foreign companies lease land from private citizens. All the land in Tanzania and Zambia is held by the government on behalf of the people. Thus, foreign companies cannot own land and must get the land on long term lease from the government.

2) The experience of Vietnam and China demonstrate that land ownership is not the most critical factor to attract FDI. These two countries have attracted billions of dollars in investment and created employment for their population without allowing FDI companies to own land.

3) The World Bank conducted "Enterprise Survey" also indicates FDI companies seek to own land where it involves capital intensive investment in heavy industries such as chemical and heavy metal industries, heavy machinery etc. According to the EDP and the objectives of the FDI outlined above, Bhutan does not seek to promote such industries.

4) It is clear that Bhutan seeks to promote FDI in the services sector. The data from the Enterprise Survey shows that 60 percent of the majority foreign owned companies

[11]World Bank Enterprise Survey: http://www.enterprisesurveys.org/

surveyed held land on lease contacts in the services sector. This indicates that ownership per se it not a critical and determining factor to attract FDI especially in the service sector. In the case of Bhutan, foreign land ownership was not a requisite for service sector investment so far. For example, the Aman and Uma Hotels are on leased land and the IT park is also built on leased land.

5) Experience from other countries show that, wherever lease hold is an option, FDI businesses prefer to lease land to protect against: expropriation risk (as experienced in Venezuela)[12] and currency devaluation an economic risk and long term exposure to economic crises(as experienced in Dubai).[13]

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[12] Venezuela Nationalizes French retail Chain, Jnauary 2010. http://online.wsj.com/article/SB10001424052748703569004575009420323919964.html

[13] Dubai Property "Investors Could Lose Everything" http://www.thedubailife.com/home/news/business-finance/dubai-property-investors-could-lose-everything

III.B. Foreign land ownership and Investment Attractiveness.

A survey of existing literature shows that there are many other factors other than land ownership that determines FDI attractiveness. The two tables below list key determinants and factors associated with the extent and pattern of FDI.

Host country determinants of FDI

A. Economic conditions

1. Markets (Size; income levels; urbanization; stability and growth prospects; access to regional markets; distribution and demand patterns.
2. Resources (Natural resources; location).
3. Competitiveness (labour availability, cost, skills, trainability; managerial technical skills; access to inputs; physical infrastructure; supplier base; technology support).

B. Host country policies

1. Macro policies (Management of crucial macro variables; ease of remittance; access to foreign exchange).
2. Private sector (Promotion of private ownership; clear and stable policies; easy entry/exit policies; efficient financial markets; other support).
3. Trade and industry (Trade strategy; regional integration and access to markets; ownership controls; competition policies; support for SMEs).
4. FDI policies (Ease of entry; ownership, incentives; access to inputs; transparent and stable policies).

C. Multi National Enterprise strategies

1. Risk perception (Perceptions of country risk, based on political factors, macro management, labor markets, policy stability).
2. Location, sourcing, Company strategies on location, sourcing of products/inputs, integration of affiliates, strategic alliances, training, technology transfer.

Source: Sanjaya Lall, Attracting Foreign Investment: New Trends, Sources and Policies, Economic Paper 31 (Commonwealth Secretariat, 1997) in Wan-Choo, Joong, Investment Promotion and Enterprise Development Bulletin for Asia and the Pacific, w.unescap.org/tid/publication/chap5_indpub2259.pdf

In 2001, the Multilateral Investment Guarantee Agency of the World Bank conducted a study to assess the following:

- Key business objectives behind FDI decisions;
- Countries and regions of the world that are most attractive to investors; and
- Key factors and considerations that influence companies' location strategies.

The findings of the study, which covered 191 companies, revealed that there are more important considerations other than land ownership when companies make investment decisions:

TOP 20 CRITICAL LOCATION FACTORS, percent cited as "very influential" for investment decisions.

1	Access to customers	77
2	Stable social and political environment	64
3	Ease of doing business	54
4	Reliability and quality of infrastructure and utilities	50
5	Ability to hire technical professionals	39
6	Ability to hire management staff	38
7	Level of corruption	36
8	Cost of labor	33
9	Crime and safety	33
10	Ability to hire skilled laborers	32
11	National taxes	29
12	Cost of utilities	28
13	Roads	26
14	Access to raw materials	24
15	Availability and quality of university and technical training	24
16	Available land with all services in place	24
17	Local taxes	24
18	Access to suppliers	23
19	Labor relations and unionization	23
20	Air service	23

Source: FOREIGN DIRECT INVESTMENT SURVEY, A Study Conducted by Multilateral Investment Guarantee Agency and Deloitte & Touché LLP, January 2002

As shown in the table above, there are at least 12 other overriding factors more important than access to land, when companies consider investment in a particular location. Major determinants location for FDI are: market access, infrastructure and availability of skilled human resources that are competitive in terms of wages.

Taking a cue from this table, it would be vital for Bhutan to invest in infrastructure, education and training and other factors the contribute to an enabling environment for the private sector rather than rushing to provide foreign land ownership rights if the country wants to attract foreign investment.

Section IV. Consequences of Foreign land ownership

Allowing foreign land ownership coupled with the provisions in the Land Act which allow corporations to hold unlimited amounts of land will lead to land concentration in the hands of a few individuals, families and businesses, and will be highly detrimental to social stability and peace. Thus far the land ceiling set at 25 acres has by and large ensured that such a valuable resource was not concentrated in the hands of a few.

However, Chapter 4.68 of the Land Act of Bhutan 2007, totally undermines this in the name of corporate and business interests: "*The land ceiling in Section 64 of this Act shall not apply to the land registered in the name of......(f) Industrial land beyond 25 acre ceiling, provided that the industrial land exceeding 25 acres is registered in the name of a Corporation*."

This clause provides for practically unlimited holdings for local corporate elite and foreign business interests.

This section highlights some of the consequences of these provisions of the Land Act and the FDI policy.

1. **Loss of control over territory.** The jurisdiction and powers of government (which represents the will of the people) are often defined by the control it has over the national territory. Foreign ownership of land could complicate the sovereign control as FDI businesses are often based on legally binding bilateral, regional or international investment agreements. If the FDI agreements are not scrutinized professionally, there is every possibility that the state could lose legal cases with foreign business when it comes to control over the land.

2. **Politics-Business Nexus**: Evidence from other developing countries (and a quick glance at FDI partnership in Bhutan) shows that in most cases the foreign investors invariably partner with the elite of the host country. Both local and foreign businesses also have or develop a strong nexus with the local social and political elite. Such a nexus leads to policy influences through lobbying where the overall interest of the nation and the people could be undermined severely. When such policy decisions affect a scarce and precious resource such as land, it is inevitable that conflicts will arise due to land concentration.

3. **Landowner-Politics Nexus**: The provisions of the Land Act that allow unlimited land holdings in the name of corporations could also lead to unhealthy nexus between politics and large landowners. There are media reports that in some countries large landowners have joined politics to control and protect their interests. In such systems where the formal political system is designed to protect the large landholders, the poor often respond through violent movements inspired by left wing ideologies leading to social and political instability.

4. **Foreign Economic Domination:** Unlimited foreign land ownership will disadvantage local businesses in the long run. Considering the access to capital that that FDI businesses have, they can purchase prime land whether it is for constructing hotels, industrial estates or to erecting tele-communications towers. The foreign companies with ownership of prime property will displace local enterprises and constrain their growth. Considering Bhutan's development path and structural constraints, it is likely that Bhutan will benefit most from promoting small and medium enterprises and focusing on the services sector. In light of this fact, access to land must be ensured for locally owned small and medium enterprises to expand in the future.

5. **Food Security**: Currently it is estimated that only 7 % of the land in Bhutan is arable. Every year this ratio is diminishing due to demand for land to develop infrastructure (such as roads and schools) housing, and industrial purposes. Allowing FDI and removing the land ceiling for corporations would greatly reduce arable land leading to greater food insecurity.

6. **Environment Consequences**: One of the reasons given for removing the land ceiling is to enable large scale commercial farming. However, such farms are set up to meet export demands and often do not contribute to domestic food production. The recently announced Hazelnut project (covering 20,000 acres) will produce hazelnuts for use in chocolates, beverages etc. Large scale commercial farming for export has social, economic, environmental and political consequences if considerable precautions are not taken. For example, commercial farming promotes monoculture, which has an impact on genetic diversity and possible negative consequences through introducing a new foreign species into the local eco-system, risk of losing single crops to pests and diseases, conflict with local farmers on water use rights etc. Further, since the hazelnut project is geared for export with little value addition locally in Bhutan, it may not contribute to employment generation and may further reduce food security. Moreover, prices of internationally traded commodities are exogenously determined by factors beyond the control of the Bhutanese people and society thereby exposing our farmers to the vicissitudes of the international commodities market.

7. **Impact on Poverty**: Land is not just a factor of production; it is also a store of value and serves as collateral for loans. Allowing foreign landownership will lead to a flurry of land transactions which will induce most people to sell their land and therefore part with an asset that secures their future wellbeing. Current experience shows that land sale has fuelled conspicuous consumption (such as procurement of large four wheel drive vehicles, imported bows and arrows, large TV sets, etc,.) and many farmers have been left with little savings or investments. This is further exacerbated by the fact that currently land prices outside urban areas are suppressed due to underdevelopment and laws that restrict conversion of land types. Thus rural people who sell their land may be shortchanged as the true value and potential of that land may be underestimated under current circumstances. Such actions have a long term

impact on poverty and increase intergenerational inequity as the present generation sells assets and consumes the returns.

8. **Xenophobia:** Land concentration in the hands of a few, whether individual or corporate bodies, will in time lead to social unrest, as evident from historical experience related to conflicts over a highly valuable asset such as land. If large tracts of land are held by those perceived to be outsiders or foreign, then this could lead to intolerance and xenophobia, a tag that a GNH promoting and seeking country like Bhutan may well like to avoid.

9. **Inflation:** One of the most immediate economic consequences of allowing foreign land ownership and removing the land ceiling is widespread speculative pressure which will cause inflation in land costs as well as other commodities and rents. While it will benefit the land sellers, this will have an undesirable inflationary impact on the cost of living. This inflationary pressure will hit the poor the hardest as they have little or no means to cushion the impact.

10. **Impact on rent and home ownership:** The high demand for land, especially in the urban areas, has led to speculation and ever escalating real estate prices. Recently the National Pension and Provident Fund, a para-statal agency declared that land in Thimphu "was scarce and unaffordable" and this affected their plans to construct housing for their members.[14] High land cost has led to high rents and this has hit the lower and middle class people the most as they live in rented properties. Unfortunately, this has also forced many Bhutanese in the border towns to live on the Indian side for the border, compromising their welfare and security. Allowing foreign land ownership in Bhutan will further drive prices higher and worsen the existing situation.

11. **National Security:** In the long term, land concentration and foreign land ownership will impact national security and sovereignty. Today, it is the desire of every Bhutanese person to build and own a home as a source of emotional well being and financial security and as an asset to bequeath to one's children. The importance of home ownership was best highlighted in His Majesty's Kasho[15] which states:

> *In order for democracy to flourish and take unshakeable root in our small, landlocked nation, my hope is that every single citizen will have the opportunity to own a home of his or her own, and become an equal partner in, and beneficiary of, the nation's progress and growth.*

Allowing foreign ownership and removing the land ceiling will cause land prices to escalate further. This will price out the local people from ever being able to own land to build a house. We must recognize that one of the best ways to secure loyalty is for people to have a stake in the economy and country. Landownership is perhaps one of the most important sources for ensuring long term loyalty and national pride.

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[14] Bhutan Today, When there is no land, June 01, 2010, Thimphu, Bhutan
[15] Wangchuk Samten, "Making sand and stone affordable." Kuensel, 16th June 2007

Conclusion

"*If GNH is about creating a happy, peaceful, prosperous and harmonious Bhutan, land, which is a basic necessity towards building a happy home, is a fundamental part of that aspiration,"* Secretary of Gross National Happiness Commission.[16]

FDI can play a vital role in the economic development process of the country. However it can also lead to undesirable outcomes. Bhutan must ensure that FDI policy is consonant with the national priorities of Bhutan and is not led by foreign corporate interests. Otherwise FDI can be exploitative in nature, whether companies seek extractive mineral resources, water resources or cheap labor.

This particular review pertaining to foreign landownership under the FDI Policy points out major concerns where the risks clearly outweigh the potential benefits. In summary this brief assessment shows that allowing foreign land ownership is not:

a. in keeping with the our primary interest to promote security and sovereignty of the country;

b. a key factor that determines economic potential and competitiveness, which in turn determines FDI attractiveness.

c. a key factor to meet the objectives of the FDI policy 2010 in promoting clean, green, sustainable and service oriented enterprises;

d. consonant with our environmental principles as FDI activities such as commercial farming (which is a justification for large land holdings) could lead to monoculture, loss of biodiversity, diversion of water resources from food production.

The Committee, therefore, recommends the government revoke the clause that allows foreign land ownership. As an alternative, Bhutan should ensure clear and transparent processes to provide stable long term lease of (non-agricultural) government land to attract and inspire foreign investor confidence.

[16] Bhutan Observer, Land kidu's far-reaching impact, 5 May 2010

Annexure I

NEGATIVE LIST

Schedule III

Sl	Activity
1	Media and Broadcasting
2	Distribution services including wholesale, retail and micro trade
3	Mining for sale of minerals in primary or raw form
4	Hotel 3 star and below
5	General Health Services
6	Industries that do not meet the Certificate of Origin requirements
7	Activities in the Prohibited List

Prohibited List

1	Activities that violate any laws of the Kingdom of Bhutan
2	Activities that threaten national security and public order
3	Activities that has harmful effects on public health, environment and Bhutanese morals and culture
4	Arms, ammunitions and explosives
5	Production of hazardous chemicals (as per restricted list of NEC)
6	Activities based on imported waste
7	Production display and sale of pornographic materials
8	Gambling and Betting
9	Tobacco and tobacco based products

Annexure II Priority List for Production and Manufacturing

Schedule II

<table>
<tr><th>Sl</th><th>Sector</th><th>Minimum Project Cost (Nu m)</th><th>Maximum Foreign Investor's Equity (%)</th><th>Conditions/Requirements</th></tr>
<tr><td>1</td><td>Agro based Production:
i. Organic farming
ii. Agro processing
iii. Bio-technology
iv. Poultry
v. Fisheries
vi. Floriculture
vii. Health Food
viii. Animal Feed
ix. Apiculture
x. Horticulture
xi. Dairy</td><td>20</td><td>74</td><td>None</td></tr>
<tr><td>2</td><td>Forest based Production</td><td>50</td><td>74</td><td>None</td></tr>
<tr><td rowspan="2">3</td><td rowspan="2">Energy
i. Hydro Power
ii. Solar and wind energy
iii. Other renewable energy</td><td colspan="3">Based on Sustainable Hydro Power Policy</td></tr>
<tr><td>20</td><td colspan="2">Based on Renewable Energy Policy</td></tr>
<tr><td>4</td><td>Water based products</td><td>50</td><td>74</td><td>None</td></tr>
<tr><td>5</td><td>Other manufacturing
i. Electronics
ii. Electricals
iii. Computer hardware
iv. Building materials</td><td>50</td><td>74</td><td>None</td></tr>
</table>

Annexure II Priority List for Services

Sl	Sector	Minimum Project Cost (Nu m)	Maximum Foreign Investor's Equity (%)	Conditions/Requirements
1	Education i. Primary Education ii. General Secondary Education iii. Higher Education	200	100	High end
2	Health i. Specialized Medical Services ii. Specialized Dental Services iii. Specialized Medical Laboratory Services iv. Specialized Diagnostic-imaging Services v. Specialized Traditional Medical Services	200	100	High end
3	Hotels/Resorts - Five star & above	200	100	International reputed hotel chains
4	Infrastructure Facilities i. Multi-dwelling residential buildings ii. Non-residential buildings iii. Outdoor sports and recreation facilities such as golf courses, botanical garden and others iv. Highways, bridges, tunnels and roads v. Airfield runways/ airports vi. Industrial estates, Industrial Parks, vii. SEZ, AEZ viii. IT Parks ix. Economic Cities x. Knowledge cities xi. Sport cities xii. Health/Wellness centres xiii. Dryport xiv. Land reclamation xv. Other similar activities	200	100	PPP Model wherein the facility returns to the Government on expiry of the term.

Sl	Sector	Minimum Project Cost (Nu m)	Maximum Foreign Investor's Equity (%)	Conditions/Requirements
5	Research & Development	10	100	Established firms employing a minimum of 5 experts
6	Head Office Services	5	100	None
7	IT/ITES i. IT/ITES inside IT Parks & SEZs	5	100	None
	ii. IT/ITES outside IT Parks & SEZs	25	74	None
8	Construction Services	100	74	None
9	Waste management i. Recycling of domestic waste ii. Waste management services	25	74	PPP model
10	Water supply and management Urban water treatment and supply	25	74	PPP model
11	4 Star Hotels	25	74	None
12	Technical and Vocational Education	25	74	None
13	Transportation & related services i. Green & non-fossil fuel based transportation ii. Mass transportation iii. Railways, ropeways & cable cars	25	74	PPP Model wherein the facility returns to the Government on expiry of the term.
14	Consultancy Services	10	74	Established firms employing a minimum of 5 experts
15	Financial Services	25	51	As per Financial Services Act