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24<sup>th</sup> SESSION OF THE NATIONAL COUNCIL**

# Review of Policies related to Vehicle Imports

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Issues, Consequences & Recommendations

Economic Affairs Committee  
National Council of Bhutan

16 Jan 2020

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- 1) Ministry of Information and Communications
- 2) Ministry of Finance
- 3) Ministry of Economic Affairs
- 4) Royal Monetary Authority
- 5) Bhutan Post
- 6) National Statistical Bureau
- 7) Bhutan National Bank

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## Background

The Economic Affairs Committee (EAC) of the National Council is pleased to provide a review of policies related to vehicle imports. 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 fulfills 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 Section 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 programs of the government;
- b) Review performance of the government;
- c) Review implementation of resolutions and laws; and
- d) Review issues of national importance.”

The Economic Affairs Committee was directed to conduct a Policy Review of the issue of rising vehicle imports and present the findings in the 24<sup>th</sup> Session based on a decision of the NC Paro Retreat held in July 2018.

## 1. Introduction

Over the last few decades, there has been a steady rise in the number of vehicles in the country. Data shows that vehicle numbers doubled from about 11,900 in 1990, to 20,000 in 2001. In the next decade the numbers tripled to 61,756 in 2011. The number exceeded 100,000 vehicles in 2018.

As a result of rising vehicle imports, the people to vehicle ratio declined from 15 percent in 2009 to 11 percent in 2011 and 7 percent in 2019. This implies that by 2019, there was one motor vehicle for every seven persons in Bhutan.

This is not surprising as global experience shows that there is a positive correlation between vehicle ownership and growing affluence, urbanization, economic growth etc. which accompany economic development. Improvements in transport sector is beneficial as it enhances productivity, enables growth, creates employment, contributes to tax revenues, etc.

On the other hand, rapid and unsustainable growth in the number of vehicles also cause negative externalities ranging from traffic congestion, accidents, air and noise pollution to wider and long term economic challenges related to increasing outflow of foreign exchange for import of vehicles, spare parts and fuel.

In the case of Bhutan, there have been growing concerns reported in the media on the rapid surge in the number of light passenger vehicles over the last two decades. This category comprises about 65 percent of the total number of vehicles in the country today.

As the road network expands in the rural areas and urban population continues to grow along with rise in income levels, the demand for personal vehicles is only expected to aggravate the aforementioned problems. The Bhutanese media have expressed deep concerns on the sustainability of such growth trends and the need to address the adverse impact of such trends on the country.

This report seeks to understand the causes and consequences of the increase in import of light passenger vehicles and review policies pertaining to vehicle imports into the country. The final section is a recommendation presented by the EAC for consideration by the House.

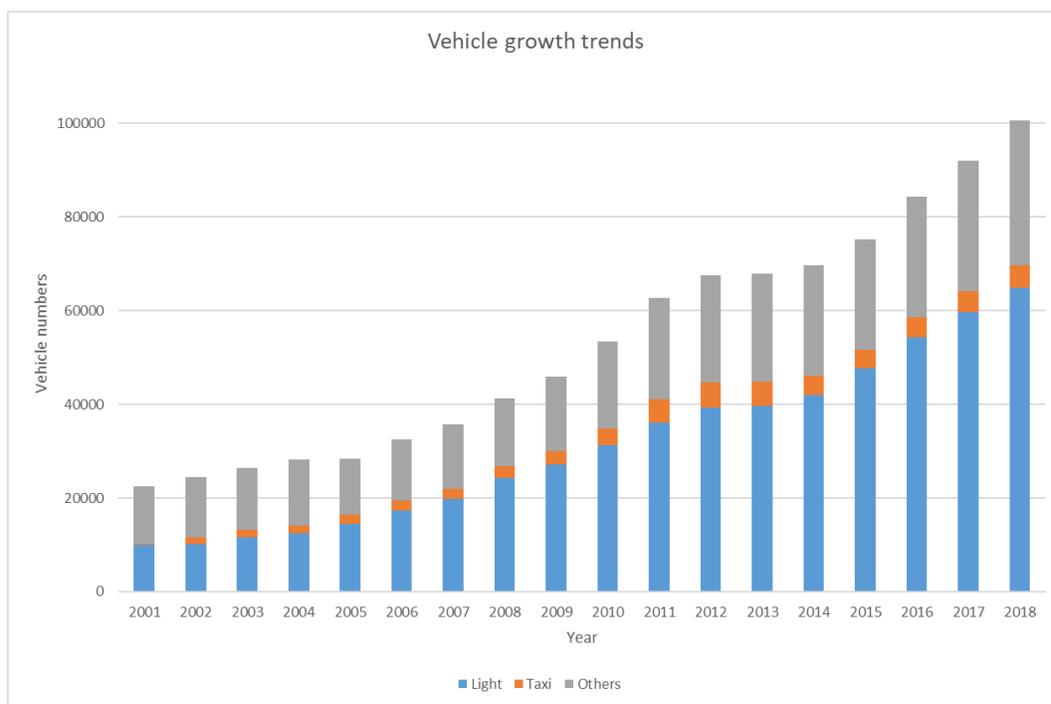
## 2. Situational Analysis

This section provides an overview of the trends and situation of vehicles in Bhutan.

### 2.a Trends in motor vehicle registration

Over the last few years, there have been numerous articles in the media on the rising number of automobiles in the country. In the last two decades or so, the number of vehicles registered in the country has increased fivefold from about 20,000 in 2001 to over 100,000 today. Thus, on average, every seven Bhutanese own a vehicle today.

The figure below based on data from RSTA shows the growth trends in the number of registered vehicles in the country.



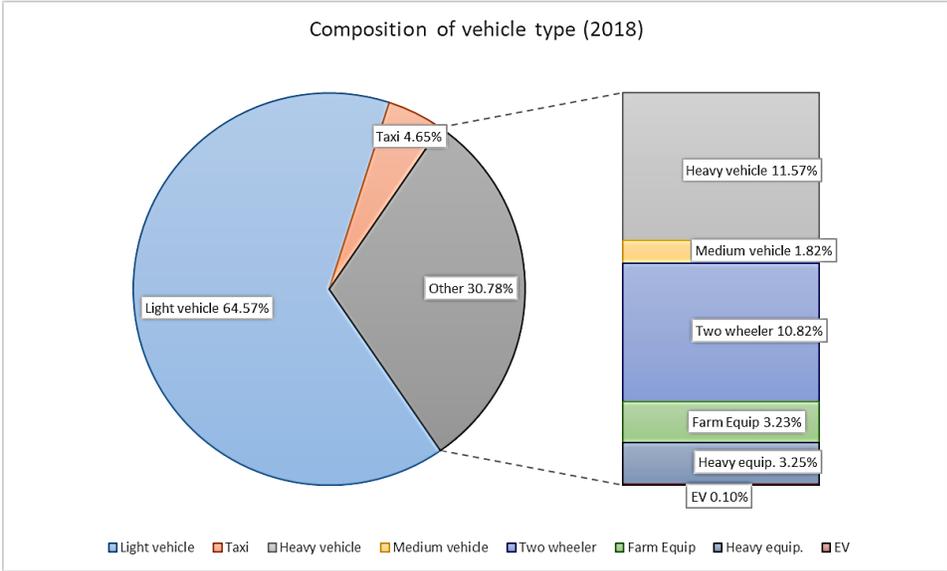
In July 2019, an article in the Kuensel newspaper revealed that in 90 days, between April to June 2019, Bhutan imported 1,505 vehicles.<sup>1</sup> This breaks down to an import of about 12 cars every day for that quarter.

The figure was more staggering in 2016/17 as reports indicated that at least 22 vehicles were imported in the country every day.

<sup>1</sup> Kuensel Newspaper, Seven Bhutanese own a Car, July 26, 2019

### 2.b Composition of Vehicle Types.

Data obtained from the RSTA shows that most of the vehicles registered in the country is in the light passenger vehicles category.



In terms of absolute numbers the composition is as follows:

Category <sup>2</sup>	Number	Percentage
Light vehicle	64,925	64.57
Medium vehicle	1,828	1.82
Heavy vehicle	11,631	11.57
Two wheeler	10,874	10.82
Farm Equip	3,245	3.23
Heavy equip.	3,271	3.25
Taxi	4,672	4.65
Electric Vehicles EV	98	0.10
<b>Total</b>	<b>100,544</b>	<b>100</b>

There has also been a major increase in the number of heavy vehicles in the country over the last few years. The number of heavy vehicles has doubled from about 6,500 in 2009 to 11,631 in 2018. This can be attributed to the demand from the construction sector and the boom in exports of river boulders.

<sup>2</sup> **Light vehicles** means a motor vehicle (which is not a two-wheeler) seating not more than 12 adults (including the driver) and not exceeding 3 tones gross vehicle weight.  
**Medium vehicles** means a motor vehicle exceeding 3 tons but not exceeding 10 tons gross vehicle weight or a bus seating between 13 and 24 passengers.  
**Heavy vehicle** is defined as motor vehicles exceeding 10 tons gross vehicle weight or a bus seating more than 25 adults (including the diver) and these are generally trucks for freight and passenger buses (including buses owned by institutions and schools)

**2.c. Distribution of Vehicles across Dzongkhags 2018 (RSTA)**

The chart below shows the distribution of vehicles across the regions of the country based on registration.

	<b>Region</b>	<b>Total</b>	<b>As %</b>
1	<b>Thimphu Region</b> Thimphu, Paro, Haa, Punakha, Wangdi and Gasa	55186	52
2	<b>Phuntsholing Region</b> Chuka and Samtse	36261	34
3	<b>Gelephu Region</b> Sarpang, Tsirang, Dagana, Zhemgang, Trongsa and Bumthang	6879	7
4	<b>Samdrupjongkhar Region</b> Samdrupjongkhar and Pema Gatshel	5347	5
5	<b>Mongar Region</b> Mongar, Lhuentse, Trashigang, Trashi Yangtse	2069	2
	<b>Grand Total</b>	<b>105742</b>	<b>100</b>

The data shows that 86 percent of all vehicles are registered in the Thimphu and Phuntsholing region making the distribution of vehicles across the country highly skewed. Thimphu as the capital city is also the major urban center while Phuntsholing is the main gateway for trade, commerce and transit of passengers and freight. Hence, these towns experience the worst effects of traffic congestion.

In addition to the above factors, Thimphu and Phuntsholing regions also see the highest movement of foreign vehicles brought in by regional tourists thereby adding to the traffic congestion and vehicular pollution. Data from RSTA shows that number of foreign vehicles entering Bhutan annually increased from 8,304 in 2017 to 9,185 in 2018.

**2.d. Family Vehicle Ownership Pattern**

Like the distribution across the country, vehicle ownership patterns are also skewed between rural and urban areas and the rich and poor households.

The Bhutan Living Standard and Survey (BLSS) 2017 shows that only 23 percent of Bhutanese households (HH) owned a family car. The balance 77 percent of households did not own a family car.

BLSS 2017 also shows that 35.5 percent of households in urban areas owned family cars compared to 10.9 percent in rural areas. The car ownership in rural areas may be inflated due to the inclusion of rapidly expanding peri-urban areas of Thimphu (like Kabesa, Debsi and RTC/Ngabiphu areas) with large number of middle and high income households residing in zones considered as rural areas. This is applicable to other peri-urban areas in other Dzongkhags.

Though unsurprising, it is also important to point out the asymmetry in family car ownership across income spectrum.

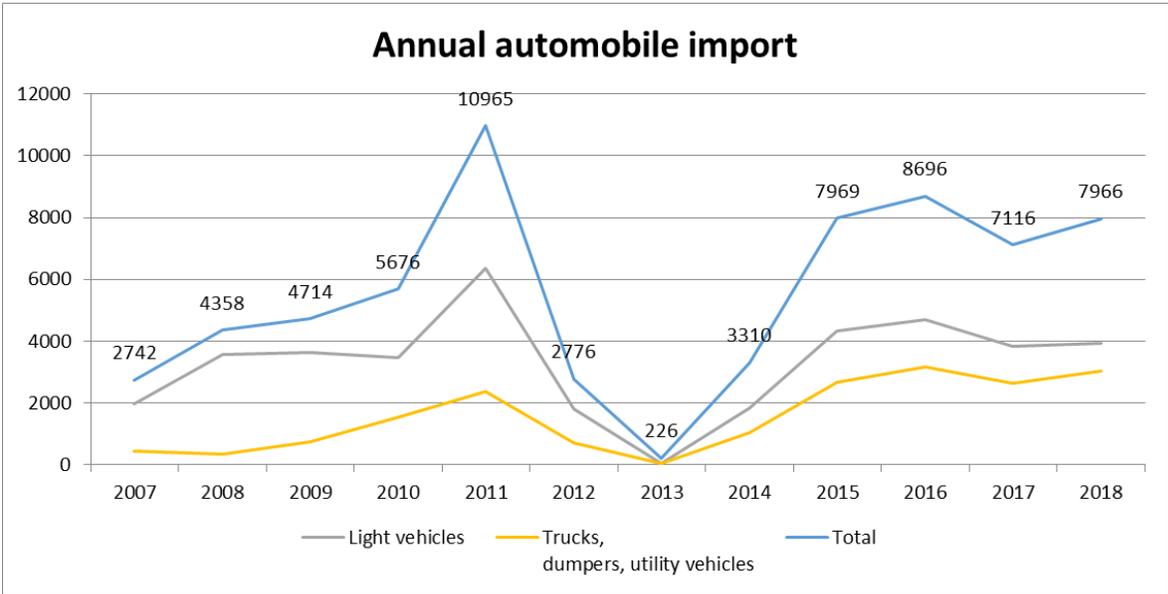
**Percent of HH owning Family Car (BLSS 2017)**

	1 Quintile (Poorest)	2 Quintile	3 Quintile	4 Quintile	5 Quintile (Richest)
BLSS 2017	3.2	10.6	17.9	31.8	53

As shown in the table above, the percentage of households with family cars in the poorest first quintile is 3.2 percent while that of the richest fifth quintile is 53 percent.

**2.e. Trends in Import of Vehicles.**

The figure below (based on data from the Ministry of Finance) provides a snapshot of the trends in vehicle imports from 2007-2009.



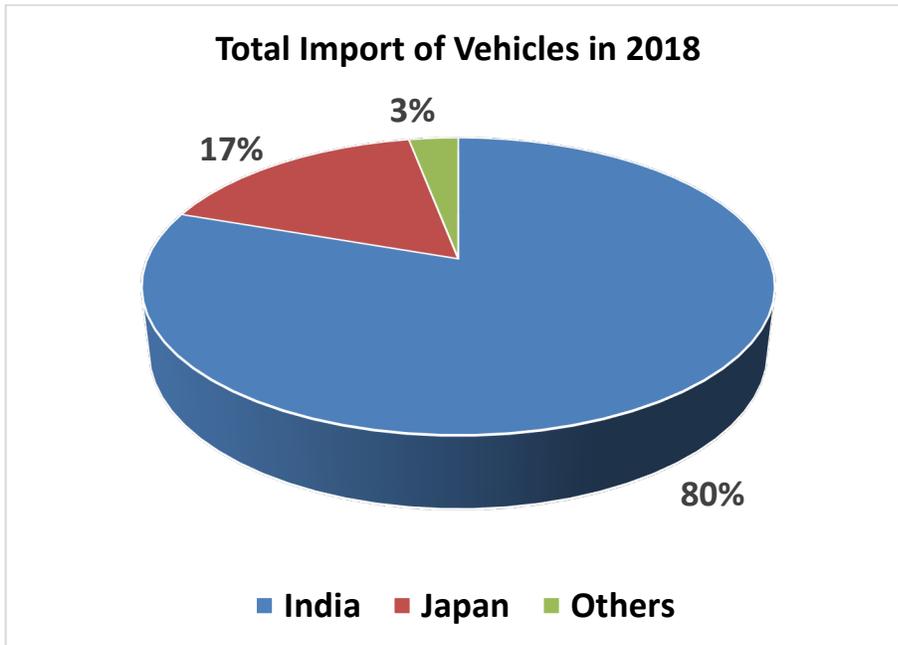
From the figure it is evident that there has been a steady rise in the number of annual automobile imports peaking at 10,965 vehicles in 2011.

The sharp drop in vehicle imports in 2012-2013 can be attributed to the ban on vehicle import due to current account deficits and the accompanying shortage of Indian Rupees. The restrictions included curtailment of transport loans, suspension of access to Indian Rupees for vehicle imports in March 2012 and freeze in purchase of government pool vehicles.

The restrictions were gradually lifted in the last quarter of 2014. However taxes and duties on import of light vehicles were increased as discussed in Section 5.b.

## 2.f. Source of Vehicle Imports

In 2018, about 15,606 vehicles were imported in the country as per data from the MOEA. A vast majority of them (12,535) were imported from India followed by Japan ((2601) and rest from other countries (470)



India is the single largest source for import of vehicles into Bhutan. This is due to the lower import tariffs levied on Indian vehicles, availability of good quality vehicles at affordable prices and lower price of spare parts.

Data from RSTA shows that import of vehicles from top five Indian car companies (Maruti, Mahindra and Hyundai, Tata and Isuzu) comprise 73 percent of all private vehicle imports in 2018.

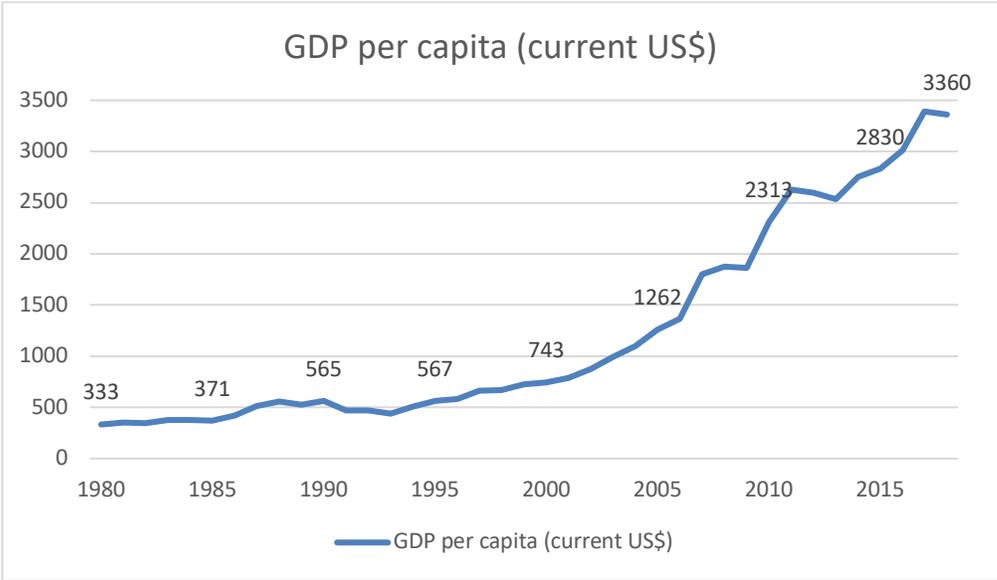
As discussed later in Section 3.b. the liberalization of the Indian economy in the early 1990s and the accompanying reforms in the Indian automotive sector provided a major impetus in increasing choice, improving quality and at the same time offering competitive prices for automobile purchase.

### 3. Causes of Growth in Vehicle Imports.

This sections provides and overview of the cause for rise in vehicle imports.

#### 3.a. Rise in Income

One of the main factors that propel the demand for vehicles, particularly passenger vehicles is household income. Given the successful development policies, the per capita GDP, used as a proxy for income, has seen a steady increase up till the 1990s and thereafter a high rate of growth as shown in the chart below.



Within a span of 15 years from 2000 to 2015, the per capita GDP increased from USD 743 to 3360. Global experience shows that increased incomes along with rising aspirations and changing lifestyles leads to increase in demand for vehicles.

The combination of rising incomes along with rising options for affordable cars (discussed in the following section) provide favorable price to income ratio which has led to an increase in demand for passenger vehicles among the middle class in Bhutan.

### 3.b. Greater Affordability

Given the strong economic linkages between the Bhutan and India which is underpinned by the Bilateral Free Trade Agreement, economic shifts in India have a corresponding impact on Bhutan.

In terms of the automobile sector, the liberalization of the Indian economy post 1992 provided the impetus for major reforms in the Indian automotive sector. This allowed large global auto makers such as Toyota, Suzuki, Hyundai to invest in India. This not only lowered price but also provided wide range of choice across the affordability spectrum. In 2018, India with a production of over four million passenger car was globally ranked the fourth largest producer.<sup>3</sup> Thus the reforms in the Indian auto sector provided Bhutanese consumers a wider choice of international brand of cars at affordable price.

The combination of increased incomes and lower prices led to favorable price to income ratio increasing the demand for vehicles in Bhutan. Price to income ratio is used to measure affordability of a certain product. As incomes have risen and prices have stabilized due to innovation and competition, the price to income ratio has become more favorable as shown in the table below constructed with data from the RCSC and various websites.

	1983	1989	1999	2005	2014
Av Monthly Salary of Entry level CS Officer in Nu.	1,140	2,800	10,200	15,030	24,557
Ex-showroom Price Delhi of entry level Car in Nu.	50,000 <sup>4</sup>	130,000 <sup>5</sup>	191,584 <sup>6</sup>	208,678 <sup>7</sup>	235,000 <sup>8</sup>
Car Type	Maruti 800	Maruti 800	Maruti 800	Maruti 800	Maruti 800
Ratio of price to months of salary	44	46	19	14	10

In 1983 when the Maruti 800 was first launched in India, there was a long waiting list for consumers and it would have cost about 4 years salary of an entry level civil service officer. In 2014, the price of a Maruti 800 was less than a year salary. The production of Maruti 800 was discontinued in 2014.

<sup>3</sup> <https://www.statista.com/statistics/226032/light-vehicle-producing-countries/>

<sup>4</sup> <https://www.team-bhp.com/forum/vintage-cars-classics-india/135712-cost-classic-cars-when-new-pics-invoices-included-2.html>

<sup>5</sup> <https://www.team-bhp.com/forum/vintage-cars-classics-india/135712-cost-classic-cars-when-new-pics-invoices-included-2.html>

<sup>6</sup> <https://www.indiatoday.in/magazine/economy/story/19991011-maruti-800-loses-urban-dominance-as-small-car-market-presents-bewildering-array-of-options-824932-1999-10-1>

<sup>7</sup> <https://web.archive.org/web/20100116171944/http://www.thehindubusinessline.com/2005/01/26/stories/2005012602240200.htm>

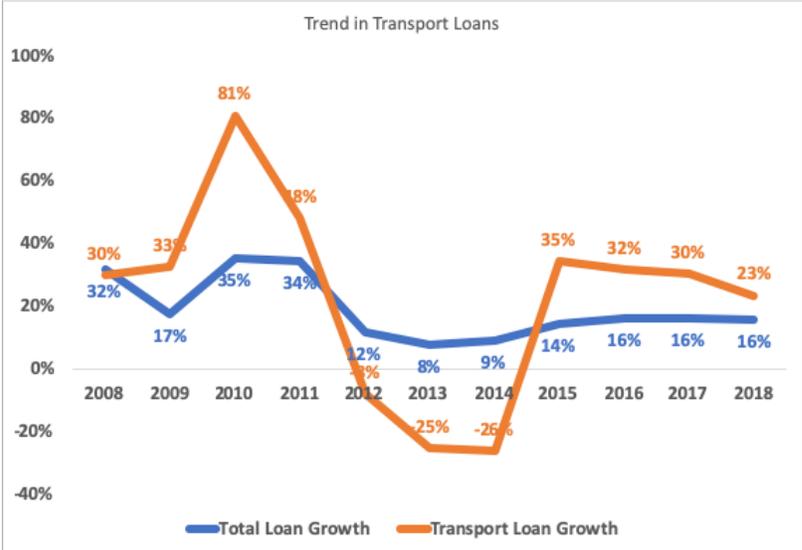
<sup>8</sup> [https://www.business-standard.com/article/companies/maruti-800-rides-into-history-114020800045\\_1.html](https://www.business-standard.com/article/companies/maruti-800-rides-into-history-114020800045_1.html)

The reforms in the Indian automotive industries of early 1990s allowed greater choice, competition, efficiency and lower prices allowing the middle class to own cars. Till the 1990s only the affluent people could afford to own cars.

In addition to the favorable price to income ratio, choices and financing options have also expanded for the consumers. In addition, the number of two income household have increased making a car more affordable.

### 3.c. Easy Credit

Besides the aforementioned two factors, access to credit also spurs the demand for consumer goods like vehicles.

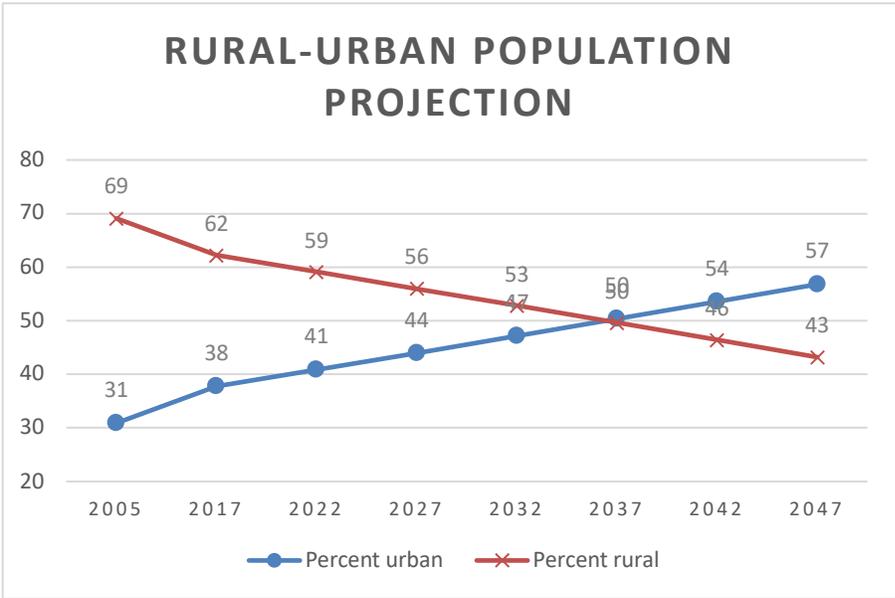


As shown in the graph above, there has been a steady growth in transport loans. The major growth of about 81 percent in 2010 corresponds to the licensing of three new financial institutions and the ease of access to credit as these new entities competed for clients.

The drastic drop in 2012 was caused due to restrictive import policies which included ban on imports and freeze on credit for purchase of nonessential commodities, including vehicles, in the face of severe trade deficit and associated shortfall of Indian rupees to finance imports.

**3.d. Urbanization**

Global experience shows that there is a dynamic link between urbanization and demand for personal vehicles. As shown in the figure below, there has been a steady increase in the urban population and projection show that the urban population will eclipse rural population within the next two decades.



Urban growth, particularly horizontal expansion as in the case of Thimphu and the development of suburbs (like Kabesa, Babena, Taba, Olakha and Debsi, Babesa, etc,) lengthen the commuting distance. In the absence of reliable and efficient public transport, it is natural that people opt for vehicle ownership.

As urbanization is a reality, and given the numerous downsides of increased number of personal vehicles, it is imperative to improve public transport. The failure to do so will exacerbate congestion and worsen levels of pollution.

### 3.e. Lack of Efficient Public Transport

Existing studies in other growing cities and towns indicate that the failure to provide efficient and reliable public transport system is one of the main causes for increased use of private vehicles and taxis.

It may be noted that in economics, public transport is considered a merit good or service. These are good or services that the government feels the public will under consume and it should therefore be subsidized or provided free so that consumption does not depend on the ability of the user to pay. Merit goods create positive externalities and can have beneficial impact for society as whole. For example, an efficient and reliable city bus service can reduce the number of private cars on the roads and thus reduce traffic congestion, minimize air and noise pollution and most importantly lead to cost savings for people and the country as a whole from reduced import of fuel and spare parts. It will also have a disproportionately beneficial impact on the poor as they will not have to purchase cars or spend on more expensive taxi services.

In the case of Thimphu City, the spread of urban areas and urban lifestyles has led to a high demand for mobility. The inability of the government to provide reliable and efficient urban transport can be seen as one of the main causes for increased demand for private light vehicles in rapidly growing urban centers like Thimphu. An official of the Bhutan Post shared that the introduction of bus services for some schools in Thimphu saw a dramatic reduction in car numbers and also saved on wear and tear of public infrastructure. For example, one bus for ferrying students has led to reduction in about 49 cars to the school twice a day.

Despite such benefits, a study conducted by the MoIC for the drafting for the National Transport Policy shows that the present number of buses in Thimphu fall short of the desirable benchmark. It is estimated that there should ideally be 60 buses for every 100,000 population. Further the present utilization rates at 78 percent are also lower than desirable rate of 98 percent indicating room for greater efficiency.

Another study conducted by the International Finance Corporation in Thimphu notes: *“From a recent traffic volume and speed survey for Norzin Lam and Chang Lam it is noted that Taxi movements in Norzin Lam are about 50% of the traffic movement and about 45% in Chang Lam. This is an extraordinarily high proportion and largely a reflection of the poor quality of public bus services. At present there is no incentive to change modes. The existing public bus service needs radical transformations as without an improved bus service a modal shift from car travel to public transport will not occur and traffic congestion will increase unabated.”*<sup>9</sup>

At the moment, Bhutan Post runs the Thimphu City Bus services with a fleet of 45 buses and ferries an estimated 8,000 passengers per day. It is estimated that Taxi services ferry quadruple the number at about 30,000 passengers per day.

Studies have shown that the present number of buses are about 41 percent short of the desirable levels. This gap is expected to be closed as the government plans to deploy more new buses in Thimphu.<sup>10</sup>

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<sup>9</sup> MOIC, Intelligent Transport Systems (ITS) Feasibility Study and Preparation of a Comprehensive ITS action plan for Thimphu City 2015

<sup>10</sup> The Bhutanese, NA discusses traffic Congestion in Thimphu City, 25 May 2019.

Officials of the Bhutan Post confirmed that the present government has allocated a budget of Nu.95.46 million that will enable the purchase of at least 24 buses. Along with the additional buses and restructuring of bus routes, efficiency and reliability is also expected to improve.

Another initiative that would boost public transit is the planned launch of the Bus Rapid Transit (BRT) system by the Thimphu Thromde by 2022.<sup>11</sup> To ensure success of the BRT and avoid duplication, it would be critical for the Thromde and Bhutan Post to find proper synergies to merge the two initiatives. There have been discussions to hand over the Thimphu city bus services to the Thromde.<sup>12</sup>

**3.f. Vehicle Quota/Subsidy**

One of the most contentious issue in the media when discussing measures to address vehicle imports, is the issuance of vehicle quotas to eligible public officials. In the past when public salaries were low, vehicle costs were high and pool vehicles scarce, the government granted a tax waiver or a subsidy for civil servants to purchase a vehicle. The situation could not be more different today as discussed in this paper.

The table below shows the rising number of exemptions granted for tax and duty free imports.

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Total
Total Quota issued	967	765	968	1129	575	202	1519	2078	1989	1871	2344	15805
o/w Diplomats Embassies	5	0	1	0	1	0	0	34	17	32	47	151
o/w Pool Vehicles	282	334	197	237	167	70	97	194	434	265	129	2646

Source: Ministry of Finance, November 2019

The impact of quotas on vehicle imports can be summarized as follows:

- i. The quota provides public officials a direct subsidy for purchase of vehicle exempts the buyer from customs duties and sales tax for import of vehicles.
- ii. As the quota commands a premium value it is often traded despite existence of rules that forbid it. The quota buyer obviously imports a vehicle and more often than not, the quota seller, uses the proceeds of the sale to buy a cheaper car.
- iii. As a result both the quota seller and buyer end up buying a vehicle each thereby doubling the impact in terms of growth in number of vehicles in the country.

Besides public officials, vehicle import tax exemptions are also granted to private tour operators and bus operators for purchase of buses, private schools and colleges, registered NGOs and others agencies like hydropower projects.

Thus rising number of vehicle import quotas for both public and private sector blunts efforts made by the government to reduce vehicle numbers using fiscal policy tools. There has also been various discussions among the public and in the media on this issue and is increasingly casting the public officials in poor light.<sup>13</sup>

<sup>11</sup> BBS, Thimphu Thromde to introduce BRT for efficient Public Transport System, May 21, 2019.  
<sup>12</sup> Kuensel, Demand for Public Transport outstrips government efforts. September 29, 2019  
<sup>13</sup> Business Bhutan, Is Vehicle Quota Needed? July 9 2019.

**3.g. Pool Vehicles**

One of the other factors that has led to rise in vehicle numbers and also contributed to congestion in towns is the rise in the number of pool vehicles. The RSTA table below shows the growth trend in the number of pool vehicles across the country.

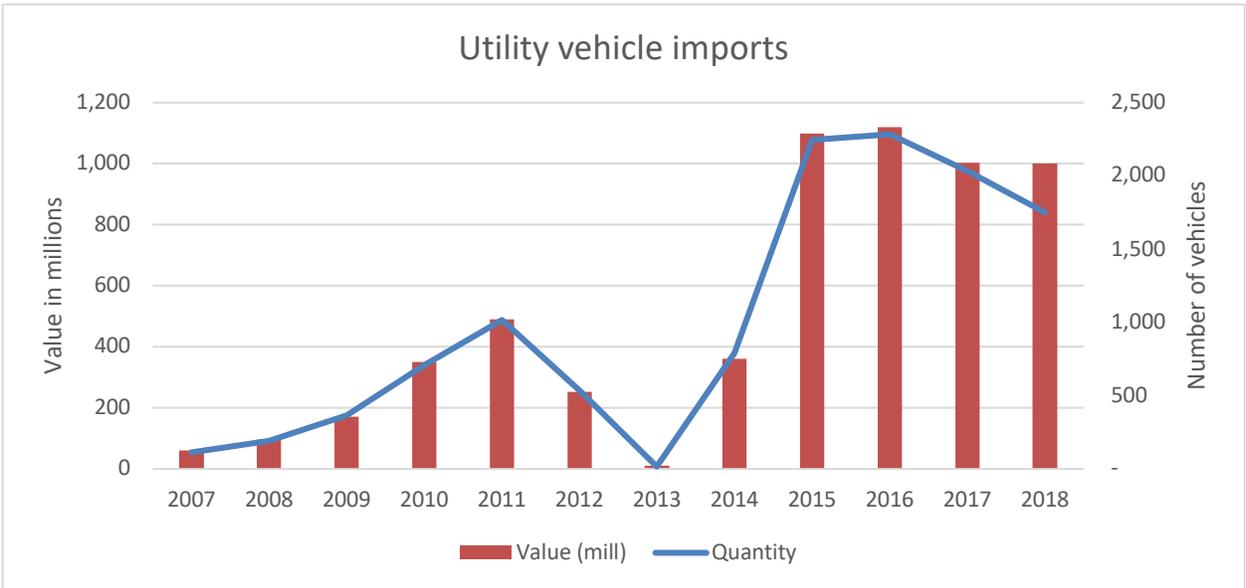
Year	2001	2005	2010	2015	2018
Total Pool Vehicles	2,666	3,191	4,622	6,231	7,073

Considering that the majority of the government agencies are located in the capital, increase in the number of pool vehicles also contribute to the congestion effects of towns like Thimphu.

**3.h. Policy on Utility Vehicles**

Besides market demand, specific government policies have a significant impact on import of vehicles. For example, even when the import ban was not fully lifted, the government permitted the import of utility vehicles (Bolero and Xenon) for people living in rural areas in November 2013.

This led to a major surge in the demand for utility vehicles as shown in the figure below.



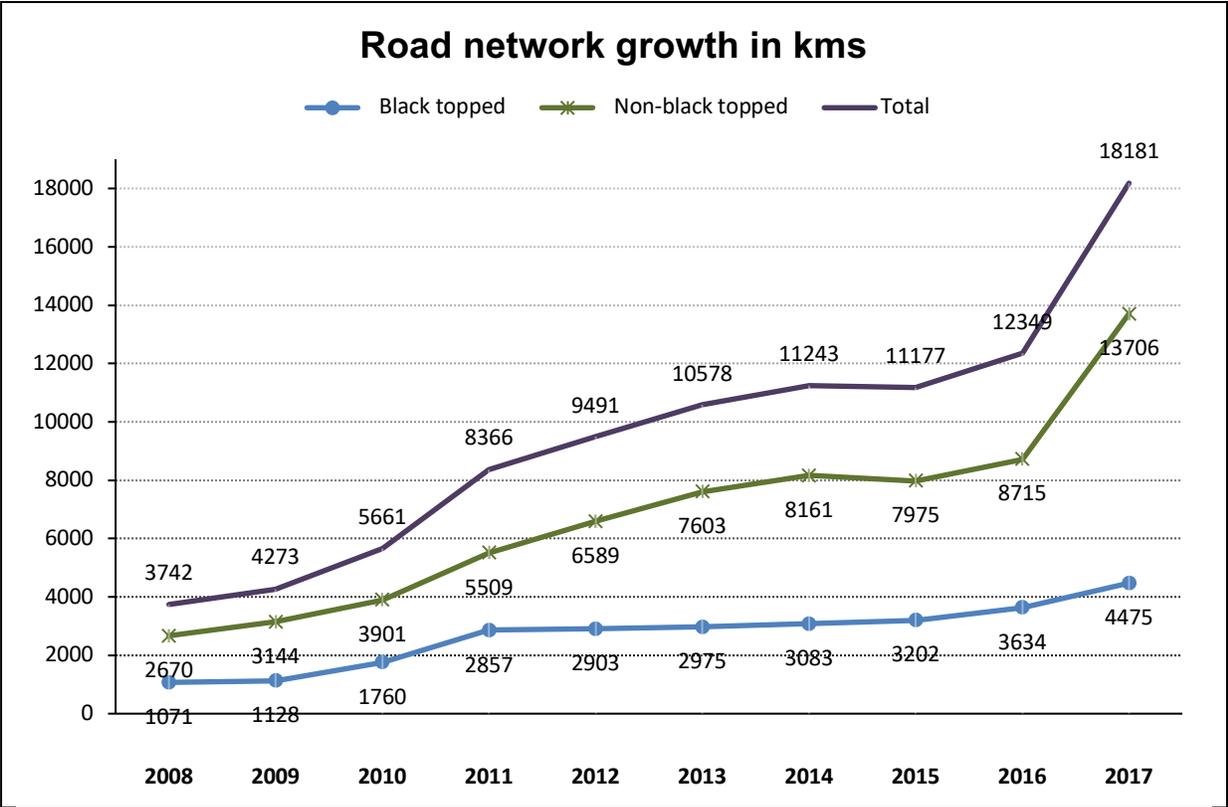
In 2014, as discussed in Section 5.b., there was major revision in import tariffs with near doubling of the sales tax and custom duties and enhanced green tax for vehicle imports. However in the case of utility vehicles, the customs duty and green tax remained unchanged while sales tax as increased nominally from 5 to 10 percent. In the new tax regime, the utility vehicles proved to be highly attractive for imports and led to a surge in numbers.

In 2015 and 2016, the imports exceeded 2,000 units per annum with import value exceeding Nu. 1 billion. As most of these utility vehicles are plying in the rural areas of Bhutan, it has provided a boom in transport services and rural economic activities.<sup>14</sup>

Although the import of utility vehicles has added to the total number of vehicles in the country, most of them are in rural areas and as such may not place measurable pressure on urban traffic congestion.

**3.i. Expanding Road Networks**

There has been a major expansion of road networks in Bhutan since 2008. As shown in the figure below, with data from the NSB, the total road length has expanded almost five fold between 2008 and 2017.



In particular, there has been major expansion of non-blacktopped farm roads in rural areas. This expansion in roads has also boosted the demand for vehicles. As discussed in the previous section, the demand for utility vehicles boomed with opening of new rural roads.

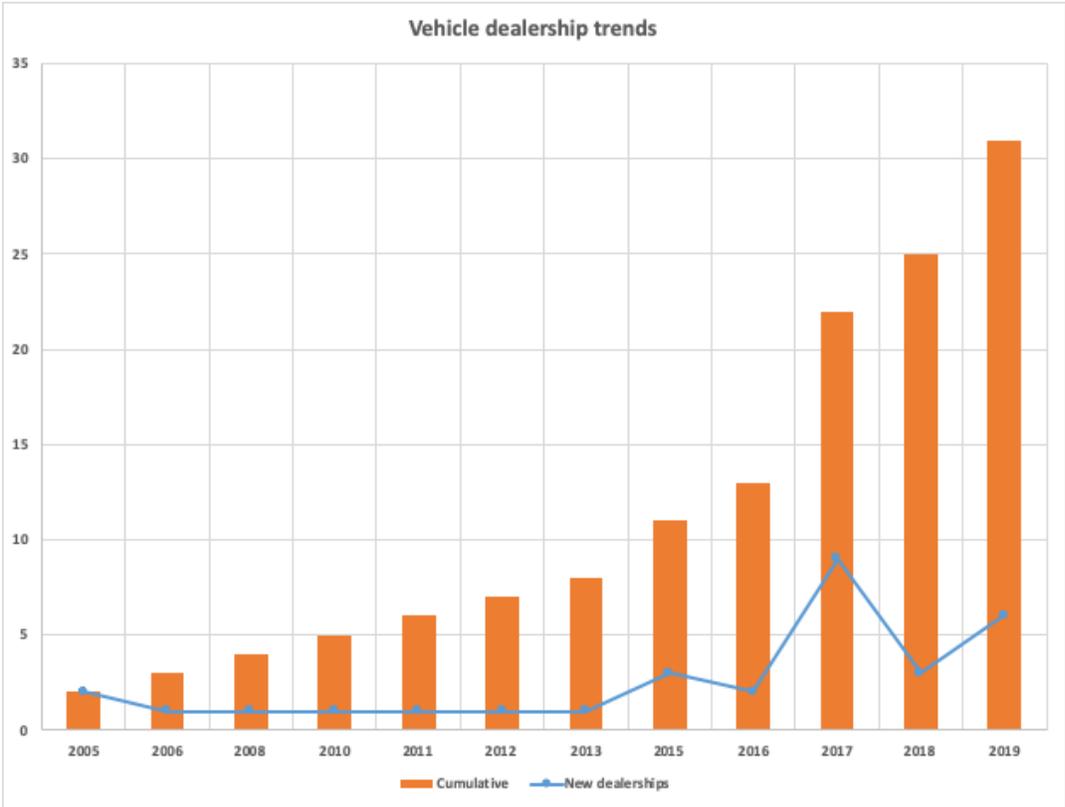
Linking of rural villages has also enabled public servants (serving in schools, BHUs, agriculture outreach centers, etc.) to improve their comfort by importing versatile and affordable vehicles to use on the roads.

<sup>14</sup> Business Bhutan, Boleros replace Horse in the East, June 5, 2019, <https://www.businessbhutan.bt/2019/06/05/boleros-replace-horses-in-the-east/>

### 3.j. Rise in Number of Vehicle Dealers

One of the other reasons for rise in the number of vehicles in the country can be attributed to the ease of availability of the vehicles due to growing number of vehicle dealers in the country.

The chart below constructed with data from the MOEA show that there has been a steady growth in the number of vehicle dealers.



On 9th June 2015, the Department of Trade, MOEA issued a Notification(No: MoEA/DT/TRMD-4/2015/14) requiring all vehicle imports and sales to be routed through authorized dealers. This was in response to consumer complaints on lack of transparency in pricing and other trade related issues.

From only 2 vehicle dealers in the country in 2005, the number of dealers rose to 11 in 2015 and 31 vehicle dealers in 2019.

The most significant growth in the number of dealership licenses was recorded in 2017 with 9 new dealers followed by 2019 with 6 new vehicle dealers.

## **4. Impact of High Growth in number of Vehicles**

Growth of the transport sector is considered a necessity for economic growth in developing economies. However, like most activities, excessive growth has adverse consequences as discussed in this section.

### **4.a. Traffic Congestion**

Given the high concentration of vehicles in Thimphu and Phuntsholing towns, it is not surprising that the problems related to traffic congestions have become common place.

Traffic congestion exerts economic costs in terms of lost productivity due to idle time spent in a traffic jam. It also leads to wasted fuel and higher levels of pollution as standing cars produce exhaust and fumes.

In the case of Thimphu, a study conducted, by the MoIC, in 2015, attributed the following conditions for traffic congestion: population growth, high automobile ownership and usage, uncontrolled parking habits, and an underperforming public transport system.<sup>15</sup>

Media reports attribute traffic congestions to other issues such as inability of the Thromde to implement parking provision rules in buildings and thereby leading to parking on roadside and the numerous zebra crossings which impede smooth traffic flow.

In 5<sup>th</sup> January 2016, given the severity of the problems associated with traffic congestion in Thimphu, the Prime Minister issued an Executive Order directing the MoIC to institute a multisectoral Taskforce to study the issue and come up with immediate measures to ease the traffic situation.<sup>16</sup>

The MoIC provided a set of immediate and long term recommendations to ease the traffic congestion. However, decisions and responses from the government have not been recorded.

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<sup>15</sup> MoIC, Intelligent Transport Systems (ITS) Feasibility Study and Preparation of a Comprehensive ITS action plan for Thimphu City, 2015

<sup>16</sup> Government Order – Traffic Congestion in Thimphu. C-2/172 dated 5 January 2016

#### 4.b. Accidents and Casualties

Rising number of vehicles also result in incidences of accidents and loss of life as shown in the tables below derived with data from NSB and RSTA.

	2013	2014	2015	2016	2017	2018
<b>Total number of Accidents</b>	<b>1094</b>	<b>791</b>	<b>715</b>	<b>726</b>	<b>862</b>	<b>1360</b>
• Thimphu	741	602	539	528	506	460
• Chuka	186	84	61	36	44	296
• % of accidents in Thimphu and Chukha	84	87	84	77	64	55

The table shows that while accident rates have declined from 2013, it increased in 2018. The number of incidents are highest in those Dzongkhags with larger concentration of vehicles. The decline as percentage of accidents in 2017 for the two dzongkhags is due to the fact that accident rates in Paro increased from 61 accidents in 2016 to 174 in 2017 and 172 in 2018.

The table below shows the data on injuries and deaths due to motor vehicle accidents.

	2013	2014	2015	2016	2017	2018
<b>Injuries from Accidents</b>	601	426	373	355	457	807
<b>Death from Accidents</b>	59	76	99	105	104	135

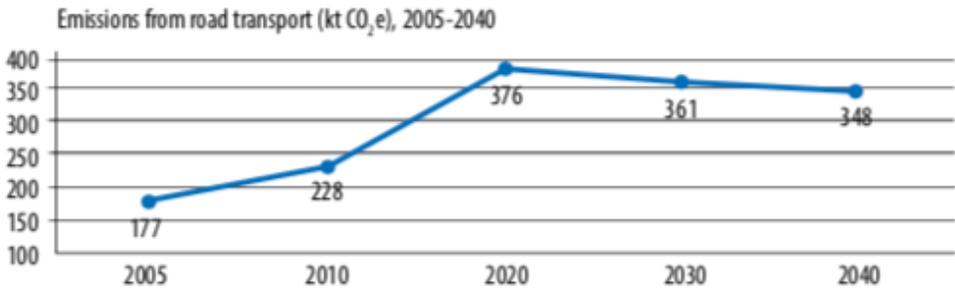
There has been a rise in number of injuries from accidents which dipped in 2014 but almost doubled in 2018. Similarly, death from motor vehicle accidents doubled in the last five years.

**4.c. Environmental Consequences**

One of the major consequence of the rapidly rising number of vehicles is the environmental consequences of air and noise pollution it imposes on society.

As shown in the chart below there has been a steady rise in Green House Gas emission from the transport sector. The National Green House Gas (GHG) Inventory of 2000 identifies the energy sector as the second highest contributor of GHG emissions after agriculture. The transport sub-sector accounts for about 44% of all energy-related GHG emissions.

**Baseline Projections for emissions from road transport**



Source: Bhutan: Low Emission Development for the Transport Sector 2016

The report states that: “Between 2005-2040, CO<sub>2</sub> emissions from the road transport sector are projected to increase from 177 kt CO<sub>2</sub>e to 348 kt CO<sub>2</sub>e – a 96 percent increase in emissions from the sector.”

Following a rise till 2020, the report further states that per capita emissions from road transport will decline thereafter. This is based on assumption that the market will saturate and the vehicle numbers will stabilize.

Further, Bhutan State of the Environment Report, 2016 links the growth in the of number of motor vehicles to the declining air quality in Thimphu. In addition to emissions, other factors such as release of particulate matter (from tire and brake wear out, road dust) have crossed WHO guideline levels posing risk to human health and wellbeing.

The main challenge in addressing the environmental consequences is due market failures that persist in such situations. Markets failures occur when a market is unable to manage its resources efficiently due to the breakdown of price mechanism caused by externalities. An externality is an impact of one’s action to another bystander.

For example, driving a car creates air and noise pollution which is a negative externality. This is an external cost which brings losses to society as a whole. The driver himself does not have to pay for the social cost as he only pays for driving (private) cost. In this case, society pays the cost of dealing with air and noise pollution.

From a societal point of view, market failures arising from enhanced use of private cars has a detrimental impact on the poor. While the car owners enjoy the private benefits of comfort, efficiency and luxury, it is the mostly poor people who bear the negative consequences as they

are exposed to ill effects of air and noise pollution without enjoying the benefits or comforts of owning or driving a car.

Since the market cannot resolve these issues, it is vital for the government to frame appropriate policies and laws to ensure that maximization of private gains do not impose high costs on society.

**4.d. Revenue Loss**

With the exception of government pool vehicles and service vehicles (ambulances, fire trucks, etc.) most of the vehicle purchases are light family vehicles. Therefore, it seems intuitive that there would not be any impact of such private purchase of vehicles on government revenue.

However, due to the issuance of quotas (which are essentially a tax subsidy) for import of private vehicles, there is a significant impact on government revenues as shown in the table below

<b>Annual Revenue Forgone due to Quotas(amount in millions)</b>						
<b>Source</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2107</b>	<b>2018</b>	<b>Total</b>
India	105.7	489.7	480.3	220.8	477.8	1774.32
Others	79.52	205.7	283.1	508.7	260.6	1337.54
Grand Total	185.2	695.3	763.4	729.6	738.4	3111.86
Source: Royal Audit Authority 2019						

The continued issuance of quotas, therefore, leads to significant financial loss for the government.

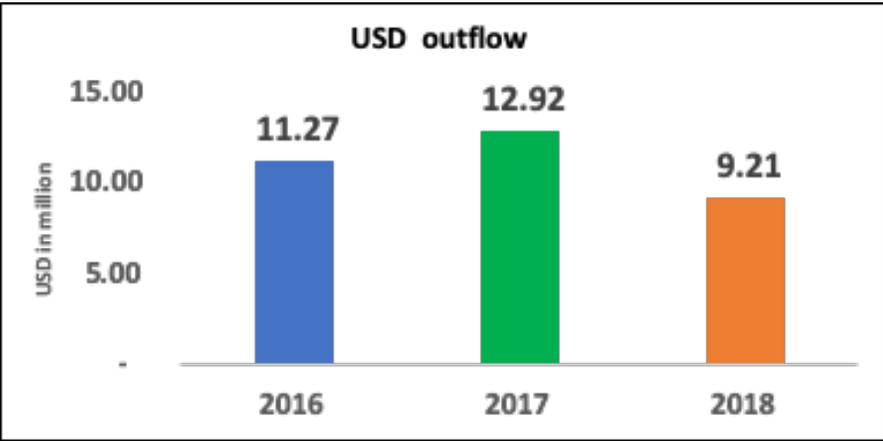
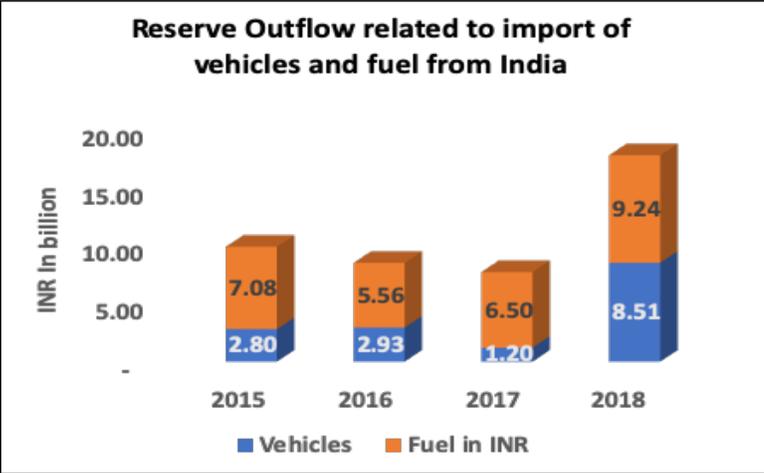
The Royal Audit Authority estimated that the annual forgone taxes due to quotas from 2014 to 2018 at Nu. 3.1 billion.<sup>17</sup>

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<sup>17</sup> Royal Audit Authority, Review Report on Government Vehicles and Foreign Vehicle Quota System March 2019

**4.e. Foreign Exchange Outflows**

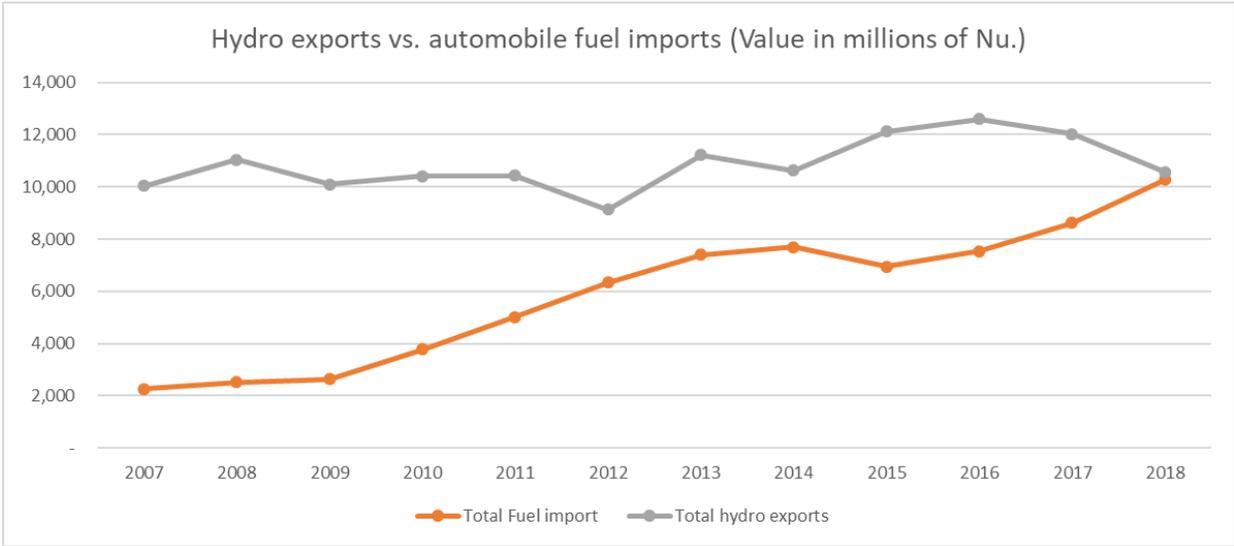
Import of vehicles has a direct impact on the foreign exchange reserves of the country. The data provided by the RMA shows the foreign exchange used for import of vehicles in the last four years.



Continued increase in the number of vehicles will have an adverse impact on the balance of payments and place pressure on Bhutan’s foreign exchange reserves. It may be noted that while there has been a temporary respite from the rupee crisis of 2102, structural imbalances remain on the external economic front.

**4.f. Rising Fuel Imports**

The figure below constructed based on data from the Ministry of Finance provides an alarming overview of the trends in export earnings from hydropower versus the expenditure for import of fuel. This data includes only petrol and diesel used to power motor vehicles and excludes LPG and aviation spirit.



In 2007, fuel import bill (for petrol and diesel) was Nu. 2.265 billion and hydroelectricity export revenues about Nu. 10 billion with a gap of about Nu 7.768 billion.

While electricity export growth fluctuated in the single digits between 2009-2013, there was double digit growth in fuel imports during the same period.

By 2018, the total fuel import bill at 10.276 billion closed in with hydro exports at Nu. 10.578 billion with a nominal gap of Nu. 301 million.

The major risk lies in the fact that while hydro export earnings are pegged to negotiated discussions, fuel prices are dependent on global oil prices denominated in US dollars.

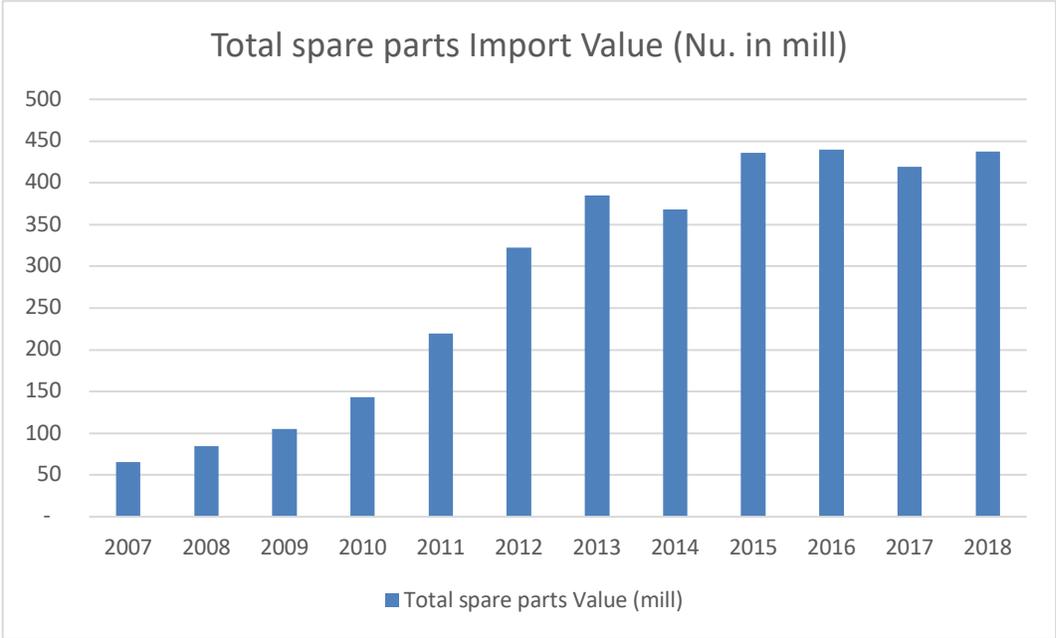
Due to global price uncertainty and the steady depreciation in the value of the Ngultrum to the US dollar, there has been a steady rise in fuel price over the years.

These currency movements will place greater strain on the international currency reserves and also exert pressure the balance of payments.

**4.g. Rising Import of Spare Parts**

One of the often overlooked factors when discussing motor vehicle imports is the need for import of spare parts.

As shown in the figure below constructed using data from the Ministry of Finance, it is evident that the rise in import of vehicles has been accompanied by rising expenditure for import of spare parts.



The total value of spare parts imported increased steadily from Nu. 66 million in 2007 and increased by more than seven fold to Nu. 440 million in 2016.

While the figure is staggering, it would be pertinent to point out that the spare parts import data also include those spares imported for heavy machineries deployed at hydropower projects and heavy trucks at construction sites and ferrying of boulders.

## 5. Govt Policies to control Growth in vehicle numbers

### 5.a. Transport Policy

The governance of the road transport sector is a complex area involving numerous government agencies as shown in the table below.

Agency	Activity
RSTA/MoIC	Formulate transport policy; RSTA: ensure road safety, and administer surface transport
Ministry of Finance	Fiscal Policy: Budget allocation and taxation, quota
Ministry of Economic Affairs	Trade Policy, Issuance of import licenses, issuance of vehicle dealership licenses
Department of Roads (MoWHS)	Plan national road networks and implement the plans Maintain their national roads
National Environment Commission	Set environment standards and regulations and specify a mission and development standards.
GNH Commission	Coordinate all major (transport) planning decision
Local Governments	Initiate local transport plan and maintain local roads
Royal Bhutan police	Enforce laws and regulations and maintain motor vehicle accident information system
Bhutan Post	Provide city bus services in urban areas

Due to the need to coordinate with multiple agencies with differing primary mandates, it is vital to ensure that there is greater coherence in managing the sector.

Currently, there is a Transport Policy 2006 which provides the basic framework for policy coordination. However, this is not available publicly. Recognizing the importance of the sector and growing complexities, the government has drafted the National Transport Policy 2017. It is in a draft form and has not been presented to the GNH Commission.

The Draft National Transport Policy among other objectives seeks to:

- provide the entire population with a safe, reliable, affordable, convenient, cost effective and environmentally friendly transport system in support of strategies for socioeconomic development;
- support development of transport master plans for each dzongkhag and progressive upgradation of all dzongkhag roads to all-weather roads based on traffic demand;
- harness private sector efficiencies in maintenance and management of roads based on a value for money analysis, according to the draft policy; and
- support to provide safe, affordable, accessible and sustainable transport services to connect all gewogs with nearest urban centers with special attention to the needs of those in vulnerable situations, women, children, persons with disabilities and older persons.

Over the years, the RGOB has commissioned many studies in the area providing deep insights into the issues.

- International Finance Corporation. Bhutan Urban Transport System: System Selection and Eco-Friendly Feasibility Report. Washington, DC, 2011
- ADB, Bhutan Transport 2040 Integrated Strategic Vision 2013
- MoIC, Intelligent Transport Systems (ITS) Feasibility Study and Preparation of a Comprehensive ITS action plan for Thimphu City , 2015
- DRE, MOEA, Energy efficiency in the Transport Sector, 2015
- MoIC, Draft National Transport Policy 2017

In view of the above, it is clear that the government officials are knowledgeable and well aware of the challenges and also the solutions. What has been lacking is the implementation of policies and the finances to oversee the recommendations.

For example, the Draft National Transport Policy 2017 still remains in the draft stage and adequate budgetary allocations have not been made for infrastructural investments for improving public transport.

The government agencies are also aware of the challenges posed by the rapid rise in vehicle numbers and the consequences especially in urban areas. For example, on 27<sup>th</sup> Nov 2015, the Prime Minister directed the MoIC to draw up a plan of action focusing on addressing road congestion in urban areas. Following multisectoral consultations, the MoIC submitted a set of 15 recommendations to the government. There was no record of implementation of the recommendations.

## 5.b. Trade Policy

The International Trade Policy of the Kingdom of Bhutan 2004 is, to date, the only comprehensive document that outlines the broad policy framework to govern the trading sector. Although the economic and political and economic scenario has evolved dramatically since then, the policy document has not been updated.

In so far as the import regime is concerned, the Policy document states the following “ The RGoB intends to establish a transparent and liberal import regime that facilitates economic growth and supports efficient allocation of its resources.”

The main trade policy tools used for management of Vehicle imports are as follows:

- **Rules and Procedures for Import from Third Countries 2002**

This regulations stipulates that an importer must obtain an import license from Department of Trade to import all goods including motor vehicles from countries other than India. In view of the Bilateral Free trade Agreement with India, there is no need for import license for vehicles from India.

- **Bhutan Micro Trade, Retail Trade and Wholesale Trade Regulations- 2006.**

This regulations governs the procedures and requirements for obtaining licenses and operation of Wholesale dealers including vehicle dealers. As per the information from the MOEA, there are currently 31 licensed motor vehicles dealers in Bhutan.

- **Notification No: MoEA/DT/TRMD-4/2015/142, dated 9<sup>th</sup> June 2015**

The Department of Trade, in response to consumer complaints on lack of transparency and other trade related issues, through a Notification conveyed the decision to require all vehicle import and sales to be routed through authorized dealers.

- **Notification No: MoEA/DT/IMP-1/2012/142, dated 7 April 2012**

This notification from the Department of Trade issued in response to the deepening current account deficits and rupee shortage in 2012 states that among other items, the import of motor vehicles (irrespective of source of country of import) shall not be permitted till further notice.

- **Notification No: MoEA/DT/IMP-1/2013/160, dated 2 December 2013**

This notification issued pursuant to the Executive Order permitting the import of Utility Vehicles and Electric Vehicles outlines the eligibility conditions for the import of utility vehicles.

- **Notification No: MoEA/DT/IMP-1/2014/323, dated 18 July 2014**

This notification states that the “existing restrictions on import of vehicles is being lifted” thereby bringing an end of what was effectively the ban on import of vehicles into Bhutan since April 2012.

**5.c. Fiscal Policy**

One of the main levers used by the government to influence demand for vehicles is through taxes and duties. Major tax reforms for vehicles were initiated in 2011, 2102 and 2014 with particular impact on import of light vehicles.

For example, till 2011 all light vehicles were liable for 20 percent Customs Duty (CD) and 15 percent Sales Tax (ST) irrespective of engine capacity.

As shown in the table below, from 2011, tax and duties were segregated and increased based on engine capacity.

Detail	2011		2012
	CD %	ST %	Green Tax
Below 1500 cc	20	20	5% for vehicles below 1800 cc 20% for vehicles that exceeded 1800 cc
1500 cc to 2500 cc	25	20	
Above 2500 cc	30	20	
Utility Vehicles	20	5	5 percent green tax

Source: Department of Revenue and Customs, MoF, 2019

In 2012, the government introduced Green tax on vehicles ranging from 5-20 percent based on engine capacity. The main rationale was to control import of vehicles in response to the rupee shortage in 2012.

In view of the rising number of vehicle imports and the impact on foreign exchange reserves, the government in an effort to control imports raised the import tariffs further and introduced new tax slabs as shown in the table below with data from DRC, MoF.

2014			
Detail	CD(%)	ST(%)	GT(%)
Below 1500 cc	45	45	10
1500 cc but not exceeding 1799 cc	50	50	15
1799cc but not exceeding 2500 cc	50	50	20
2500 cc to 3000 cc	50	50	25
3000 cc and beyond	100	50	30
Utility vehicles	20	10	5

Source: Department of Revenue and Customs, MoF, 2019

In a bid to promote electric vehicles, electric vehicles were exempted from all Sales Tax, Customs Duties and Green Tax.

Likewise the tax increase for utility vehicles (gross vehicle weight not exceeding 5 tons and value under Nu. 800,000) was minimal. While Sales Tax increased by 5 percent, the Customs Duty and Green Tax were not increased in 2014 leading to the impacts already discussed in section 3.h.

#### 5.d. Monetary Policy

In view of the concerns related to rising vehicle imports the RMA uses Loan to Value (LTV) Ratio as a policy tool to control excessive lending and exposure of the financial institutions to a single sector such a vehicle imports.

	<b>Loan</b>	<b>Buyer Equity</b>	<b>Remark</b>
Till 2012	75	25	All vehicles
2014	50	50	Light vehicles
2014	60	40	Bus and Trucks
2017	30	70	Light vehicles
2017	40	60	Buses and Trucks
2018	50	50	Light Electric Vehicles

The Royal Monetary Authority's (RMA) directive to reduce the loan to value ratio for vehicles from 50% to 30% has sparked off ambivalent reactions from different sections of the society including stakeholders.<sup>18</sup>

#### Challenges to implementing LTV Policy intervention:

##### 1) Invoice Manipulation by some Dealers

In order to circumvent the limitation on loans given by FIs, the dealers in collusion with the buyer and the banks have manipulated the invoice by inflating the cost of the vehicle and thereby enabling the buyers to take larger proportion of the vehicle cost as loans from the financial institutions.<sup>19</sup>

##### 2) Pre Financing by some Dealers

There have also been instances where some automobile dealers have used their own Over draft Facilities (linked to stock/inventory) to finance the equity portion of the buyer to enable the buyer to take loan for the remaining portion.

##### 3) Financing from Other sources

While the LTV ratio has some impact on curtailing consumer demand, the impact is also limited as money is fungible and buyers use sources like personal loans for financing automobile purchase.

The innovative malpractices have reduced the effectiveness of the monetary policy tools to address rising import of vehicles.

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<sup>18</sup> Business Bhutan, Vehicle Loan Directive, Headed Right, 16 August 2017.

<sup>19</sup> RMA cautions banks to be wary of invoice issued by car dealers, Kuensel, May 16, 2018

### **5.e. Environment Policy**

With a view to protect the environment, the 53<sup>rd</sup> Coordination Meeting of the Council of Ministers decided to ban import of all secondhand vehicles into Bhutan regardless of its origin on 30<sup>th</sup> November, 1999.

National Assembly in 200 passed the “Sales Tax, Customs and Excise Act 2000”. Section 45(h) of the Act, restricting the import of used or second hand goods, vehicles, machinery and equipment into the country. The spirit of this legal provision is further elaborated in the Rules and Procedures for Imports from Third Countries 2001

Based on these provisions, the import of used or second hand cars into the country has been banned by law, except for those that belong to officials of Diplomatic Missions and International Organizations and experts. Even in these cases, the vehicles are required to be re-exported upon the repatriation of the official

However the policy was relaxed on 2013, when the Government allowed the import of following secondhand Ambulances Fire-fighting vehicles and Garbage Truck which are less than 10 years old. This exception was made since the above vehicles are meant for public use and came as part of grant assistance.

Further, on 10<sup>th</sup> March 2014, as per letter C-3/26/325, the Government approved the import of second hand electric Nissan Leaf electric vehicles with mileage less than 30,000 kms to be used as taxis in the country. This modified the ban on import of all secondhand automobiles regardless of origin issued vide COM/02/99/48 dated December 6, 1999.

The government continues to make concerted efforts to encourage the use of electric cars by providing tax incentives as well as plans to expand charging facilities for EVs.

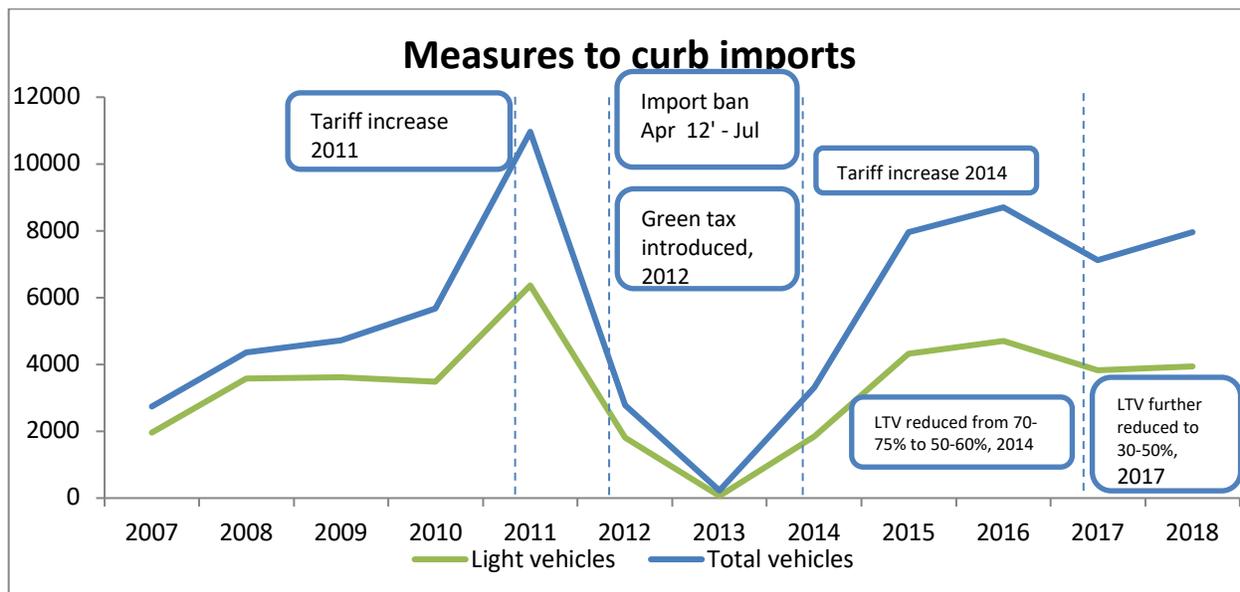
In the latest development towards the implementation of Bhutan Sustainable Low-Emission Urban Transport system, the Ministry of Information and Communications (MoIC) has written to the Royal Monetary Authority (RMA) to increase loan ceiling on purchase of electric vehicle taxis to 70 per cent.<sup>20</sup>

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<sup>20</sup> BBS, 300 more taxis to switch to electric vehicles within 3 years

## 6. Effect of Policies on Vehicle Imports

The chart below shows the trends in vehicle imports along with the policy interventions made by the government and the RMA.



From the above chart, it is clear that apart from the period between 2012 and 2013, where there was a sharp contraction in vehicle imports due to restrictions on transport credit and curtailment of government vehicle purchase, the impact of the policies have been fairly nominal. As a severe measure, a ban on imports was placed from April 2012 to July 2014.<sup>21</sup>

The gradual increase in vehicle imports from 2013 onwards can be attributed to government lifting the ban on electric and Utility Vehicles vide Government Order C-2/13/152 dated 12 November 2013.

Despite tariff increase in 2014, the pent up demand during the ban period led to rapid increase in the number of vehicles imported. This is due to boom in construction related transport following the rupee shortage and demand for transport vehicles for hydropower and export of boulders.

Examining more closely, the chart shows that demand for light vehicles also increased after 2013 onwards despite hike in taxes in 2014. This indicates that there is relatively low elasticity of demand vis-à-vis policy measures. This could be attributed to the following reasons:

- 1) Tax effect nullified by the Vehicle import Quota as discussed in Section 3.e;
- 2) Monetary Policy effect nullified by the fungibility of Money as discussed in 5.c;
- 3) Populist Policy measures such as tax incentives for Utility Vehicles as discussed in 3.g;
- 4) Other environment related concessions made as discussed in Section 5.d; and

<sup>21</sup> BBS, Govt Lifts Ban on Import of Vehicles, July 20, 2014. <http://www.bbs.bt/news/?p=41957>

- 5) Poor public transport to meet the demand for transport services in rapidly expanding urban areas.

The above reasons were re-affirmed by the government officials during the various meetings conducted in the drafting of this report.

## **Conclusion**

Global experience shows that growth in vehicle ownership accompanies economic development as peoples incomes rise and road infrastructure expands. There are several economic benefits of rise in vehicle ownership as it enhances living standards and also improves efficiency of mobility.

However, unbridled increase in vehicle numbers can be detrimental to social welfare and eventually undermine social welfare due to negative externalities. Based on present trends in the growth of vehicle numbers there are people who contend that we cannot let the number of vehicles grow indefinitely due to the adverse social, environmental and economic impacts.

However, it is important to highlight that the consequences related to congestion and pollution are largely confined to more urbanized areas of Bhutan in the Thimphu and Chukha regions. Therefore, it would be unfair to adopt one size fits all policy decisions across the country.

The effectiveness of any government is judged by its ability to influence the development trajectory of the country on a desired path. The main tools at the disposal of the government to influence the direction of the national progress includes legislative, regulatory and policy making powers amongst others. As the growth in number of light passenger vehicles in the country can be attributed to market failures, it is even more important for the government to intervene to correct the market failure.

## **Committee Recommendations**

During the process of research and review, the Committee noted that there has been widespread concern about rapid rise in vehicle numbers.

The government has taken several measures to control import of vehicles. However, the efforts have not been successful for reasons outlined earlier.

In view of the importance to address this issue, the Committee is honored to submit the following recommendations:

### **1. Enact Effective National Transport Policy and Improve Coordination.**

Considering that the transport sector is highly complex and requires coordination among various government ministries and agencies, it is vital to have a comprehensive and coherent transport policy to govern the area.

The fact that the Prime Minister had to issue an Executive Order, in 2016, directing the MOIC to institute a multi-sectoral Task Force to study the issues related to traffic congestion is proof enough that coordinated efforts do not exist and must be initiated to address issues related to vehicular imports and congestion and pollution.

Although the transport sector in Bhutan has undergone significant changes since the adoption of the 2006 Transport Policy, successive government have neither been able enact a new transport policy nor undertake institutional reforms to address the emerging challenges in the sector. As outlined in Section 5.a. various donor funded studies have already been conducted over the years to provide substantive inputs into the area.

Therefore, the Economic Affairs Committee recommends to:

- Fast track the adoption of the National Transport Policy (2017 draft) and pursue the necessary institutional reforms and restructuring to improve the Transport Sector; and
- Coordinate with the Dzongkhags to ensure that adequate space is reserved for urban transport infrastructure in the Dzongkhag towns to incorporate public transport in the future.

### **2. Abolish the Import Quota granted to Privileged Public Officials**

Given the overall economic development of the country, increased incomes, enhanced availability of vehicles in terms of quality and affordability and the rising number of pool vehicles, loss of revenue, the relevance of continued grant of vehicle import quota for privileged public officials has to be questioned. This has been pointed out in the reports of the Royal Audit Authority and the Fourth Pay Commission.

Further, discussions with government officials in the conduct of this Policy Review also revealed categorically that the issuance of quotas for public officials have emasculated the effectiveness of government's fiscal policy tools to reduce vehicle imports. There is also growing public

derision expressed in the media of such tax subsidies granted to a category of public officials who are already considered to be privileged.

In view of the above, the EAC recommends the government to discontinue of the issuance of quota for public officials.

### **3. Design Targeted Interventions**

This findings of this review report has reiterated the findings of other government studies that the direct impact of increased vehicle imports in terms of congestion, pollution is mainly confined to a few urban areas. Therefore, it is important to ensure that finding solutions to address the difficulties in a few urban towns do not penalize other parts of the country.

Therefore, the EAC recommends the government to implement some of the regulations and recommendations that have emerged from the government itself but have not been implemented due to lack of political will. The recommendations are as follows:

- i. Consider introducing Congestion Charges for high traffic volume areas in towns;
- ii. Improve Pedestrian experience by making certain areas free of personal vehicles to encourage people to walk and/or use public transport;
- iii. Direct Local governments, particularly Thromdes to:
  - a. enhance its efforts to enforce parking requirements in buildings; and
  - b. enforce no parking on public roads to ensure smooth traffic flow.

### **4. Improve Public Transport**

Various studies conducted within Bhutan and experience from other countries show that the improvement of public transport systems is the most effective means to reduce the demand for private vehicles and the negative externalities of rising vehicle numbers. This applies to both intra city buses as well as between towns and villages.

The EAC commends the government for the additional investments made in improving City Bus transport in Thimphu and other towns and would like to emphasize the need to further invest in public transport. As a merit good that benefits society as a whole, the government must realize that the non-monetized social returns from such public service far outstrips the revenues. Public transport also has disproportionately lower per capita consumption of fuel and spares and high benefits to the poorer sections of society and thus their wellbeing must be prioritized.

Therefore, the EAC recommends the following:

- i. Continue its support to expand public bus transport including the Bus Rapid Transit System to improve its efficiency and reliability;
- ii. Continue to provide subsidies to improve public bus transport; and
- iii. Once improved in terms of efficiency and reliability encourage senior public officials to use public bus transport whenever possible as it will lend greater respectability and also ensure quality is maintained for benefit of the public.

**END OF REPORT**