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Growth Strategies and Rural Transformations in Bhutan: An Institutional Analysis

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School of Finance and Management / Centre for Development, Environment and Policy SOAS, University of London
Declaration for SOAS PhD thesis

I have read and understood Regulation 21 of the General and Admissions Regulations for students of the SOAS, University of London concerning plagiarism. I undertake that all the material presented for examination is my own work and has not been written for me, in whole or in part, by any other person. I also undertake that any quotation or paraphrase from the published or unpublished work of another person has been duly acknowledged in the work which I present for examination.

Signed: [Signature]  Date: 31 January 2018
To Liz
Acknowledgements

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Abstract

The Ph.D. project looks at how formal and informal institutions shape governance in the tourism value chain in Bhutan. The implications for processes of economic inclusion and upgrading are explored, together with broader considerations on the industry's contribution to economic growth. The mechanisms identified are further explored and tested in two rural communities in central Bhutan, analysing the implications for rural livelihoods' diversification and specialisation. The findings of this thesis show that despite the presence of market-enhancing formal institutions, high transaction costs in the business environment are bridged through informal networks based on trust. These mechanisms have important implications for economic inclusion and upgrading in the tourism value chain and for the direct participation of rural communities. Close networks not only minimise transaction costs but also transact valuable information and resources providing competitive advantage. Yet, networks can support inclusion and in other cases exacerbate exclusion. Mechanisms of “go-betweenness” are identified, indicating the possibility to make tourism more inclusive through targeted government interventions and sectoral policies. Beyond the direct implications for the industry case study in Bhutan, the findings challenge and extend the concept of governance used in a GVCs/GCCs framework as well as broaden the scope of institutional analysis to understand processes and outcomes of economic participation.
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Acronyms

ABTO………. Association of Bhutanese Tour Operators
BCCI………. Bhutan Chamber of Commerce and Industry
BTN……….. Bhutanese Ngultrum (Bhutanese local currency)
CBST………. Community based sustainable tourism
PEMC ……… Phobjikha Environment Management Committee
CF………….. Community forest
CSO……….. Civil society organisation
EAC……….. Parliamentary Economic Affairs Committee
EDP……….. Economic Development Policy
FDI……….. Foreign Direct Investments
GAB……..... Guides Association of Bhutan
GCC……….. Global Commodity Chain
GNHC…….. Gross National Happiness Commission (Planning Commission)
GPN……….. Global Production Network
GVC……….. Global Value Chains
HH………….. Household
HRAB……….. Hotels and Restaurants Association of Bhutan
ICIMOD…….. International Centre for Integrated Mountain Development
INR……….. Indian Rupee
JEEF…….. Japan Environmental Education Forum
JICA……..... Japan International Cooperation Agency
JSWNP……. Jigme Singye Wangchuck National Park
LAT.......... Livelihoods Assessment Tool
MoAF......... Ministry of Agriculture and Forests
MoLHR....... Ministry of Labour and Human Resources
NIE......... New Institutional Economic
NRED........ Nature Recreation and Ecotourism Division
NSB......... National Statistics Bureau (of Bhutan)
ODA........ Official development assistance
PLCA........ Phobjikha Landscape Conservation Area
PRA......... Participatory Rural Appraisal
RMA......... Royal Monetary Authority
RNR......... Renewable Natural Resources
RSPN........ Royal Society for Protection of Nature
SAARC...... South Asian Association for Regional Cooperation
SL.......... Sustainable Livelihoods
SLA......... Sustainable Livelihoods Approach
SLF......... Sustainable Livelihoods Framework
SNV......... Stichting Nederlandse Vrijwilligers (Netherlands Development Organization)
TCB......... Tourism Council of Bhutan
TO......... Tour Operator
UNDP......... United Nations Development Programme
UNESCO..... United Nations Educational, Scientific and Cultural Organization
UNWTO...... United Nations World Tourism Organization
USD......... United States Dollar
WB......... The World Bank
VC.......... Value Chain
WTO......... World Trade Organization
Introduction

In the effort to define, operationalise and estimate inclusive growth, some researchers have increasingly put emphasis on the understanding of the characteristics of the economic process. They have advocated complementing the macro-indicators for measuring inclusiveness identified by various scholars (and their effects on outcomes - such as economic output), with the understanding of the “intrinsic characteristics of the economic process” (e.g. Ramos et al., 2013; Ranieri and Ramos, 2013a). The concern with the process of growth is motivated by the idea that in addition to sharing the benefits of growth, “people must actively participate in the growth process” (Ranieri and Ramos, 2013b, p. 1), hence, the interest on how growth is generated and who benefits from it.

Participation is a key aspect of inclusive growth because it is associated with the extent to which people can productively engage in an economy and access more productive opportunities. Inclusive growth is conceptualised as “entailing the expansion of opportunities for participation” (ibid, p.1) in the economy, with a direct engagement and with a better integration of the more disadvantaged population sectors in productive economic activities. For developing and transition economies this implies economic restructuring, aiming at broadening the economic base to provide productive economic opportunities and increased productivity.

In this context, two issues motivate the focus on the economic process. The first is that there is evidence that economic growth can happen without any impact on variables important for economic inclusion such as employment growth, reduction of poverty or inequality. The second is related to the sustainability of the growth process itself. It is argued that although redistribution and transfers of income can result in greater inclusion (through reduction of poverty or inequality), the gains in inclusion obtained might be based on weaker socioeconomic fundamentals “than if the gains [in income poverty and inequality] resulted from a better integration of the poor in the economic process” (Ramos and Ranieri, 2013, p. 1). Furthermore, an inclusive growth strategy should be based not only in participating in economic activities (through self- or waged employment), but also receiving rewards for it.
(productivity/income). Some authors, therefore, have also incorporated consumer expenditure in macro-analyses as an indicator and proxy of the possibility of enjoying the “fruits” of work (Suryanarayana, 2013).

This PhD project aims at understanding the economic process - and with it the mechanisms - behind economic inclusion and economic upgrading (these two concepts are hereafter broadly defined as economic participation) in the fast growing Bhutanese tourism industry. It also looks at the implications that these mechanisms have for rural livelihoods, to understand to what extent rural households are able to diversify into more highly productive activities like tourism.

By taking a critical realist philosophical stance and a new institutional economic perspective, the research will look at the interaction between the formal and informal constraints, stressing on the “governance mechanisms” that enable (or prevent) economic actors to participate in the economy. Sectoral analysis is often approached through a value chain framework in the literature. Understanding governance is key to understand the terms of participation in value chains. If governance is defined as encompassing both formal and informal rules that constrain behaviour, it becomes a central aspect to be analysed in order to understand the process of growth and with it, answer questions of economic inclusion and poverty reduction in specific sectors or value chains.

An institutional perspective acquires relevance for several reasons. The first is related to the idea of governance in value chains. In fact, in this current era of globalisation, global value chains offer significant opportunities and governments often actively engage in policies that target key sectors for growth, to build capabilities and diversify the economic base, to position in global markets and sustain the development effort aiming at jobs creation and market linkages, to engage broader parts of the population in productive activities (all perspectives important to inclusive growth). Therefore, the empirical analysis will contribute to the value chain literature by incorporating an institutional perspective and by expanding the concept of governance. The analysis will take into account the roles of various actors placed in their social-cultural context, beyond the verticality of relationships between lead firms and first-tier suppliers.
While governance in value chain framework capture processes of globalisation and how they impact on localities, the converse is also valid. In fact, the value chain framework links firms in different locations but also the specific social and institutional contexts where these firms arise, operate, and in which they remain embedded (Henderson et al., 2002). However, the limited understanding of institutions in the value chains framework makes it difficult to study these aspects.

This links to a second reason. In fact, Bhutan is a country in political and economic transition. The early work of Davis and North (1971) identified the “institutional environment [as] the set of fundamental political, social, and legal ground rules that establishes the basis for production, exchange and distribution” (p. 6) and the institutional arrangements between economic agents as the elements “that governs the way in which these units can cooperate and/or compete…the arrangement may be either a formal or an informal one, and it may be temporary or long-lived” (p.7). Institutionalists believe that the interaction between the two influences the process of growth and therefore the economic performance and ultimately the development trajectories of nations.

It has been argued that in many developing countries and in economies in transition, the institutional environment, shaped by states that are too weak or too powerful, can either exacerbate or reduce “uncertainty that comes from weak and under-developed markets” (Chhibber, 2000, p. 306). At the same time and under certain conditions, informal institutions can have a supplementary or substituting role within an uncertain institutional environment and enhance market performance when market are small and weak (Stiglitz, 2000). At the macro-level, this influences economic growth. At the micro-level, this impacts on the availability of and access to economic opportunities. Altogether, this interaction influences the pace and the pattern of growth.

The institutional perspective acquires relevance in the area of policy for economic growth and restructuring. Authors like Khan (2012) or Rodrik (2004 and 2008) work in the area of industrial/productive policies and growth oriented governance and they have strongly pointed out the importance of tackling specific forms of market and coordination failures, identifying changes in institutional arrangements that can improve economic outcomes and economic opportunities for entrepreneurship and employment.
In transition economies empirical work has been pointing at having a more comprehensive view toward institutional conditions that include “not only legal and financial change but also comprehensive conditions of law enforcement, including reform of the organization of government and the development of self-enforcing social norms that foster entrepreneurship, trust, respect of legality and commitment.” (Roland, 2008, p. 7). As a matter of fact recent evidence from quantitative cross-country analysis has shown precisely the relevance of informal institutions for economic growth, leading to consider the benefits of formal institutions only if grounded in previously established informal constraints (Williamson, 2009).

In his work, North emphasises formal institutions as well as societal norms and beliefs, but few studies deal with these “informal institutions”, specifically trust and social capital (Ménard and Shirley, 2014). Menard and Shirley (2014), making suggestions for future research, point at exploring informal institutions (specifically trust and social capital), as well as how the “(Northean) rules that determine the security and functioning of property rights or the laws that affect contractual credibility and enforcement shape the choice of (Williamsonian) modes of governance and of the ways to organize transactions” (p.28).

This leads to the third reason, which is related to the case study setting and on how to assess growth strategies with regards to inclusive economic growth and the micro-level analysis of livelihoods changes in the targeted sector. Incorporating an institutional perspective in a meso- and micro-level analysis provides a more dynamic and encompassing understanding of growth strategies and how they are impacting on livelihoods.

The case study setting

Bhutan follows a centralised five year programming to implement economic and sectorial policies. The Royal Government of Bhutan has a clear mandate on inclusive development from its 11th Five Year Plan (titled Self-reliance and Inclusive Green Socio-Economic Development) which implementation started in September 2013 and it is due to be completed in 2018. Bhutan is also undertaking a progressive change towards liberalisation that brings with it policy change, favouring broader economic inclusion that is impacting on livelihoods diversification in rural areas.
The 11th Plan wishes to ensure inclusiveness by targeting the disadvantaged and vulnerable groups “so that all sections of [the] population enjoy the benefits of socio-economic development” (GNHC, 2013, p. 131). To do so strategies are focusing on sustaining social development and strategic infrastructure development (Ibid, p.14).

This, however, also means a bigger private sector. Bhutan’s economic strategy is strongly focused on macroeconomic stability through inflation targeting and fiscal sustainability, but it has more recently acknowledged the increasing consensus that in developing countries macroeconomic frameworks aiming at stabilisation must be balanced with broader development objectives. Hence, microeconomic strategies in the 11th Plan are aiming at facilitating diversification of the economic base, employment-intensive sectors with potential for backward and forward linkages, and the provision of specific credit lines channelled towards such priority sectors (Ibid, p.79-80).

A recent report of the Royal Monetary Authority shows that after economic growth\(^1\) slowed to just about 2.1 percent in 2013, real GDP improved to 5.7 percent in 2014 and 6.5 percent in 2015. These “jumps” in GDP that are predicted to reach 10.2 percent in the next two fiscal years, are due to specific projects: new hydropower constructions and commissioning of ongoing projects. This sector is also projected to be the main export sector and source of foreign reserves, while at the moment foreign aid and hydropower financing are the main contributors of hard-currency and capital account surplus (RMA, 2016).

Overall, the main concern associated with the prospective double digit acceleration in economic growth is expressed by commentators in the national press: the worry that the economic growth will bring little to the society (Kuensel, 2017). On the same lines, RMA evidenced how “…longer term strategies are needed for structural transformation by strengthening productive sectors such as cottage and small scale industries and development of agriculture sector” (RMA, 2016, p. 6) to avoid dependence on a single sector and make economic growth more inclusive.

In the 11\(^{th}\) Five Year Plan, tourism is among the forefront industries that should contribute to accelerate and sustain growth. Tourism is part of the Rapid

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\(^1\) Generally, developing countries and particularly least developed countries are characterised by fast growth rates, given their relatively low starting point.
Investment in Selected Enterprises (RISE) programme. The selection of priority sectors was based on three criteria: 1) employment generation, 2) revenues to the Government, and 3) returns to the entrepreneurs (GNHC, 2013, p.146). However, challenges remain for Bhutan to expand its economic base and make growth more inclusive, and these include, for example, efforts to channel credit to productive sectors and foster financial inclusion (RMA, 2016).

The RMA (2016) estimated that the five largest sectors as a share in nominal GDP are currently agriculture, construction, electricity and water supply, the general government sector and the transport, storage and communication. Nonetheless, in terms of real annual growth, the sub-sectors of hotels and restaurants, has been one of the fastest growing (16.2 percent real growth in 2015).

In fact, more recently, and for the pressing youth unemployment, the relevance of the tourism industry for local economic development has been highlighted in initiatives like the Rural Economy Advancement Programme (REAP) that falls under the Inclusive Social Development strategy. Its focus is on:

“…securing sustainable livelihoods through programmes that emphasize on diversifying crop cultivation to enhance food security and nutritional intake, generating supplementary income through skills development in non-farm livelihood activities, and building social capital through formation of self-help groups for mutual collaboration”. (GNHC, 2013, p. 123)

Nonetheless, Bhutan’s choice of a gradual liberalisation of the economy is reflected in a controlled tourism governance, through a tariff system (this will be detailed in section 6.1). Policies seem to have been successful in leveraging the potential of tourism to contribute to macroeconomic stability and minimise the impacts on the environment and the culture (e.g. Smith, 1981 and Rinzin et al., 2007). But this approach has more recently been criticised by some scholars, in some cases arguing openly against the tariff that hampers entrepreneurship (Nyaupane and Timothy, 2010). Others highlight problems associated with tourism development in rural areas particularly linked to potential growing
inequalities (Gurung and Seeland, 2011). In addition, the link between tourism and its macroeconomic contribution is now less clear and its positive contribution is challenged by its own ongoing evolution. This is why this PhD projects aims at understanding the economic process and the mechanisms behind economic inclusion and economic upgrading in the fast growing Bhutanese tourism industry.

**The thesis structure**

The thesis opens with a review of inclusive growth to identify definitions and recent approaches. The section shows how the conceptual and policy focus has shifted from poverty reduction in the presence of fast growth (pro-poor growth), towards encouraging productive participation, productivity growth and therefore structural transformations that ultimately would sustain the pace of growth. In fact, fast growth is no assurance for poverty reduction and equality acquires relevance to sustain both growth and poverty reduction. Equality, however, is understood as providing equal opportunities to people, with the predominant focus of getting them involved productively in the society. Hence, the focus on economic transformation and the analysis of bottlenecks in the business environment that hamper growth in employment and in labour productivity are central for a sustained and broad based growth.

A particular strand of literature (from The International Policy Centre for Inclusive Growth) has recently advocated to complementing macro-indicators, measurements of inclusiveness (and its effect on outcomes - such as economic output), and bottlenecks’ analysis to structural transformations and employment generation, with an enhanced understanding of the economic process associated with economic growth.

In fact, one of the macro-level studies of Ramos et al. (2013) revealed that many countries achieved high results in inclusiveness with low economic growth and those that performed worst in inclusiveness had very high economic growth rates. They argue that “this lack of correlation emphasises the need to shift the focus away from the size of the increase in economic output to how the output is generated” (ibid, p.41). This focus is particularly interesting because it provides the possibility to study mechanisms of economic participation based
on the analysis of institutions and bringing back into the “equation” the social contexts and socio-political and cultural processes associated with it.

In chapter 2 and 3 it is argued that value chain is a useful framework conceptually, analytically, and it offers sufficient theoretical flexibility to deepen the understanding of processes of economic participation. This review is far from being an *ode* to the value chain framework and it provides both a critic and way forward to its limitation.

The conceptual link is given by the fact that inclusiveness is concerned with economic growth that provides economic opportunities through processes of structural transformations. Under the current features of globalisation, global value chains (GVCs) have a pivotal role for structural transformations (e.g. by shaping global investments, division of labour and therefore influencing participation, productivity and ultimately economic growth). Governments also actively engage with policy tool-kits sustaining specific sectors to sustain growth and other broad development efforts.

Therefore, in the literature review three useful analytical advantages are identified. The first is the focus on governance and upgrading. Value chain governance casts light on issues of power and inter-firm interaction and how these influence allocation of resources, and the distribution of risks and gains. Basically, governance defines the terms of participation, how value is created and distributed among participants. In addition, upgrading looks at issues of productivity and it allows to strategically analyse the possibility to improve an economic actor’s position in the economy and its capacity to generate rents.

Both are relevant aspects for inclusive growth. However, in order to understand the characteristics of the economic process this basic framework needs to be enriched by a conception of governance capable to look beyond the verticality of lead-firm – supplier relationships. A review of the global production networks literature provides the elements for a more comprehensive understanding of governance.

This ultimately allows the integration of different theoretical perspectives: transaction costs may in fact justify certain value chain configurations (the famous typologies identified by Gereffi et al. 2005), but the interaction between the institutional environment and institutional arrangements and particularly the role of informal institutions, add socio-economic perspectives that are often
overlooked. In addition the research philosophy enhances the analysis of economic processes, as it aims at the understanding of the context, mechanisms and outcomes, for economic inclusion in the tourism value chain in Bhutan (see section 4.2).

The emerging literature linking value chain, industrial and productive policies represents the second important analytical advantage. The section shows how scholars and practitioners believe policies for growth should be shaped to harness the positive effects of the integration in global production networks, driving change in productive capabilities, essential for the transformation of the economy. This will provide an analytical “hook” to the analysis of the “tourism tariff system” in Bhutan. The tariff system (together with other policies) will be analysed under these lenses, deepening the understanding of institutional arrangements and their relevance to the conceptual ideas behind inclusive growth.

The third analytical advantage comes from the integration with the livelihood framework and the link that this provides to the micro-level analysis, particularly inter-household horizontal and vertical dynamics and the study of social networks. Dorward (2009) and co-authors (e.g. Dorward et al. 2003, 2005, 2009), integrated the institutional dimension and people’s aspirations. Particularly, the conceptualization of stepping-out (changing livelihoods activities), stepping-up (improving livelihoods) and hanging-in (protecting livelihoods) for households involved in different economic activities and markets (with strong overlaps with the concept of upgrading in value chains) provides a dynamic understanding of livelihoods.

The link between social networks and livelihoods diversification has hardly been explored in the literature of livelihoods diversification. Yet, social networks are highlighted as important for the adoption and diffusion of innovation, given that can catalyse trust between early and later adopters, by enhancing the interaction and encourage knowledge flows (e.g. Giuliani et al., 2011 on the evaluation of economic clusters).

A range of variables is identified from the literature review to be used in the quantitative analysis (section 7.2). These include demographic variables, asset variables (including social network variables), flows variables and
variables such as the time constraints that impact on the possibility to dedicate time to new activities and take full advantage of asset endowments.

A summary is provided at the end of the literature review, highlighting the main elements that are included in the framework for the analysis. It has to be noted that this research starts with general objectives (and a general research question) that are derived from existing discussions on value chain governance and livelihoods, institutions and inclusive growth. Some “constructs” were identified as guiding elements upon which data have been collected during fieldwork. This guiding question and the constructs developed into more specific research questions and tools as the empirical work proceeded.

In general, advocating for the study of social contexts might not seem a novelty, but it becomes relevant to extend the value chain framework incorporating institutional dynamics into the idea of governance. Particularly, issues of power relations that are not static (as the value chain framework seem to imply) and that governance is therefore shaped by multiple actors, often sustained and influenced by webs of relationships and by socio-cultural norms and beliefs.

Research questions were formulated as follows:

1-a) What institutional elements characterise the governance of the Bhutanese tourism value chain?
1-b) How do these elements influence inclusion and economic upgrading opportunities in the tourism value chain?
2-a) To what extent are rural households able to diversify into higher productivity activities such as tourism?

Chapter 4 describes the research process. The research questions are provided there with the research philosophy and the ontological and epistemological stances. Chapter 4 also discusses how the research questions were developed, the research design and the motivation for adopting the design. The chapter also contains reflections about the fieldwork and the adaptation undertaken to the many circumstances that emerged while in Bhutan.

Following the work of Ianchovichina and Lundström (2009a), chapter 5 provides an analysis of the context, based on secondary sources. It outlines factors of growth and drivers of poverty reduction in Bhutan, productivity and
employment growths, major challenges and opportunities for economic transformation and diversification, complemented with information on specific social norms in Bhutan.

Chapter 6 and chapter 7 contain the analyses of primary data supported by the analysis of secondary sources (previous research and policy documents) that provide the context in which economic actors operate. Chapter 6 uses primary and secondary sources to trace the interaction between the institutional environment and arrangements and contextualise the interaction of economic actors. How do policies, regulation and the government influence economic actors' coordination and vice-versa? How the emerging governance influences economic inclusion and upgrading in the Bhutanese context? Reflections upon these issues will answer questions 1a) and 1b). The main focus is exploratory to understand the economic process.

Chapter 7 contains the analysis of survey and network data at the household level, in two rural communities in central Bhutan. The relevance of this analysis relates to the prevalence of rural poverty in Bhutan. Chapter 7 complements Chapter 6 and is both exploratory and explanatory. The mixed-methods design is explained in detail in section 4.3, but quantitative methods in this research project are embedded in the qualitative analysis to enhance the understanding of the case. The chapter opens with a description of the study setting (Gangtey and Phobji valley in central Bhutan). An historical reconstruction of the livelihoods is provided, highlighting the key micro and macro drivers for social and economic change. The analysis of primary data is based on simple statistics and relationships on key variables and network data. Network data are obtained through a specialised software for network analysis (UCINET). The main findings of Chapter 7 confirm the relevance of social network to access new livelihoods and to sustain them with knowledge flows and provision of key assets (financial support and tacit knowledge in particular). Overall, the feedback to the literature reviewed resides mainly in the understanding of the socio-economic processes that underpin economic action in Bhutan, expanding the idea of governance in value chains and providing a more dynamic understanding of livelihoods strategies.
Chapter 1 - Inclusive growth

Structural transformations, productive engagement of broader population sectors, and the focus on the process of growth (i.e. a dynamic understanding of growth) are key aspects identified by some leading scholars in the literature on inclusive growth. They advocate for approaches that would focus on the “process” of growth to assess inclusive growth, with the objective to cast light on how growth is generated and who is able to benefit from it. Focusing on the process of growth requires a focus on understanding the mechanisms behind economic participation and economic growth.

Chapter 2 - Growth strategies and global value chains

A focus on value chains governance through an institutional perspective based on NIE would allow a better understanding of the process of growth. The chapter takes three steps. It argues that if structural transformations are central to inclusive growth to provide broader and better opportunities for productive engagement, insertion in global value chains have a high potential to stimulate investments, job creation and more broadly economic restructuring and growth, particularly in developing countries. The focus on value chains governance enables the understanding of both the process and the impacts of particular sectoral strategies that are functional to the development of specific value chains. It is argued that the analysis of governance in the value chain framework has been deployed narrowly to study coordination between lead firms and suppliers, overlooking more complex “horizontal” interactions that have the potential to expand the understanding of governance. The value chain framework has the potential to capture governance mechanisms at sectoral level emerging from the interests and the interaction of multiple actors placed in their socio-cultural context and to cast light on the process of growth at sectoral level.

Chapter 3 – Addressing livelihoods through value chains

Understanding the impacts generated by governance mechanisms in value chains represents an additional unexploited potential of this framework. Authors have integrated a livelihood framework to capture impacts on income streams of different livelihoods activities associated to the insertion in specific value chains. In addition to income streams, in this chapter it is proposed a focus on tangible and intangible assets that would capture more effectively the links between the meso- and the micro- levels, and contribute to a more dynamic understanding of livelihoods strategies at the household level, influenced by informal institutions related to gender, cultural norms, community and, specifically, social networks. In fact, relationships of assets and income streams can capture intra-household and inter-household dynamics (using “agency variables” such as social capital variables including social networks and others such as time constrains). The livelihoods’ framework modified by Dorward and co-authors that
conceptualise livelihood strategies in ‘hanging in, stepping up, and stepping out’ allows a much useful link with the “upgrading literature” in value chains.

Chapter 4 – Methodology

The methodology chapter presents the research questions and the overall research strategy framed within the critical realist research philosophy. Methods employed include analysis of policy documents to provide a deep understanding of the context, observations used to develop other research tools such as interviews and a survey by questionnaire. The interviews and the review of policy documents had the objective to provide empirical evidence about the process of sectoral growth and identify governance mechanisms, answering research questions 1a. What institutional elements characterise the governance of the Bhutanese tourism value chain? 1b. How do these elements influence inclusion and economic upgrading opportunities in the tourism value chain? The survey by questionnaire and the network analysis were used to collect data on livelihoods and assets to test specific governance mechanisms identified and to understand their effect on livelihoods activities (transformations, and possible specialization), answering question 2. To what extent rural households are able to diversify into higher productive activities such as tourism?

Chapter 5 – Background analysis and profile of economic actors in Bhutan

By providing information about the general context through the review of reports, research and policy documents on poverty and economic development in Bhutan, key drivers of structural change, poverty reduction and growth are identified. A monograph on social capital in Bhutan also provides a valuable background study on the socio-cultural context and local institutions, framing the analysis in chapter 6 and 7.

Chapter 6 – An institutional analysis of tourism governance

The chapter traces the historical trajectory of tourism development in Bhutan and takes into account the role of multiple actors (see summary of Chapter 2 in this flow chart) involved in the industry evolution. The aim is to understand how production and value-addition take place, identify the distribution of rewards along the chain and more importantly, elucidate the processes of economic inclusion and upgrading. This chapter answers research questions 1a and 1b,

Chapter 7 – Community level analysis
The chapter contains an historical reconstruction of the livelihoods’ changes that shaped two communities selected for the study in central Bhutan during the last 35 years, discussing key micro and macro drivers of social, economic and environmental change. The analytical part contains a quantitative study on the main relationships between key assets and agency variable (described in the methodology) enriched by interview data that provide evidence on the effectiveness of rural development strategies for the area and for Bhutan. This chapter answers question 2 and it confirms the importance (yet varied role) of governance mechanisms like trust and social networks play in diversification opportunities for rural households. Findings show that both calculated rational interests and kinship explain the importance of social networks in influencing opportunities. While this leads to significant opportunities for some, it can also lead to barriers to inclusiveness for others.
Chapter 1 – Inclusive Growth

Abstract
The development objectives of the 21st century to reduce poverty globally are at the root of the work on pro-poor growth. A growing literature has recently emerged on how economic growth can be sustained by inclusiveness and how inclusiveness can help reducing income inequality gaps. With the change in paradigm, new concerns on the equity component of the growth approach to poverty reduction and serious doubts of its capacity to tackle distributional issues and asymmetries of power also emerged. The objective of this introductory section is to show how the focus on growth has shifted from poverty reduction towards encouraging productive participation, productivity growth and therefore structural transformations.

1.1 From pro-poor growth to inclusive growth

There is an active debate about the shift in paradigm from pro-poor growth to inclusive growth, particularly on whether inclusive growth can be considered an effective advancement or a regressive step in understanding the processes of economic growth and its relationships with poverty reduction and inequality. Equity and participation in the growth process are the main issues highlighted in the debate, together with the challenge of getting a clear and operational definition of the new concept (McKinley, 2009 and 2010; Saad-Filho, 2011; Ranieri and Ramos, 2013a).

One of the main highlights is the multidimensionality attached to the concept of inclusive growth. While pro-poor growth literature is mainly based on unidimensional outcomes - by focusing almost exclusively on income and on the relationship between economic growth, income poverty and income distribution, inclusive growth is more widely understood as multidimensional and embracing the notion of economic participation, structural transformations and
the understanding of the processes of growth (e.g. Ianchovichina and Lundström, 2009b; Ramos et al., 2013).

Critics point out that the potential of a multidimensional stance on the growth processes has been somehow diluted by a legacy of orthodox economic policies with an excessive focus on markets (Saad-Filho, 2011). Similarly, Porter and Craig (2005) argue how “clusters of values” around poverty reduction and inclusion in the development discourse have been drawn in a way that the market ideology remains central with good-governance policies imprimaturs to sustain economic growth, being strongly advocated and imposed in developing countries. In this context, they argue, poverty reduction and now “inclusion” strategies can only perpetuate the periphery of the poor. As noted by Saad-Filho (2011):

“In the late 1990s, the mainstream was compelled to admit that poverty reduction and redistribution were not spontaneous by-products of growth.... Instead, poverty has to be addressed directly through a dedicated set of economic and social policy tools. The [International Financial Institutions] also had to confront claims that inequality is harmful because it induces political and economic instability.” (Saad-Filho, 2011, p. 330).

Certainly, the global commitment to the Millennium Development Goals in the 2000s shifted the terms of the debate around growth to a more “humanised dimension” (Saad-Filho, 2011, p. 322) with an increased recognition of the need for participation of people in the process of growth to achieve “healthier” economic conditions, thereby addressing “the root causes of poverty and inequality” (Ranieri and Ramos, 2013a, p. 3; but see also (Ali, 2007a; Cook, 2006).

Another feature associated with the paradigm shift, is that there is wide recognition that behind the fast growth of Asian countries in the late 20th century (East Asian Tigers particularly - Hong Kong, Singapore, South Korea and Taiwan) and other emerging countries’ economies there was “the visible hand of the state rather than the invisible hand of the market that helped part of the developing world catch-up with the industrialised countries” (Nayyar, 2013).
This is in terms of catching-up in industrialization but also in terms of per-capita income growth that was initially accompanied by stable and low inequality as the state remained active with poverty reduction programmes (Ranieri and Ramos, 2013a, p. 3; Cook, 2006).

Recently, however, the IMF warned how growth has been less inclusive and less pro-poor in Asia\(^2\). Poverty has fallen across the region over the last two decades but inequality has increased, “dampening the impact of growth on poverty reduction. As a result, relative to other regions and to Asia’s own past, the recent period of growth has been both less inclusive and less pro-poor” (Balakrishnan et al., 2013, p. 28).

The available evidence that poverty reduction and equality through trickle-down effects of markets is difficult to achieve without policies concerning the poor and intervening in the pattern of low growth, brought about stronger presumptions that growth, poverty and inequality are in fact, complementary concepts (Ramos et al., 2013). A recent paper from Ravallion (2014) reinforces the evidence of the complementary of two factors: equity - or reduced inequality - and fast growth - that is to say, reducing the income inequality gap brings more effective poverty reduction in the presence of growth, and sustains growth itself.

His work based on empirical data of income poverty, income inequality and economic growth in developing countries, shows that even though growth has generally helped reducing the incidence of absolute income poverty, this has been less in more unequal countries. Furthermore, high income inequality threatens future progress against poverty by attenuating growth prospects and widening gaps in living standards between the rich and the poor (Ravallion, 2014).

Ravallion has worked extensively on poverty reduction and on techniques to measure whether income poverty can be reduced in the presence of economic growth. Ravallion’s original idea of pro-poor growth emphasised rapid growth to reduce poverty (absolute improvements) - pointing at the success of China “in reducing extreme poverty through rapid economic growth — even

\(^2\) The paper, follows the Ravallion and Chen (2003) definition of pro-poor growth: growth is pro-poor when “it reduces poverty. Inclusive growth, on the other hand, is defined as growth which is not associated with an increase in inequality, Rauniyar and Kanbur (2010). In particular, growth is inclusive when it is not associated with a reduction in the income share of the bottom quintile of the income distribution” (Balakrishnan et al., 2013, p. 8).
though its inequality worsened” (Cited in McKinley, 2009, p. 6). With his recent study, Ravallion (2014) seems to provide evidence on the “trade-off”, that unequal distribution of wealth will also decelerate economic growth, motivating policy-makers to look at inequalities and include more broadly members of the society in the process of growth.

A recent report published by the McKinsey Global Institute (Elstrodt et al., 2014) on Brazil’s stagnant economic growth, shows from a different angle the same picture presented by Ravallion (2014). In this case, the authors’ main concern is economic growth and how to advise policy-makers in Brazil to unlock unexploited potentials. Their key message is: more inclusiveness is good for economic growth. The report acknowledges the important contribution of growth for poverty eradication through redistribution measures and social programmes3, but at the same time it claims that these measures are not enough to sustain growth.

According to the report, Brazil’s new middle class should be engaged fully in the process of growth by making people and enterprises more productive, increasing human capital, removing barriers to competition and international trade (Brazil focused its economic development policies mainly inwards due to the size of its internal market), reducing the informal sector, fostering entrepreneurship and innovation, and engaging in more intense production and consumption cycles, that all together would help to sustain growth.

Yet, these production and consumption “cycles” also show vulnerabilities, that is, household debt has grown from 20percent of income in 2005 to 43percent in 2012, with high real interest rates on credit (Elstrodt et al., 2014). Similar trends are witnessed by the Economic Commission for Latin America and the Caribbean from other Latin American countries4 (Gray Molina, 2014). It is important to note the two sides of a same coin: growing inequalities and vulnerabilities versus the imperative of economic growth and the kind of recommendations related to how countries (and their citizens) should engage in more productive, rewarding (value-added) and growth-oriented activities.

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3 The authors refer to the Bolsa Familiar, a conditional cash transfer programme.
4 The Economic Commission for Latin America and the Caribbean published new data on consumption, spending and borrowing. Latin American households have become increasingly indebted, with consumer credit and credit cards representing the largest part of the burden (Gray Molina, 2014).
McKinley (2009) noted that the World Bank World Development Report 2006 recognises equity has an “intrinsic value” even though, he argues, it is still far from becoming an end in itself (p.3). For McKinley the change from pro-poor to inclusive growth is also marked by a specific set of events that is the 2008 financial crisis and the consequent recession in developed economies that somehow made more unlikely fast (and consequently pro-poor) economic growth witnessed in the past.

Equity and growth are seen as complementary. Nonetheless, with inclusive growth, the equity component (that is to say the pro-poor effect which should reduce inequality) seems to be further diluted. In fact, by assuming a distribution-neutral growth (that is the top 10percent and the bottom 40percent see their income increased at the same rate), the author demonstrates how the inequality gap increases even if in relative terms the (re)distribution of growth is “neutral” (McKinley, 2009, p.17). Saad-Filho (2011) highlights the danger of a restrictive concept of equity in inclusive growth that would exclude redistributive features, with the exception of social safety-nets to target the chronically poor. In this way, he argues, poverty reduction is still seen as coming from faster growth rather than from policies that address specific constraints faced by the poor (Ibid).

The World Bank definition of inclusive growth is in fact based on equality of opportunities (Ianchovichina and Lundström, 2009b) and concern mainly with rapid growth and the capacity of people to participate fully in the growth process and sustain growth.

“Rapid and sustained poverty reduction requires inclusive growth that allows people to contribute to and benefit from economic growth. Rapid pace of growth is unquestionably necessary for substantial poverty reduction, but for this growth to be sustainable in the long run, it should be broad-based across sectors, and inclusive of the large part of the country’s labor force. This … implies a direct link between the macro and micro determinants of growth. The micro dimension captures the importance of structural transformation for economic diversification and competition... The inclusive growth definition is in line with the absolute definition of
pro-poor growth, but not the relative definition … [the] absolute pro-poor growth can be the result of direct income redistribution schemes, for growth to be inclusive, productivity must be improved and new employment opportunities created. In short, inclusive growth is about raising the pace of growth and enlarging the size of the economy, while levelling the playing field for investment and increasing productive employment opportunities … [focusing] on productive employment rather than income redistribution” (Ianchovichina and Lundström, 2009b, pp. 1-3-4).

1.2 Operationalization of inclusive growth

Scholars are still far from a consensus on how to conceptualise and measure inclusive growth. Ranieri and Ramos (2013a) argue that some features and definitions of pro-poor and inclusive growth are almost undiscernible, particularly those that focus on income outcomes. The inclusive growth definition is in line with the absolute definition of pro-poor growth, but not the relative definition (Ianchovichina and Lundström, 2009a). Under the absolute definition, growth is considered to be pro-poor provided that poor people benefit in absolute terms (Ravallion and Chen, 2003). “In contrast, in the relative definition, growth is ‘pro-poor’ if and only if the incomes of poor people grow faster than those of the non-poor, and inequality declines” (Ianchovichina and Lundström, 2009a, p. 3).

From the literature it emerges that an important line for differentiating the two concepts can be traced to the focus between outcomes (e.g. output growth, income growth or income inequality) as opposed to process, which emphasises more the opportunities to participate, as well as the understanding of who can participate in the process of growth (Ianchovichina and Lundström, 2009a; Klasen, 2010; Ranieri and Ramos, 2013a). These two latter dimensions are complementary in inclusive growth. Yet, inclusive growth can still be assessed focusing on outcome if non-income dimensions are considered. For example, Ali and Son (2007) focus on access to health and education and how they are distributed along the income distribution. In this case “inclusive growth occurs when improvements are tilted towards the income-poor” (Klasen, 2010, p. 6).
Ianchovichina and Lundström (2009a) consider process as referring to structural transformations. In their views, inclusive growth is a long-term quest that requires a focus on productive capacities and productive employment, economic diversification and competition that are difficult to capture with aggregate analyses. They focus on the importance of analysing bottlenecks of economic transformations, and on contexts and “ex-ante analysis of constraints to future economic development” (p.4). As noted by (Klasen, 2010) this approach relates to a strand of literature that focuses on access to opportunities and concentrates on the poor as participants, contributors and beneficiaries of economic growth.

The literature on equal access to opportunities (and increased opportunities as result of the growth process) focuses on policies that reduce “bad inequalities” often associated with market failures (e.g. Ali, 2007b, 2007a; Ali and Zhuang, 2007). In fact, “capability enhancement must be accompanied by the creation of productive and decent employment opportunities for the less

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5 Bad inequalities are those related to market failures (particularly credit market failures that prevent investments in human or physical capital), coordination failures and governance failures that “prevent individuals from connecting to markets and limit investments in human and physical capital” (Chaudhuri and Ravallion, 2006, p. 17). Bad inequalities are also linked to more structural features such as geography, social exclusion, inadequate levels of human capital, lack of access to credit and policy impediments. These in fact can lead for example to either low levels of publicly-available and/or private endowments (i.e. rural roads, electrification or availability of private land or financial capital) that constraints business opportunities. In a context with prevalence of bad inequalities people with little wealth or low incomes find it difficult to invest and be part of the growth process.
well-off and to ensure that they get access” to them (Ali, 2007b, p. 10). Particularly, the notion of participation via “productive employment” and “productivity” growth, which embraces not only the outcome but also the process of growth, has been seen as getting prominence in the debate around inclusive growth (Ranieri and Ramos, 2013a, p. 13).

Highlighting the constant and interconnected features in the various definitions will serve the purpose to outline here what elements are going to be considered in this research project. First, inclusive growth has been thought as growth that promotes development in its multiple dimensions such as income, living conditions and empowerment (defined as having a say in the growth process), expanding economic opportunities and focusing at the same time on the pace and the pattern of growth. The concept requires reduction of inequalities in access to opportunities available from the growth process, which might include access to public goods and services, assets, productive employment and to social safety nets for the chronically poor. There is less focus on income redistribution and more emphasis in the direct participation in the growth process as a strategy to increase incomes for excluded groups (e.g. Ali 2007a, p.8; Ali and Son, 2007; Klasen, 2010; McKinley, 2010; Ianchovichina and Lundström, 2009b, 2009a). Second, what matters for inclusive growth is also how people from different parts of society engage in the process of growth and how benefits are shared. The focus on the process of growth and participation (particularly those elements that enable or inhibit people’s participation based on ethnicity, gender and geographical aspects) are central in Ianchovichina and Lundström (2009a), Ranieri and Ramos (2013a, 2013b) and (Ali, 2007a).

Ranieri and Ramos (2013b) argue:

“The concern with the process of growth is based on the understanding that in addition to sharing the benefits of growth, people must actively participate in the growth process. Accordingly, with respect to process, inclusive growth can be thought of as entailing the expansion of opportunities for participation, which can include both engagement in productive economic activities and
having a say on the orientation of the growth process.” (Ranieri and Ramos, 2013b, p. 1).

1.3 Estimating and assessing inclusive growth: the relevance of the process of growth

The often too blurry conceptualisations highlighted in the previous chapter lead to the debate of what should be considered as inclusive growth. Operational definitions in fact, include among others, consumption\(^6\) and its expansion, as a proxy for inclusion together with the expansion of incomes (Suryanarayana, 2013), productive employment, productivity growth, absolute poverty, asset inequality, ease of access to markets, credit and resources (Sáez, 2013).

As highlighted above there are two strands of literature: one that has been developing measurements at macro-level and another that is turning to a more meso- and micro-level analysis of inclusive growth. At the macro level (Ranieri and Ramos (2013a) reviewed the current attempts to measure inclusive growth with indices that include several dimensions of the concept. Such indicators encompass economic growth, productive employment, economic infrastructure, income poverty and equity, gender equity, human capabilities and social protection (McKinley 2010 cited in Ranieri and Ramos, 2013a). The composite indices are used for cross-country analysis and comparisons.

Other indicators measuring the inclusiveness of growth developed by Ramos et al. (2013) excluded the amount of growth achieved from the index so that models could be estimated to assess the impact of inclusiveness on growth. Their index is based on three indicators - income poverty, inequality and the employment-to-population ratio - used as proxies for the benefit-sharing and participation which are salient features of inclusive growth intended as “a process that enhances benefit-sharing and participation” (Ranieri and Ramos, 2013a, p. 12; Ramos et al., 2013).

Nonetheless, Ranieri and Ramos are sceptical about the use of indices and indicators for a number of reasons. Some doubts are related to data

\(^6\) With the controversy that brings with it in terms of vulnerabilities and debt bargains for households seen above for Latin America.
choices and availability, composition of indices (e.g. the weight attributed to each indicator) and causality directions especially in the presence blurry definitions (see Ranieri and Ramos, 2013a, pp. 13–15). In general the constraints at the macro-level are associated with finding a proper working definition of inclusive growth and proxies to operationalise those definitions with the available aggregate data. The authors argue in favour of complementing the measurements of inclusiveness and the effect on outcomes (i.e. on economic output) with the understanding of the intrinsic characteristics of the economic process, “investigating the socioeconomic processes behind what is happening provides an unprejudiced perspective that brings the prospect of greater discernment about inclusion, both conceptually and analytically” (Ramos and Ranieri, 2013, p. 1).

The study of Ramos et al. (2013) in fact reveals that many countries achieved high results in inclusiveness with low economic growth and those that performed worst in inclusiveness had very high economic growth. They argue that “this lack of correlation emphasises the need to shift the focus away from the size of the increase in economic output to how the output is generated” (p.41). This is also the concern of Ianchovichina and Lundström (2009a) when they noted the effects of extractive industries in an economy - Dutch disease that brings contraction in non-resource sectors, lack of broad employment opportunities, but still output growth at macro level – and the relevance of policies for inclusive growth as important components of government strategies.

Despite the strong focus on economic growth, the perspectives briefly outlined above embraces problems of access to assets (particularly land and credit access, but also education and health), ownership and participation as well as broad structural inequalities including those emerging from structural transformations brought about by technological changes, shifts in property rights and transformations in the labour market, particularly for weaker groups (e.g. Ali 2007b; Rauniyar and Kanbur, 2010).

The work of Ianchovichina and Lundström (2009a) focuses on structural transformations and equality of opportunities in terms of access to markets and resources, productive participation and employment. Therefore, by enlarging the size of the economy and by enhancing productive participation and productivity would influence the long-term “pace” of growth, utilising labour force...
otherwise “trapped in low productivity activities” (Ianchovichina and Lundström, 2009a, p.3).

Table 1: The inclusive growth analytics

<table>
<thead>
<tr>
<th>1. Get an overall picture of what activities specific groups are engaged in and to what extent these activities have the potential for growth or if migration to other sectors are possible – in the short and the long run.</th>
</tr>
</thead>
<tbody>
<tr>
<td>a) <em>Background analysis</em>, to understand factors of growth and poverty reduction in the country, productivity and employment dynamics, major challenges and opportunities for economic transformation and diversification.</td>
</tr>
<tr>
<td>b) <em>Profile of economic actors</em> that would encompass the understanding of dynamics associated particularly to excluded groups, providing a description of income earning activities of self- or wage-employed, distinguished by sector, size of firm, by geographical area (e.g. rural, urban), by sub-national unit (e.g. provincial, state and others), by type (e.g. formal or informal), and other relevant characteristics.</td>
</tr>
</tbody>
</table>

| 2. Finding the constraints to inclusive growth, from the perspective of different economic actors. |

Source: Ianchovichina and Lundström (2009a, p. 9). The authors encourage the use of different tools and data and it follows 2 phases.

As argued by Ianchovichina and Lundström (2009a):

> “Employment growth generates new jobs and income for the individual – from wages or self-employment - while productivity growth has the potential to lift the wages of those employed and the returns to the self-employed. After all, in many low-income countries the problem is not unemployment, but rather underemployment. Hence, inclusive growth is not only about employment growth, but also about productivity growth... The ability of individuals to be productively employed depends on the opportunities to make full use of available resources as the economy evolves over time.” (p.7).

The following section (chapter 2) will argue that if the outcome and the processes are equally important to understand inclusive growth, the framework developed to understand global value chains – with its focus on processes of globalisation and trade, governance, competitiveness, value-capturing, productivity and structural change, and its integration with the livelihoods’ framework to understand micro-dynamics – can provide a useful analytical
basis at meso- and micro-levels, to understand processes and outcomes of economic participation.

The focus on policies for sustainable income growth and sectorial strategies in value chains highlighted in Kaplinsky and Morris (2016), are relevant to the discussion on competition, productive capacities, productive employment and economic diversification. The section will open with a review of what it is known about structural transformation processes and the relevance of institutions in the process of structural change. A review of the analytical framework associated with global value chains will follow, highlighting the importance of governance to understand the implication for economic participation (inclusion/exclusion and upgrading). Limitations of the concept of governance in value chains will also be pointed out.
Chapter 2 – Growth strategies and global value chains

Abstract
Given the focus on productivity and employment, structural transformations become central to a sustained and inclusive economic growth. This section navigates the literature on structural transformations and value chains. It is argued that under current features of globalisation, global value chains (GVCs) have a pivotal role for transformations but the link to features of both structural transformations and inclusiveness does not happen automatically. The arguments in favour of industrial and productive policies is provided together with an understanding of how scholars and practitioners believe economic policies should be shaped to harness the positive effects of integration in global production networks, driving change in productive capabilities. Governance remains a central aspect for the capacity to bring about structural change as well as to engage with the vulnerable segments of the society.

2.1 Transformational growth

Structural transformation can be considered both an instrument for and an effect of economic growth (Green, 2014) and it requires reallocation of labour and capital across sectors and a shift to higher productivity activities through a process of change that involves resource mobilisation, technology adoption, changes in the levels of extraction in natural resources and learning processes (Herrendorf et al., 2013; Salazar Xirinachs et al., 2014; Stiglitz, 1989). The trajectory normally entitles a shift in composition of economic activities within agriculture and from agriculture to manufacturing, and services in later stages (Haggblade et al., 2010). These shifts, combined with urbanisation, are normally regarded as the “defining features of the development process” (Start and Johnson, 2004, p. 4).

Diversification in the economy can take place at different levels (sectoral/individual), spaces (rural/urban) as well as types (formal/informal) and these various dimensions may not always be interconnected or evident (Start and Johnson, 2004). Furthermore, the transition to a market economy requires investments in new productive structures to adapt to different market demands.
The process is understood as driven by increasing productivity usually in resource sectors (primary sectors) particularly in agriculture, whose increased productivity drives a higher consumption of non-farm products and services as compared to food. This produces an increasing relevance of manufacturing and services in the total national output, accompanied by capital and labour shifts out of agriculture (Haggblade et al. 2010).

As a consequence, this translates into higher levels of employment and wages leading to stronger domestic demand and possibly economies of scale, which are driven by intra- and cross-sectoral linkages as well as expanding export markets (UNCTAD, 2016, p. VII). In fact, “reallocation of resource appears to be driven [also] by the interaction of economic growth and openness to trade” (Imbs and Wacziarg, 2003, p. 84). As a consequence a considerable empirical literature also tested the relevance of an export-led growth hypothesis.

Evidence also showed that at a macro-level sectoral specialisation happens very late in the development process and that “countries diversify over most of their development path” (Imbs and Wacziarg, 2003, p. 64). In other words sectoral specialisation only happens in high-income economies with the exception of small countries that can be constrained given their conditions and endowments (Ianchovichina and Lundström, 2009b).

These processes of diversification and specialisation are not exclusively by-products of a transition to a market economy or market forces. There is a strong consensus that the insertion in global markets and the distribution of gains (profits) from productivity growth need the right policy framework to drive decisions of economic actors about investment that potentially can generate additional productive capacity, technological upgrading and change (UNCTAD, 2016, p. VII). In fact, transformations based on the trajectories outlined above are not straightforward especially in developing economies where market failures and government failures are pervasive (e.g. Rodrik, 2004; Stiglitz, 1989). Under these circumstances, efforts to diversify and modernise the economy might not provide alone leverages out from low equilibrium traps (Khan, 2012).
From an institutional perspective the role of the formal and informal institutions is central to understand the process of economic transformation, particularly for developing and transition economies\(^7\) (North, 1990; North, 2003).

“New institutionalists questioned mainstream assumptions that different rates of development were purely the result of different endowments of resources and human capital or of different rates of investment and adoption of new technologies” (Ménard and Shirley, 2014, p. 12)

Shirley argues that:

“When information is costly and property rights are poorly protected, contracts become hard to specify and enforce and transaction costs are high. Societies with persistently higher transaction costs have less trade, fewer firms, less specialisation, less investment and lower productivity” (Shirley, 2008, p. 613).

It has been argued that in many developing countries and in economies in transition, the institutional environments, shaped by states that are too weak or too powerful, can either exacerbate or reduce “uncertainty that comes from weak and under-developed markets” (Chhibber, 2000, p. 306). At the same time and under certain conditions, informal institutions can have a supplementary or substituting role within an uncertain institutional environment and enhance market performance when markets are small and weak (Stiglitz, 2000).

According to Stiglitz, economies transit from a situation where “economic activity is embedded in social relations, to one in which social relations are embedded in the economic system. This change is not uniform across the world, nor is it ever complete” (Stiglitz, 2000, p. 65). At the macro-level, this influences economic growth. At the micro-level, this impacts on the availability

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\(^7\) As highlighted by Solow in Dasgupta and Serageldin (2000) “Originally, economists believed that the accumulation of capital in the form of tangible capital was in fact able to explain economic progress. Than they added human capital and realise the importance of education and training. The exercise has paid off in terms of understanding productivity. The study of formal and informal institutions has added another layer” (p.6).
of and access to economic opportunities. Altogether these influence the pace and the pattern of growth.

The initial focus of institutional economics on formal rules and the interaction between three key concepts – transaction costs, property rights, and contracts – fed what is commonly known as the “good governance agenda” that justified considerable aid being channelled to support market-friendly formal institutions and governance, in developing and transition countries.

Nonetheless, the work of institutionalists is much more articulated. In transition economies empirical work has been pointing at the importance of informal institutions. As stated by Roland:

“One needs a more comprehensive view toward institutional conditions. These include not only legal and financial change but also comprehensive conditions of law enforcement, including reform of the organization of government and the development of self-enforcing social norms that foster entrepreneurship, trust, respect of legality and commitment. One cannot expect full-fledged institutions to be introduced overnight. However, minimum institutions underpinning market development must be present from the beginning because these define the rules of the game and thus place restrictions on undesired kinds of individual behaviour.” (Roland, 2008, p. 7).

Recent evidence from quantitative cross-country analysis has shown the relevance of informal institutions for economic growth and added evidence on the limitation of transplanting formal institutions. These analyses also provided evidence that formal institutions are beneficial if grounded in previously established informal constraints (Williamson, 2009).

Therefore, new institutional economics have demonstrated “a growing interest in themes that traditionally pertained to economic sociology” (Dutraive, 2009, p. 9), with cultural backgrounds, beliefs and social norms, playing an important role in determining economic choices. In fact, institutions can be “powerful motivators precisely because they incorporate individuals’ beliefs and internalized norms about the world, including their expectations of how others
will behave and will expect them to behave” (Ménard and Shirley, 2014, p. 27). This, it is argued to have extended North’s research, with studies looking at the role informal institutions such as trust and social networks (Dutraive, 2009; Ménard and Shirley, 2014).

Hence, if governance is defined as encompassing both formal and informal rules that constrain behaviour, it becomes a central aspect to be analysed in order to understand the process of growth, transformations and with it, questions of economic inclusion and poverty reduction.

As argued by Dutraive (2009), “studies devoted to transition [economies] learn much about the subtlety of the relations between political institutions and economic efficiency” (p.12). Different outcomes in relation to investments or redistribution of benefits to broader slices of the society depend on the role of the governing leaders in setting-up and shaping conditions for those mechanisms to materialise. Therefore, institutions, not only determine economic outcomes but also the distribution of resource (rents) that can reinforce power of dominant classes and shape economic development in different ways.

In this respect, one of North’s latest work, contained more radical views on the role of the elites, that it helps explaining why institutions – such as markets, elections, and corporate law – of developed economies (defined by North as “open access orders” OAO) transplanted into developing economies (defined as “limited access orders” LAO) do not have the foreseen effects (North et al., 2011). With reference to the interaction of local elites with and influence on multinational corporations and international investments/investors, North et al. argue that

the ability of a developing country’s “elites to rely on multinational firms for profitable interaction with the global system lessens their incentive to improve domestically established organizations and even the organization of the government itself. The result is that many developing countries’ today have dualistic economies, with a domestic economy governed by LAO rules and international enclaves run by a separate set of rules and institutions, sometimes enforced by foreign OAOs.” (North et al., 2011, p. 15).
Green (2014), referring to African least developed economies noted a strong tendency of current policies aiming at modernisation that are more and more legitimizing “initiatives intended to restructure rural economies and the production practice of small farmers who must be reconfigured as commercial farmers or farm workers” (p.2). And referring to inclusive growth, she also argues that:

“middle income Africa is part of a powerful global reimagining of development driven by the ambitions of elites seeking a move away from the post adjustment prioritisation of poverty and social sectors towards what are perceived to be the economic opportunities offered through large scale growth” (ibid, p.1).

Whether more or less radical lenses are adopted to understand structural transformations and institutional dynamics, it is clear that the process does not follow a simple occupational shift. Trajectories are dynamic and uncertain, particularly if processes of liberalisation, globalisation and with it institutional changes are also accounted for.

The UNCTAD report on trade and development (UNCTAD, 2016) shows three different trajectories in terms of economic diversification and specialisation, with a small number of countries catching-up in industrialisation (robust production, investment, knowledge and income linkages built over decades and with an increase presence and diversity of manufacturing), the majority of developing countries however, have experienced stalled industrialisation or deindustrialisation.

Furthermore, the process of globalization of production and industrialisation are not always accompanied by a rise of quality jobs (ILO, 2002, p.35-7 cited in Siegmann et al., 2014; but also Ali, 2007b). In line with the observations contained in the UNCTAD’s 2016 report, Losch et al. (2012 cited in Alobo Loison, 2015) highlighted how Africa’s stagnating industrialisation made smallholder farming the primary choice for gainful employment for the young labour force.

This provides a link to policies associated to processes of growth and economic globalisation. The case of Mozambique’s growth, for example, shows
how industrial megaprojects can stimulate strong economic growth and exports, yet creating few opportunities for jobs outside agriculture, with worsening in poverty and inequality (Virtanen and Ehrenpreis, 2007). An enclave industry\(^8\) characterised by little or non-existent backward and forward linkages creates few direct jobs and provides fewer opportunities in related industries with little spill-over effects in skills acquisition and more in general in broader investments, while the benefits of economic growth “leak” to foreign investors (Virtanen and Ehrenpreis, 2007; Cunguara and Hanlon, 2012).

Cunguara and Hanlon (2012) suggest the central role that agriculture can play in reducing poverty and inequality, given the agricultural vocation of Mozambique and the importance of increasing agricultural productivity - leveraging development through trade in agricultural goods and agro-processing.

There are various mechanisms implied in the case of Mozambique and in the policy recommendation of Cunguara and Hanlon (2012). These will be analysed in the following sections and they are related to: 1. policies for economic growth, that can drive the insertion in global production networks; 2. the relevance of value chains that can affect the viability of both, investments in industrial capabilities as well as smallholders’ ability to enhance productivity through commercial agriculture; 3. the models related to rural livelihoods diversification and the non-farm economy. These points will be explored through the “lenses” provided by the new institutional economic theory, looking at the interaction between formal and informal institutions.

The role of value chain in structural transformations and the importance of productive policies will be assessed in the following section. The micro-level dynamics associated to livelihoods diversification and the influence of institutions will be discussed in more details in Chapter 3. Particularly issues related to the non-farm economy and access to higher productivity activity will be discussed in section 3.3 with special reference to social networks.

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\(^8\) Enclave industries are often associated with extractive industries such as mining often regarded as “detached” from local socio-economic systems with little positive impacts on the development of host communities and local capabilities (Kaplinsky and Morris, 2014).
2.2 The role of global value chains in structural transformations

Following the previous section, GVCs influence division of labour and the integration in global networks of trade (Kaplinsky and Morris, 2016; Start and Johnson, 2004). The GVC framework emerged in response to an increased complexity of global economic networks made of inter-firm and intra-firm relationships. These features evolved from the Washington Consensus’s focus on deregulated markets and export-oriented strategies for economic growth. Free trade was seen as supporting the capacity to develop national economies of disadvantaged countries (Gereffi, 2014a).

While these features represent the enabling factors for GVCs to emerge, free-trade and laissez-faire approaches demonstrated limited range in terms of creation of high-income jobs, forward and backward linkages, wealth creation and “catching-up” trajectories. There have been serious negative implications for development processes because institutions, know-how and markets were not created (e.g. Lin and Chang, 2009; Gereffi, 2014a, UNCTAD 2016). In this scenario economic transformations may have happened fast but at the same time being potentially fictitious (like the case of Mozambique above), characterised by jobless growth or even by immiserating growth\(^9\) (Kaplinsky & Morris, 2016).

The Trade and Development Report 2016 (UNCTAD, 2016) argues that GVCs are not immune from these mechanisms. The low barriers to entry at the bottom of the chain make it easy for developing countries to access global exports (in manufacturing and in other sectors), but the risk is to remain trapped in low value-added/low rent activities particularly for countries with small productive capacity - such as landlocked developing countries. Other risks associated with the participation in GVCs or GPNs include specialisation on a narrow range of production activities and capabilities that would favour internal upgrading but with overdependence from lead firms and with few spill-over effects in terms of productivity, imitation by domestic firms and employment. The report also concludes that there is little evidence about the link between

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\(^9\) Kaplinsky & Morris define this “a process of increasing economic activity with declining real incomes” (2016, p.3).
GVCs and industrialisation and that GVCs should not be seen as a "panacea" but rather as an opportunity (UNCTAD, 2016, p. 121).

Nonetheless, Gereffi (2014a) highlights the opportunities from these changing features of trade and the evolution of global value chains after the global financial crisis in 2008: the emergence of new economies with large suppliers that contributed to rebalance bargaining power against multinationals and markets in developed countries; the possibility to trade with different end-markets (within regional networks and not just with developed countries) that enables less sophisticated products to be traded in less demanding and more accessible markets (in terms of quality standard, variety and supply that configure lower degrees of entry barriers); the focus on value-addition and productivity in value chains that allows a strategic view about integration within global networks of trade (Ibid). However, being competition and competitiveness salient features of GVCs, ways to counteract their negative effects (vulnerabilities transmitted by international competition to local economies, domestic markets and local entrepreneurs) and harnessing the positive ones (for example on poverty and equity) become priorities (Gereffi, 2014b) and justify the design of specific public policies.

From a value chain perspective the link from competitiveness and trade to structural change, poverty reduction and equity, is bridged by the analytical advantages that working at sectoral and actor-oriented levels bring to development practitioners and agencies. Strategies for economic development, upgrading, diversification and poverty reduction through market-based interventions are defined by linking global and local levels of analysis and by seeing strategically countries, regions, small and medium enterprises and local stakeholders, moving “upwards” in the value chain (upgrading) through value creation, enhancement and capture, which increase productivity and incomes (Gereffi, 2014a; Henderson et al., 2002). The evolution of the concept and the progressive integration between the literature on GVCs and other streams related to Global Production Networks (GPNs) and livelihoods have brought about more encompassing frameworks to analyse these phenomena of global integration, competitiveness, trade and transformations.

10 Gereffi is probably one of the best known authors, but many other scholars have worked using value chain approaches. www.globalvaluechains.org listed 745 publication and more than 570 authors as of 20 July 2014.
The following section (2.3) will look at the analytical framework developed to study GVCs and the criticisms associated with it\textsuperscript{11}. For example, Newman (2012) recognises that the framework (developed by Gereffi and co-authors) and the resulting empirical work have been useful in explaining paths of industrialisation and transformations, providing insights about “contemporary capitalism” and strategies for developing countries’ to upgrade (p.160). But she also argues how the framework opportunistically accommodates various theories from economics (particularly transaction costs and value-added) and other social sciences, moving away from “its roots in radical economic sociology” and “political economy of capitalism” (Ibid, p.159).

GVCs work has spotlighted current forms of disaggregation of production and consumption across nations and the pragmatic application of GVCs framework allowed recent studies to provide insights on phenomena related to liberalization, globalisation and patterns of “inclusion” in global markets in a number of sectors. In fact, although earlier work on GVCs focused on labour-intensive manufacturing, the recent research output from the research project “Capturing the Gains” (www.capturingthegains.org/) extended its application to sectors spanning from agro-food to the service industries like tourism.

Another feature of the current work on GVCs is the renewed importance of productive sectors policies. The relevance of industrial policies or “productive sector policies” (as recently redefined by Kaplinsky and Morris 2016), to sustain structural change and positively impact on poverty alleviation, will be discussed in section 2.4.

2.3 The value chain analytical framework

As introduced in section 2.2, the GVC basic framework uses two interrelated concepts: governance and upgrading. With the value chain framework the value that is captured from participating in value chains - rather than the goods exported - acquire more significance (Gereffi, 2014a). The analysis of governance casts light on issues of power and inter-firm interaction and how these influence allocation of resources, and the distribution of risks

\textsuperscript{11} I use the term GVCs, rather than related concepts such as global commodity chains or global production networks, given the importance that the term has gained in policy and academic articles (see Newman, 2012, p.155 or Gereffi, 2014a, b).
and gains among stakeholders. Normally, power is analysed in relation to lead firms (chain governance) or to a set of actors in the chain, to obtain a picture on how they influence their interrelated networks (sector governance). In general, the analysis of governance entitles the identification of

“actors involved in the production and distribution of a particular good or service and mapping out the relationships that exist among them with the aim of finding out where and how value-addition takes place, the division of labour and the distribution of rewards along the chain” (Newman, 2012, p.157).

Governance in the basic framework sees buyer-driven chains (big retailers and marketers of final products, normally associated with labour-intensive goods) and producer-driven chains (final-product manufacturers, usually found in capital and technology-intensive industries), sourcing their products from a network of suppliers. Nevertheless, GVC structures are evolving and these two main typologies coexist with other more complex forms of governance. Buyer-driven chains tend to be coordinated via market, modular, or relational governance, and producer-driven chains tend to be coordinated via captive or hierarchical governance (Gereffi et al., 2005). More recently an emphasis on sectoral analysis and chain linkages, associated with issues of international trade, investments and inter-firm coordination vis à vis poverty issues is also emerging (Humphrey and Navas-Alemán, 2010; Gereffi, 2014a).

As argued by Coe et al. (2008) the expansion of the governance forms in GVCs, is important but it only considers relationships between suppliers and lead firms. Other authors like Gibbon et al. (2008), stressed the importance of bringing the social context back into the concept of governance in GVC. Morris and Staritz (2014), building on the work of Hess and Yeung (2006), argue that the focus on “technical relationships” in value chains have diluted the importance of socio-cultural dimensions, particularly institutional dynamics, stressing the importance of social embeddedness in shaping value chains (locally and globally) and with that, upgrading mechanisms of suppliers. Furthermore, studies have also shown that relationships in which a supplier
sees itself involved are not everlasting and asymmetry of power may actually reverse and change (see Blažek, 2016 for a review).

This shows an increasing integration of perspectives from the substantial work on GPNs, into GVCs and vice-versa (e.g. Ponte, 2014). GPN framework has strong overlaps with GVCs but it traditionally looked beyond the verticality of relationships or the single lead-firm governance incorporating a number of conceptual categories (value, power and embeddedness) and conceptual dimensions (firms, sectors, networks and institutions) that influence governance and upgrading (Henderson et al., 2002).

Nonetheless, GVC and GPN are used more and more as synonymous with current studies under GVCs framework increasingly embracing bits of conceptual elements borrowed from the GPN framework. Morris and Staritz (2014), for example, studied the role of ownership, embeddedness and markets in the Madagascar’s export apparel industry tracing the implications for economic upgrading and the sustainability of the industry. Authors like Ponte (2014) focused on the role of institutions (formal and informal) and non-firm actors arguing for a “multipolar governance” that include the role of firms, governments, NGOs, consumer association, unions or industry association in shaping governance (Ponte, 2014). Therefore, the analysis of power relationships also become more complex with authors highlighting its dynamic features given that supplier can change position in complex networks and can be subjected to different power structures not solely originating by lead firms (Blažek, 2016, p. 5). In chapter 3, it will also be shown how studies that focused on poverty/development issues have increasingly integrated horizontal and non-linear networked levels and multipolar approaches into the analysis of value chains.

The concept of economic upgrading (and more recently also social upgrading) is a more bottom-up perspective that allows to strategically analyse the possibility to improve an actor’s position in the economy. Economic upgrading “describes the process by which actors/firms operating at lower value-added segments can move towards higher value-added activities within a given chain or diversify into higher value-added activities across chains” (Newman, 2012, p.157).
Understanding governance can help economic actors identify upgrading opportunities. Particularly, from an economic upgrading standpoint, the implication for policy-makers or for a small firm in a developing country is to think strategically about other actors in the chains and focus on their abilities and on how to achieve sustainable economic upgrading that would provide sustainable income growths (www.globalvaluechains.org; Kaplinsky and Morris, 2016). Given the strategic orientation of value chain thinking, economic upgrading is about building the capability to “climb the value chain” from basic activities to more advanced forms of supply - using for example low-cost and unskilled labour as an initial entry points (Gereffi, 2014b, 2014a; Gereffi et al., 2005).

These concepts are now widely applied also to service sectors like tourism as the work of Barham et al. (2007), Tejada et al. (2011) and Christian et al. (2011) demonstrate. In the tourism sector, upgrading is complex since tourism is an industry formed by various niches and services. There can be multiple trajectories to upgrade at different levels (i.e. countries, tourism destinations within the country, firms within the tourism destinations) and potentially simultaneously. The different paths can be facilitated by global arrangement (agreements with tour operators and travel agents in international markets), sector and local capabilities (i.e. human capital) as well as domestic policies (Christian et al., 2011).

Another feature emerging from recent studies is that while GVCs are growing in terms of geography, organizational fragmentation and dynamism, the opportunities to upgrade can change very quickly and economic actors may not always have the information and the knowledge to think and to act strategically (in economic terms these are defined as information and coordination externalities) in such complex supranational networks. In this respect Kaplinsky and Morris (2016) add an additional layer for the analysis of GVCs, which is the capacity for an economic actor to generate, appropriate, exploit and protect rents, where rents are defined as the income derived from different levels of competition and barriers to entry to which an economic actor is subjected that influence its income streams.
Kaplinsky and Morris (2016) identified three sources of rents: factor endowment; capacity to innovate (dynamic – Schumpeterian – rents) that plays a role in economic upgrading because it enables economic actors to take advantage of opportunities in specific niches or segments of the value chain and exploit those rents; and exogenous rents that are created outside the value chain by actors such as the State through the provision of better infrastructure, skilled workforce and other inputs affecting their capacity to produce (Ibid).

<table>
<thead>
<tr>
<th>Table 2: Upgrading typologies</th>
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<tbody>
<tr>
<td><strong>Generic upgrading trajectories</strong></td>
</tr>
<tr>
<td>1. <strong>Product upgrading</strong> - moving into more sophisticated and higher value products, often requiring more skilled jobs for items with enhanced features.</td>
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<td>2. <strong>Process upgrading</strong> - transforming inputs into outputs more efficiently by reorganizing the production system or introducing more sophisticated technologies; this could also imply a process of change in intensity from labour to capital.</td>
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<tr>
<td>3. <strong>Functional upgrading</strong> - acquiring new functions (or abandoning existing functions) to increase the overall skill content of the activities towards higher value-added tasks, for example, inclusion of finishing, packaging, logistics and transport via vertical integration; or via specialization, which substitutes one set of activities for another.</td>
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<tr>
<td>4. <strong>Chain upgrading</strong> - in which firms move into new industries or product markets, which often utilize different marketing channels, and manufacturing technologies.</td>
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<tr>
<td><strong>Tourism industry specific upgrading trajectories</strong></td>
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<tr>
<td>Entry into the value chain (Chain upgrading):</td>
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<tr>
<td>• Countries become a destination for incoming tourists.</td>
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<tr>
<td>• Firms or individuals in another industries shift to tourism.</td>
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<tr>
<td>• Firms that catered to domestic tourism add international tourism.</td>
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<tr>
<td>• Firms or households integrate agriculture with tourism services.</td>
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<tr>
<td>Upgrading within the tour operator segment (functional upgrading):</td>
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<tr>
<td>• Firms move along the tour operator segment (the lowest segment is as a guide, upgrading to excursion operator, local arranger or national arranger for an incoming agent).</td>
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<tr>
<td>• A tour operator integrate accommodation services.</td>
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<tr>
<td>Upgrading within the hotel segment (product and functional upgrading):</td>
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<tr>
<td>• Countries offer larger and higher quality hotels.</td>
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<tr>
<td>• Hotel that started as small or budget accommodation upgrades in size and/or standard.</td>
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<tr>
<td>• Local hotel “brand” is created/expanded into a chain or a hotel management company.</td>
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<tr>
<td>• Hotels integrate services typical of tour operating.</td>
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<tr>
<td>Adding tourism types (product upgrading)</td>
</tr>
<tr>
<td>• Countries expand their offer by developing tourism in different regions or by cultivating a particular tourism product such as “adventure” or “cultural” tourism.</td>
</tr>
<tr>
<td>Adopting ITC (process upgrading)</td>
</tr>
<tr>
<td>• Firms, country marketing boards adopt IT such as website design and computer reservation systems.</td>
</tr>
</tbody>
</table>

Source: Adapted from Humphrey and Schmitz (2002), Tejada et al. (2011, p. 1630) and Christian et al. (2011, p.15).
functional repositioning for example is an upgrading strategy that aims to move from areas of low rent into areas with higher rents.

In a vertically specialised value chain (mostly associated with manufacturing), a lead-firm may outsource assembly functions, and for a firm that provides low-cost labour the upgrading strategy may be process improvements. Once a firm increases its efficiency in assembly and capabilities increase, an additional possible step could be to move from assembly to manufacturing, and so on until being able to design its own products (Kaplinsky and Morris, 2016).

The strategic orientation towards “upward mobility”, value-addition and rents (particularly the development of dynamic rents associated to innovation), and the recognition that in developing countries markets alone are not efficient neither for the production and dissemination of knowledge (learning) for industry development, nor for the spontaneous development of backward, forward, and horizontal linkages, links the GVCs literature to the discourse on industrial policies. In fact, developing countries have long known market failures in the presence of market liberalisation policies that influenced negatively the possibility to achieve sustained income growths.

Industrial or productive policies are an integral part of the governance structure, influencing through formal rules incentive structures and therefore investments. These policies have recently been more widely recognised to form a necessary tool-kit to mitigate negative effects of trade and markets to sustain income and productivity growths. This ultimately would impact poverty reduction through job creation favouring broader economic inclusion.

2.4 The role of industrial/productive policies in value chains

As presented above, this section explains how industrial policies can provide the incentive structures and the necessary support to achieve economic restructuring through diversification and the strategic insertion in global markets. Greenwald and Stiglitz (2013) argue that when the government makes expenditure decisions through interventions encompassing investments in hardware (e.g. infrastructure) and software (e.g. education), it affects the structure of the economy. Greenwald and Stiglitz (2013) with this broad
perspective, argue that “rules and regulations, the legal frameworks and how they are enforced, affect the structure of the economy, so unwittingly, government is always engaged in industrial policy”, by shaping incentives and disincentives for productive investments (Greenwald and Stiglitz 2013, p.43).

Authors like Harrison and Rodríguez-Clare (2010) include in the definition of industrial policies all mechanisms that deviate from policy neutrality in trade and in the allocation of resources across industries. These include tax breaks, trade policies (e.g. export and production subsidies, tariff, quotas and exchange rates manipulation), FDI policies (ruling for example on local content requirements, employment requirements or repatriation of profits) or ownership policies. In fact, these interventions can all sustain national ventures and/or take the most from international investments, ultimately shaping the sectoral structure of the economy (Harrison and Rodríguez-Clare 2010).

Broadly speaking industrial policies are aiming at supporting two things: the development of capabilities in productive sectors and the desire to tackle market failures that can frustrate the acquisition of such capabilities. However, as pointed out by Kaplinsky and Morris (2016) resource allocation and integration in global markets “is characterised by both market and policy failure” and this is why a measured stance emerged on the use of such policies “that gives renewed legitimacy to the role the state can play in supporting (as opposed to command or guiding) the development of capabilities in the productive sector” (ibid, p.9).

Scholars are in fact divided on how to deploy these instruments and if to deploy them at all (Lin and Chang, 2009; Smart, 2017). There is no agreement on the extent of the resources that should be deployed and neither for how long these resources need to support investment initiatives; nor on the extent they have to conform to comparative advantage, and therefore on the way in which specific sectors are identified and targeted and monitored (Lin and Chang, 2009).

The points of agreement seem to be that some level of comparative advantage and resource endowment are necessary elements for feasible government interventions (Harrison and Rodríguez-Clare, 2010). Policies should be aiming at promoting productive investments to foster skills acquisition and learning processes through technology adoption stimulating dynamic rents.
Industrial policies need to be pragmatic to tackle certain types of market failures, that ultimately can frustrate strategies of economic “upgrading” and value-capturing (Rodrik, 2004; Lin and Chang, 2009; Khan, 2013; Gereffi and Sturgeon, 2013).

Another point of agreement is that the state should be a “facilitator” avoiding the mistake of import substituting strategies of the past. This translates into a view of strategic collaboration between the government and the private sector to increase productivity or sustain diversification (Rodrik, 2004; Harrison and Rodriguez-Clare, 2010; Gereffi, 2014b; and Lin in the debate contained in Lin and Chang, 2009). Particularly Rodrik regarding industrial policies has stressed the idea that developing societies “need to embed private initiative in a framework of public action that encourages restructuring, diversification, and technological dynamism beyond what market forces on their own would generate” (2004, p.1).

Rodrik (2004) envisages a strategic and transparent collaboration between the private and the public sectors to solve what he defines “information and coordination externalities”. Coordination “externalities” are ascribed not only to technology and industrial structure, but also to human capital, infrastructure and institutions, as ideally investments in these areas need to be made simultaneously (Rodrik, 2004). Information externalities entail the process of “discovery” of the cost structure of a specific entrepreneurial opportunity or innovation (ibid). In this context, government subsidies are mechanisms that encourage innovation and offset the “first-mover disadvantage” leveraging the bargain of experimenting innovation away from the private sector (Lin and Chang, 2009, p. 485). In other words rent allocation can be a pre-condition for adequate levels of entrepreneurship to emerge (as opposed to competition).

But, “outcomes of similar [productive] policies can vary significantly across contexts” (Khan, 2013, p.243) and they depend on the different powers and capabilities of the organisations involved in shaping resource allocation and/or designing regulatory frameworks. Khan (2013) defines the constellation of economic, political and bureaucratic organisations as “political settlements” that have the power to establish, manage and monitor/enforce processes of rent allocation.
Authors like Rodrik and Khan look pragmatically at the “practice” of institutional design and unorthodox arrangements for economic growth in developing countries. Khan (2012) for example is one of the authors that observed how growth can actually happen without the so called “good” institutions and criticises the “good governance agenda” policy imprimatur, arguing in favour of institutional arrangements that would favour a more pragmatic and context specific “growth enhancing governance”.

Rodrik (2008) on the same lines argues that relational contracting is not necessarily negative when more formal institution and legal systems are weak and particularly when these arrangements are conducive of growth and are efficient for example, in excluding unreliable actors from the economic system. Based on that, different types of rents generated through such policies may turn productive or unproductive, with income streams captured by interest groups and/or unproductive firms, but without achieving the expected outcomes – stimulate productive capacities (Ibid). Therefore policy tool-kits can differ based on the context, strategies and objectives but both authors envisage a strategic and transparent collaboration between the private and the public sectors.

Gereffi and Sturgeon (2013) and Kaplinsky and Morris (2016) argue for industrial policies that need to take into account the current “GVC-driven era”, characterised by a substantial trade liberalisation (Kaplinsky and Morris, 2016, p.17) and by a “deeply intertwined” and “overlapping business networks created through recurrent waves of foreign direct investment (FDI) and global sourcing”. The current scenario is one in which there is a growing interconnectivity between global and local actors with companies, localities and entire countries that have come to occupy specialized niches within GVCs. “Intentionally or not, governments currently engage in GVC-oriented industrialization when targeting key sectors for growth” (Gereffi and Sturgeon, 2013, p.330).

This view allows these authors to mark a clear distance from the ideas attached to import substituting strategies of the past, while moving to consider policies needed to participate in global markets and trade networks through VCs that at the same time can serve national development interests, focusing on vertical specialisation and on the possibility of moving into higher-value niches by targeting key sectors for growth (Gereffi and Sturgeon, 2013).
In general terms, the policy mix will be based on the nature of the involvement, the source of competitiveness and therefore the context of upgrading. Conversely, policies and regulations set the context (considered exogenous to VC) for corporate decision-making. Therefore, decisions by lead firms about investing, outsourcing or offshoring are strategic decisions made on the basis of the policies and programmes of countries. For example, in GVCs, lead foreign firms might be less receptive to government policies aiming at involving local suppliers in production, particularly when attracting investments is also characterised by a competitive environment with few FDI and many developing countries willing to attract them (Gereffi and Sturgeon, 2013). Kaplinsky and Morris (2016) in this regard favour productive policies that would strengthen local capabilities, creating incentives for investors to create linkages (among other infrastructure and education).

Gereffi and Sturgeon (2013) and Kaplinsky and Morris (2016), despite some differences in the strategic orientation and priorities of these policies (i.e. focus on value-addition versus development of specific functions and capabilities in vertical value chains), consider this new group of GVC-specific policies complementary to conventional industrial policies described above. “GVC-oriented industrial policies” link specific “slices” of industries and sectors by increasing their technological content and value-added and by linking them to international production networks (Gereffi and Sturgeon, 2013). The authors distinguish between horizontal (policies that affect entire national economies); selective policy interventions to target strategic sectors (for example those with high potential for forward and backward linkages with domestic suppliers) and; GVCs policies to move into higher value-niches. They also identify factors that drive them, and what makes them feasible (ibid).

Kaplinsky and Morris (2016) see upgrading strategies and policies differing depending on the sector. They group strategies in two main groups characterised by manufacturing and resource sectors. In vertical specialised value chains (driven by lead firms or global suppliers and associated with manufacturing) the objective might not be to develop a sector and to capture value-addition but to specialise in specific functions, through the development of specific capabilities. Government actions in this case (at a firm, cluster or sector levels) may encompass financial incentives, human resource development and
promotion of R&D with the objective of specialising in specific capabilities targeting segments of value chains (Kaplinsky and Morris, 2016).

In natural resource sectors “linkage development policies” include interventions to capture greater value-added. This might include policies targeting local content requirement, building ad hoc infrastructure, provide marketing institutions to support domestic processing, export taxes to support local value-addition, building industrial zones (to favour local manufacturing and clusters), introduce human resources programmes to meet specific needs (Ibid, p.16).

Whether scholars frame policy tool-kits within concepts of industrial policies, GVC-oriented policies or productive sector policies, considerations by authors such as Khan and Rodrik maintain their importance, particularly for developing economies. Rents need to be managed and monitored in particular ways in order to be effective in supporting upgrading and/or an advantageous insertion in global networks of production and trade. The need for strategic collaboration is based on the fact that neither the private nor the public sector’s organisations have a clear view on “the location and nature of the market failures that block diversification” (Rodrik, 2004, p.16). Khan call these “contracting failures” that would constrain adoption and learning of new entrepreneurial ideas (Khan, 2013).

For developing countries these policies could contribute to avoid “low equilibrium traps” and built wider opportunities for people to actively participate in the process of growth by generating suitable productive opportunities and income streams. Chapter 3 will provide a review of the literature on livelihoods diversification, aiming at understanding what mechanisms and drivers have been identified as important for households or individuals for their direct participation in markets and access to higher productivity activities. The chapter will provide a review of the livelihoods framework to understand opportunities and challenges associated to its use in such a dynamic setting. The framework developed by Dorward (2009) and other co-authors working at the point of interception between markets and livelihoods seems to be relevant given its focus on institutions and the possibility to capture processes happening at different levels of analysis.
Chapter 3 – Addressing livelihoods through value chains: linking the meso- and the micro-levels

Abstract

The concept of “economic upgrading” in value chain framework, follows the one of economic restructuring and transformation. These processes can take place at different levels (e.g. country or regions, sectors within regions, firms, households, individuals). Despite the broad recognition that policies tackling issues of linkages and upgrading can favour “distributional spin-offs” by generating capacity, employment and income (Kaplinsky and Morris, 2016, p.18), one of the main challenges in this literature is to reconcile the concept of economic upgrading with livelihoods. How to address poverty and equity via the promotion of economic livelihoods and the engagement with markets dominated the discussion on value chain development at the micro-level. Improving market linkages among chain actors is the central strategy with participation in various markets often advocated for small-holders and poor households. Recent evidence in microeconomic panel data studies suggests that markets do not benefit by default. In agricultural markets initial assets endowments are important to benefit from markets. Other studies, took into account “agency variables” to show that tangible assets are just one part of the picture to sustain economic livelihoods. Few studies are starting to highlight the role of informal institutions and with them the role of social networks to sustain livelihoods diversification and economic participation particularly when opportunities are scarce.

3.1 Sustainable livelihoods and pro-poor market development: the bridging role of institutions

Green (2014) highlighted how for African Least Developed Countries, current policies seem to concentrate on drivers for large scale growth, tackling education, large scale formal employment and changes in productive relations. By following the instances above, diversification into higher productive activities and employment creation are seen as having poverty reducing and inclusive
effects. This is because the structural changes that accompany industries upgrading (namely technological and institutional changes) would sustain long-run improvements in factors (such as labour) and its productivity (Lin and Chang 2009).

Gereffi (2014b, 2014a) argues that while value chains broadly aim at industrial upgrading, the impact of GVCs on poverty and equity can be monitored at micro-levels by focusing on issues of participation (employment and micro-enterprise), gender and sustainable livelihoods. At a micro-level, upgrading could be seen as a change in participation for small producers in value chains linking livelihoods upstream and downstream to distant production and exchange networks (Bolwig et al., 2010). Pro-poor interventions in value chains aim at promoting businesses, employment and reduce poverty by identifying bottlenecks for poor producers and small enterprises often in the agricultural sector or in rural development contexts, improving knowledge and resources flows (to avoid market failures for example) and enhancing productivity and efficiency that would enable poor producers to harness opportunities coming from domestic and global markets (Humphrey and Navas-Aleman, 2010, p. 11). However, in this respect two main criticisms are addressed at this approach.

Newman (2012) stresses the importance of turning the attention back to the political economy and “to the horizontal factors that contextualise and determine chain outcomes” (p.160). For Newman, the focus on the sole vertical aspects of the chain gives limited explanatory power to the approach. Similarly, Bolwig et al. (2010) stress the importance of horizontal aspects, particularly how integration into GVCs is locally mediated, and the analysis of power relations that exist not only within the chain but also in the local system (p.178).

This shows a convergence of “criticisms” from the macro and the micro perspectives. It was shown in the previous section how Gibbon et al. (2008) and Morris and Staritz (2014) stressed the importance of the local context and social, cultural and political issues and how they shape linkages and upgrading dynamics determining the allocation of value-adding activities and rents. For poverty reduction the concerns expressed by Bolwig et al. (2010) point at the same direction. For example, Green (2014) in the case of Tanzania highlights processes of change in land tenure systems’ driven by local transformations
that consolidate inequalities through small scale land acquisition from local elites or new middle classes seeking access to land for future profits.

The other criticism is related to the outcomes. Scholars and practitioners of value chains have addressed the issue of poverty in two ways. The literature related to the project “Capturing the Gains” focused on social upgrading (or downgrading), looking at the relationship between firms’ upgrading and labour conditions and labour standards (e.g. Barrientos et al., 2011). This is based on the recognition that the development of GVCs and economic upgrading of firms and the economic gains from participating in global supply-chains do not always translate into decent jobs (Gereffi, 2014b).

Questions are raised also about inclusiveness, particularly for the weakest elements of the chain (Gereffi, 2014b). In fact, in value chains there is a “limited understanding of the determinants of household participation and the benefits across different types of households” (Donovan and Poole, 2014, p.2). This particular point goes back to Bolwig et al. (2010) on how integration in value chains is locally mediated as well as the limitation of addressing terms of participation and upgrading as a pure managerial and competency issue. The risk is to downplaying not only the asymmetrical power relations within a specific value chain, but also the cultural, social and political context and how these elements impact on livelihoods.

In fact, in value chains decisions about pricing, standards and functional division of labour are often taken elsewhere in downstream side of the chain (Riisgaard et al., 2010, p. 197). Furthermore, people may be able to participate in value chains but be highly marginalised in other aspects, which highlight the complex issues associated with “participation” (i.e. Bolwig et al., 2010, p.178). The analysis of the “terms of participation” needs to look beyond the production and exchange relations in the value chain “since the nature of participants’ power and leverage depends on the full range of livelihoods activities and social relations on which they depend, including with other social actors, such as patrons and dependents” (Bolwig et al., 2010, p. 186).

The livelihoods approach and framework

A livelihoods perspective linked to a value chain approach is best equipped to understand terms of participation, upgrading trajectories, rewards
and risks\textsuperscript{12} as well as outcomes of poverty and inequality associated with horizontal and vertical aspects of value chains. The livelihoods framework combined with value chain approach, gives the possibility to analyse endowments (assets) and their interaction with processes and institutions more systematically. It can facilitate household and intra-household level micro-analysis, linking them to national and global levels. Particularly it can help identify how formal and informal institutions influence livelihoods strategies, resource allocation decisions and the “terms of participation”. These “terms” ultimately determine participants’ power and influence various outcomes for households and individuals.

In fact, the term “livelihood” is often associated with income streams but the concept includes “social relationships and institutions that mediate people’s access to different assets and income” (Ellis, 2000, p. 291). It is also widely recognised that focusing exclusively on income and expenditure measurements is a limited approach to analysing and understanding livelihoods (Scoones, 1998).

Following these premises, the sustainable livelihoods approach (SLA), recognises that people have capabilities, assets, and they actively engage in various activities to sustain their livelihoods. Furthermore, SLA sees development action as emerging from the experience of the poor through participatory methodologies that allow the understanding of local worldviews and meanings of well-being. It sees development as emerging from the point of view of what people have and therefore focus on strengthening people’s own initiatives and solutions (Chambers, 1995).

The broad understanding of the SLA is that what makes livelihood sustainable are the assets that households or individuals have and the context in which those are found. As such, assets become an indicator of what people have and upon which they can act. For example, Moser (1998) shows how the poor themselves are managers of complex assets portfolios and how asset management can affect households’ vulnerability in urban contexts.

\textsuperscript{12} Bolwig et al. (2010) see a desirable changes in participation (at the ‘horizontal’ and ‘vertical’ levels) as one that increases rewards and/or reduces exposure to risk “where rewards and risks are understood both in financial terms and with regard to outcomes related to poverty, gender and the environment” (p.177).
This approach employs the “sustainable livelihoods framework” (SLF) to assess people’s assets and monitoring livelihoods and their transformations (Ashley and Carney, 1999). Asset stocks provide prospects for future income and consumption, they serve as a cushion against income shocks and are indicative of future economic livelihoods and well-being (Carter & Barrett, 2006 cited by Anderson, 2012).

The sustainable livelihoods approach is not immune to criticisms. Scoones (2009) highlights four types of challenges for SLA. These include: the “failure to address wider, global processes and their impingement on livelihood concerns at the local level” (p. 187); the lack of long-term vision on rural economies and changing environmental conditions; power and politics; and knowledge (Scoones, 2009).

Approaches such as pro-poor market development that foresee the role of markets and the direct participation of the poor (e.g. value chain and “Making Markets Work for the Poor” approaches) have been used in combination with the SLA. This “blending” has been partially filling the gaps identified by Scoones (2009, p.188), particularly the need to assess processes of globalisation and long-term process of transformation in rural economies. Other approaches, such as the use of governance analyses and political economy of service delivery are also contributing to filling the challenges associated with “politics and power”\(^{13}\) identified by Scoones (2009).

**Institutions and livelihoods**

Institutions have primary importance for linking SL to pro-poor market approaches. Scoones (2009) argues that the new institutional economic perspective have generated a “productive conversation” between the economic discipline and the advocates of the SLA.

“The sustainable livelihoods framework… linked inputs (designated with the term ‘capitals’ or ‘assets’) and outputs (livelihood strategies), connected in turn to outcomes, which combined familiar territory (of

\(^{13}\) An early example of such analysis is found in Freeman et al., (2004) and Ellis and Freeman (2004), linking the micro-level livelihoods perspective with the macro-level governance structures for poverty reduction.
The livelihoods approach recognises that decisions and actions based on assets available to people do not happen in a *vacuum* - people take decisions about their lives based on (or constrained by) the assets, institutions and the understanding they have of the conditions around them. Mazibuko (2013) for example, effectively portrays the relevance of “institutions and processes” for the allocation of resources and for the functioning (or non-functioning) of assets in apartheid South Africa. She shows how policies (e.g. land policies) may not always be conducive to outcomes benefiting the poor, sometimes perpetuating marginalisation and preventing access to key assets such as land. In addition, the greater influence of supranational institutions, transnational corporations, GVCs and powerful private lobbies on the policy processes relevant to the poor, market liberalisation and privatisation of key public services, are some of the aspects highlighted in her work (Mazibuko, 2013).

A more pragmatic view of the livelihood framework that includes the role of “institutions and processes” has been theoretically and analytically applied by Dorward and co-authors in several publications in relations to growth of agricultural economies and livelihoods transformations. Dorward et al., 2005 for example argue in favour of institutional diversity for growth. They suggest that non-competitive and non-market forms of coordination and exchange (hence regarded as sub-optimal by neo-classical economists) may be more effective particularly in developing countries where the institutional environment is weak.

The argument goes that “different economies may successfully develop along different technological and institutional development paths… and that successful economic development will commonly involve… a path that depends upon non-standard market arrangements” (Ibid, p.18).

Non-market institutions such as community groups and cooperatives are often regarded as alternative ways to mitigate market failures, tackling adverse power structures and sustaining livelihoods strategies more effectively than markets in different sectors (e.g. Donovan and Poole, 2014), ultimately impacting on poverty reduction.
The key message is that institutional arrangements should not be overlooked (particularly forms of non-market coordination) as long as they are systems that solve coordination and information problems among economic actors and serve the objective of moving away from poverty traps (Dorward et al., 2005, 2003). Poverty traps are defined as a “vicious cycles” where assets endowments and/or return to assets for individuals or households are so low that they cannot ensure increases in economic livelihoods into the future (Anderson, 2012). Poverty traps are associated with low-level equilibrium and both scenarios see people involved in low productivity activities in a system with high transaction costs and risks, high unit costs and small markets (Dorward et al., 2003).

Development interventions can therefore aim at institutional changes that make the most of an “appropriate mix of targeted investments in institutional arrangements and the institutional environments” to escape poverty traps supporting agricultural or other sectors growth (Dorward et al. 2005, p.22). These interventions would depend on the development path as well as the level of institutional development of a specific country. Institutional analysis can be beneficial to tailor such interventions.

Therefore, value chain approaches and the productive inclusion of the poor would benefit from the understanding of how market and non-market institutions interact, how formal and informal institutions work for participants and how institutional arrangements need to evolve “if they are to foster the productive and sustain inclusion” (Zapata et al., 2010, p. 1).

**Linking upgrading mechanisms to livelihoods**

People generally aspire to maintain their current welfare or to advance it and in doing so, people can attempt to expand their existing livelihood activities or move into new ones, or invest in new assets for future welfare. All this can take place in the context of an uncertain environment (Dorward et al., 2009).

The focus on assets in SLA offers the possibility to understand how, for example farmers, benefit from linkages to higher-value markets with emphasis on households’ assets and the ability of households to build assets over time - namely investments and accumulation (e.g. Donovan and Poole, 2014) or to understand households’ abilities to convert their assets into economic
livelihoods (e.g. Anderson, 2012) together with the significance of institutional environment and arrangements that can facilitate those processes.

The conceptualisation developed by Dorward integrates the idea of economic transformations, livelihoods transformations and poverty reduction, and it links micro-processes of livelihood changes to wider sectoral and macro-economic contexts. It takes advantage of a common concern from neoliberalism and alternative conceptualisations of development that share the view “that development involves decreasing livelihoods vulnerability and increasing livelihood productivity (and incomes), and change in livelihoods activities (with increased importance of non-farm activities)” (Dorward, 2009, p. 136).

Table 3: Dorward’s categorisation of livelihoods strategies

<table>
<thead>
<tr>
<th>Category</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. ‘Hanging In’</td>
<td>where assets are held and activities aim to maintain livelihood levels, often in the face of adverse socio-economic circumstances or in circumstances where stagnant market opportunities or poor natural resource potential lock households in subsistence activities.</td>
</tr>
<tr>
<td>2. ‘Stepping Up’</td>
<td>where current activities are engaged in expanding and/or investing in assets to expand these activities, increasing production and income to improve livelihoods as in the case of commercial agriculture.</td>
</tr>
<tr>
<td>3. ‘Stepping Out’</td>
<td>where existing activities are engaged in to accumulate assets which in time can then provide a base for moving into different activities that have initial investment requirements leading to higher and/or more stable returns and not necessarily related to farming (e.g. migration to cities and/or local engagement in non-farm activities).</td>
</tr>
</tbody>
</table>

Source: Dorward et al., 2009.

Dorward’s framework account for complex issues related to the interaction between institutions, markets, assets, livelihoods and poverty and it involves analysis of interactions at different levels. It offers overlaps with the concepts of upgrading identified in the value chain framework, but yet is a better analytical framework for micro-level analysis of both outcomes and processes. It has the potential to bridge some of the concerns associated with poor people’s integration in value chains highlighted by Bolwig et al. (2010), to better understand processes of change and how they are locally mediated. Bolwig et al. (2010) stated:

“… there is a need for theoretical accounts and methodologies that can mediate between different arenas and levels of social process – that can link, for example household – and intrahousehold-level
micro-analysis, with accounts of global and national processes… attention has to be paid both to the vertical links… – and to the horizontal ones – the ways in which the impact and nature of integration into globalised systems are locally mediated’ (p.178).

3.2 The livelihoods diversification literature: insights and limitations

Applied at the micro-level, Dorward’s framework (presented above) can help understanding the circumstances, opportunities and constraints that people face in using their assets, and acting within a specific environment. The literature developed by Dorward and by Ellis share a common focus on the dynamics associated with livelihoods and their transformations, beyond “reduction of poverty at the margins” (Scoones, 2009, p. 182). This long-term perspective on livelihoods, beyond adaptation, is particularly relevant to inclusive growth that is concerned about jobs creation and participation in higher productivity activities and long-term sustainable income growths.

How do Dorward’s framework and the literature on livelihoods’ diversification contribute to the understanding of processes of livelihoods transformation? The diversification literature is concerned with strategies that households or individuals undertake to maintain a diverse portfolio of activities to secure survival and/or improve standards of living14 (Ellis, 2000 and 1998).

Livelihood diversification is not a phenomenon exclusive to rural settings or to developing countries and it refers to an increasing in “multiplicity” of activities regardless of the sector (Start and Johnson, 2004, p. 1). However, economic studies in rural settings distinguish between several different categories and sub-categories of income sources that are used to classify the multiple livelihood strategies available. “Off-farm” and “non-farm” income sources are often used as synonymous in rural studies. A useful distinction is provided by Alobo Loison (2015) who suggests a classification by location (on-farm and off-farm), by sector (farm and non-farm), and by function that include wage employment and self-employment.

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14 This process is described as the trajectories households construct “a diverse portfolio of activities and social support capabilities in order to survive and improve their standard of living” (Ellis, 1998, p. 1).
Given the current predominant discourses that see agriculture as a business driven by markets and entrepreneurship (Scoones 2009; Green, 2014), the distinction by function could benefit from an additional category that would foresee the entrepreneurial aspect (cottage and small industry for example) related to farm and non-farm rural activities.

In studies related to poverty in rural settings and in developing countries the farm household is the “natural” unit of analysis and often the “point of departure” to study the dynamics associated with diversification given the prevalence of agricultural practices.

As such, Ellis (2000) uses the farm household economic model as a framework to predict diversification based on standard micro-economic theory. Ellis (2000 and 1998) noted how diversification and specialisation are functions of the marginal return to the time spent doing an activity (on-farm or other income generating activities) given an asset base. Specialisation would take place if returns increase with respect to the time spent on an activity as more assets are invested (on-farm factors that enable these mechanisms are raise in farm output prices or raise in farm productivity and yield). Diversification takes place in the presence of decreasing marginal returns to assets. If these basic mechanisms apply to off-farm or non-farm wage rates, or more remunerative non-farm self-employment compared to on-farm activities, the incentives to diversify or specialise into those more rewarding activities would increase (Ellis, 2000, p. 292).

Based on these basic mechanisms, rural households’ participation in on-farm activities may decline relative to non-farm activities\(^{15}\), provided that there are well-functioning markets, and infrastructure for transport and communication that can drove those incentives. Specialisation in the long-run would reconfigure farming on a larger scale (agriculture as a business) or impel a change into non-farm sectors, in both cases providing higher returns (Timmer, 2009 cited in Alobo Loison, 2015, p.1127). The take-away message from Ellis is that the “direction of the resource allocation by family members will reflect real comparative returns to different activities in different locations, modified by

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\(^{15}\) This is a cause and a consequence of structural transformations. At the macro-level, transformation of the economy is then likely to provide more opportunities in the non-agricultural economy (Winters et al., 2009, p. 1438).
considerations of risk and the long term social security of the family” (Ellis, 1998, p.23).

Ellis (2000 and 1998) provides a detailed description of drivers and mechanisms for rural households to diversify based on this model (see Table 4 for a brief summary). For the author diversification into a wider portfolio of activities is a livelihood strategy in itself. Diversification can be the result of an opportunity (hence a deliberate strategy) or a matter of survival, but additionally he noted how this distinction fails to capture the complexity of local circumstances and motivations (Ellis, 1998). There is a “continuum of causes, motivations and constraints” that varies across households and individuals and at different points in time (Ellis 2000, p. 292).

Table 4: Why diversification occurs

| • To counteract unstable income flows (smoothing incomes flows). |
| • Ex ante risk management strategy. |
| • To take advantage of more favourable labour markets. |
| • To counteract credit market failures and generate cash to make investments. |
| • Asset strategy (accumulation). |
| • Ex post coping strategy (after a shock). |

Source: Adapted from Ellis 1998 and 2000. Based on the farm household economic model. All these determinants are interrelated even if conceptually distinct and are mediated by social institutions.

Ellis (1998) also points out that the term livelihood encompasses a broader concept than just income streams. The definition includes “income… social [relationships and] institutions..., gender relations, and property rights required to support and to sustain a given standard of living... [it] also include access to, and benefits derived from, social and public services provided by the state” (Ibid, p.4). Therefore, central to the analysis are also social institutions through which livelihoods are mediated and services delivered by the state or other organisations.

Beyond assets and markets forces that influence labour allocation through prices, the context within which a household operates influences the decision to allocate labour to certain activities (Winters et al., 2009). The state influences activities providing key assets and services thought investment in infrastructure, provision of services (such as agricultural extensions, training and education, agencies for the coordination and efficiency of activities), policy and regulations
that also govern the interaction with the private sector. Civil society organisations can also influences the rules that govern the use of assets. Altogether these contextual factors influence considerations about participation, configuring levels of transaction costs and barriers to entry (Winters et al. 2009).

Despite these encompassing definitions, the analytical categories provided to understand why diversification occurs are based on the household economic model of standard microeconomic theory. This is problematic because households and individuals are not just constrained or favoured by the ownership or availability of material assets and motivated by returns and by rational thinking, they are also influenced by the effects of intangible assets and more broadly by the institutions and processes that are beyond their control.

All these elements are well considered in the livelihood approach described previously. As a matter of fact, Ellis himself argues that an individual or a household choice may be “socially circumscribed” at standards of living well above the survival level or the critical minimum stock of assets (Ellis, 2000, p.292), and recent analytical studies have started digging into the effects of less tangible assets to show how households can be constrained despite their assets’ levels. Anderson (2012) for example refers to these as “binding micro-constraints to household agency” (p.1405) that prevent the conversion process of key assets (e.g. educated labour, capital, and land) into economic livelihoods. Thus, he suggests, targeted policies that would consider not just levels of asset stocks, but also for the personal and social environment in which the assets are provided (ibid).

The relevance of asset endowments in cross-country studies

Cross-country studies often overlook these aspects for lack of data. They focus on the key assets that are significant for rural households to increase their productivity, but are unable to capture the complexity of institutions as their influence can be specific to some countries and not others. These studies usually reveal constraints or highlight the relevance of specific asset bundles with positive or negative effects on welfare (i.e. entry barriers such as lack of land or education that can limit the ability of a household to engage in a certain activity) that can be of relevance for countries with similar characteristics or be relevant across countries.
These types of studies test hypotheses emerging from a considerable literature available on the key enablers that affect the choice of and the accessibility to different income generating activities. Different levels of access to land is therefore (and logically) linked to greater agricultural production (and possibly productivity through commercial agriculture) and less participation in agricultural or non-agricultural wages. Education gives competences and skills that enable access to non-farm activities (waged or self-employed) usually with higher returns (studies usually consider non-farm economy important for the higher wages/returns that it gives). Education is often seen as a key determinant to access higher productivity activities provided that those activities are available, as studies point out that this particular relationship strengthens as countries develop.

For example, Winters et al. (2009), using a cross-country analysis of 15 countries at different stages of development found that land, education and access to infrastructure influence the economic choices of rural households. They found that higher levels of education and greater access to infrastructure predict access to non-agricultural wage employment, while improved land access is linked to improved agricultural production with a positive effect on rural income generation (ibid).

Similarly, a recent study in Nepal by Rahut et al. (2014) explored enablers of rural livelihoods strategies. The Nepalese context shows that over 50 percent of the households had diversified outside the farm but only 2.6 percent were able to shift completely into the non-farm sector. By looking at average years of schooling they were able to identify that those who specialised in the non-farm sector had 5.2 years of schooling in average compared to 1.5 years of those involved in purely agricultural activities. Their analysis found that education, ethnicity and location were the strongest predictors for livelihoods diversification outside agriculture.

In both studies cited above, location and access to infrastructure were key determinants of income options within the non-agricultural sector. In fact, infrastructure enables access to markets (including labour markets) and access to input for production, facilitating rural-urban linkages. These key assets (education, infrastructural development/location and land) are all assets that can be influenced directly and simultaneously by government policies. Hence,
policies implications in such studies are mainly associated with the provision of assets that are important for diversification into rural non-agricultural activities.

These kind of studies also identify a considerable poverty reduction potential from diversification into non-agricultural activities given the higher returns. Haggblade et al. (2010) show how non-farm activities make-up a large part of the rural economy. Incomes from non-farm sources have grown in importance, accounting for about 50 percent in Asia and Latin America. The literature review provided by Alobo Loison (2015) about rural livelihoods diversification in sub-Saharan Africa shows the importance of livelihood diversification for economic growth, employment, food security, but she also noted how the processes of diversification deserve more attention.

In fact, despite the fact that diversification into non-farm activities is associated with a positive effect on poverty reduction given the higher returns associated with those activities (e.g. Rahut et al. 2014, Haggblade et al., 2010) – and this is true especially for countries characterised by small land holding among households and fast growing populations – the most lucrative non-farm opportunities require sets of assets to enable people to effectively participate rarely available to the most vulnerable segments of the population (Bezu et al., 2012). Therefore, questions arise on who is able to access higher productivity non-farm opportunities and whether the non-farm economy can alleviate or exacerbate inequality. The following section will explore these issues. The role of informal institutions and on the role of intangible assets to facilitate access to higher productive opportunities will be further explored in 3.4 and 3.5.

3.3 The rural non-farm economy and the access to higher productivity activities

The non-farm or off-farm employment/self-employment or cottage industry are often seen as important given the low capital requirement that is often associated with them (Haggblade et al. 2010). Non-farm activities can provide opportunities for people with no assets. From the perspective of vulnerable landless and near-landless households, availability of non-farm income is key for survival (Ellis, 1998). In Bhutan, for example, the latest available household survey points out that job creation in rural areas has been pro-poor as “most
rural households in the bottom quintile now rank wages and salaries as their main source of income” (NSB 2014a, p.47). Scenarios that welcome the creation of non-farm opportunities are normally associated with poor agrarian countries struggling with growing numbers of marginal farmers, with poor agricultural performances or with increasing large scale commercial agriculture that “squeeze out of agriculture” the small farmers (Haggblade et al., 2010, p. 1429).

Nonetheless, productivity remains central. The abundance of labour-intensive opportunities may be welcome as they serve the purpose of being pro-poor, but it may translate into low-productivity jobs that might signal “distress diversification” (Haggblade et al., 2010, p. 1432). The absence of opportunities for higher productivity would perpetuate persistent low-equilibrium paths (Dorward et al., 2003).

For example, a recent study in Bhutan assessed the impact of vocational training programmes in construction skills. The study showed a positive effect of diversification on household incomes and raised income for participants in non-competitive labour markets. Nonetheless, it is suggested that greater attention should be placed on connecting these types of trainings with income-generating opportunities, placement services, entrepreneurship and mentoring service to increase the potential of value-addition in more competitive labour markets. This ultimately will have the potential for a stronger poverty reducing effects through higher incomes and skills consolidation (Chun and Watanabe, 2012).

Haggblade et al. (2010) effectively describe the variability of opportunities available in the non-farm sectors in rural areas in term of types (trading, agro-processing, manufacturing, commercial, and service activities), scale of individual rural non-farm businesses (from part-time self-employment in house-based cottage industries to large-scale agro-processing multinational-owned enterprises that offer opportunity for employment) and sectoral (with the prevalence of trade, transport, construction and services over manufacturing). However, they also noted how low productivity household manufacturing (basket, pottery and other tools) are usually those that are first substituted by cheap imported items. This implies that in general, rural non-farm employment in trade, transport, construction and services grow faster than manufacturing as the economy grows in rural area (Haggblade et al., 2010).
There is certain agreement that richer households tend to specialise in higher-return farm and/or non-farm activities and more favourable labour markets exactly because they have critical assets at their disposal (e.g. Reardon et al., 2000; Donovan and Poole, 2014; Aloblo Loison, 2015). In general, therefore un-equalising effects seem to come from the availability (or lack thereof) of assets and mechanisms through which poor people are excluded from accessing more favourable positions (Reardon et al., 2000).

Given the variability of the skills and capital requirements for the variety of non-farm activities in a growing economy, poor households with low levels of asset endowments tend to be confined to low-return non-farm activities (wage labour or small scale rural non-farm business) or farm activities (subsistence agriculture) that leave them trapped in structural poverty. These mechanisms ultimately have an impact on income distribution and inequality implying that the non-farm poverty reduction and equality links can be rather weak. The evidence given in the previous section shows which assets are considered important to sustain diversification into higher productivity non-farm activities (Winters et al. 2009; Rahut et al. 2014). Such findings influence policy to equalise access to opportunities through the provision of key assets.

Ellis (1998) provides examples where diversification can have an equalising effect on rural incomes. The effect might be indirect – by enabling poor households to overcome credit and risk constraints for accessing both non-farm income sources or by incentivising more entrepreneurial attitudes to modernise the farm and increase farm productivity. Evidence shows that this pattern is extremely beneficial to the small farm output as compared to the large farm output (Taylor and Wyatt, 1996 cited by Ellis, 1998). Equalising direct effects might include availability of domestic remittances, livestock, non-farm wages, non-farm self-employment (Ibid). In contrast, better-off families may have access to non-earned rental income and benefit from the flow of international remittances for example. But international migration as opposed to national migration, involves barriers to entry that can only be bridged by better-off households (Ellis, 1998). Hence diversification into non-farm activities can have a duality of impacts.

As a matter of fact, Reardon et al. (2000) and Haggblade et al. (2010) point out that empirical studies show “no consistent pattern” related to non-farm
earnings on income distribution (Haggblade et al., p.1432) with very different outcomes depending on the contexts and the complex interrelation among agriculture, rural non-farm businesses and the national and global economy (Ibid).

Haggblade et al. (2010) suggest that linking-up to a growing rural non-farm economy can be done in two ways for poor households: participation as entrepreneurs in growing non-farm value chains or as employees in expanding labour markets, including waged farm employment in growing commercial agriculture. It is argued that self-employment accounts for about 25 percent of rural non-farm employment and entrepreneurship is a very important mechanism although weak credit markets and high seasonality lead to high “death rates” of enterprises (Liedholm, 2007 cited by Haggblade et al. 2010).

Evidence provided by a review of household surveys from Africa, Asia and Latin America shows that poor people are unable to overcome important entry barriers to many non-farm activities that cause unequal access to opportunities (Reardon et al., 2000). The expanding value chains, trade and niche markets are requiring more and more important investments in machines, processing, transportation and knowledge of production and marketing, and better capacity for coordination. Access to value chain as workers will also require better skills (Ibid).

Following this argument they link the capital requirements to the need for investments and they point out that despite the likelihood that incentives to invest in non-farm assets are higher in poor households (because their risk aversion motive motivates them to diversify), liquidity and credit constraints on diversification for the poor may lead to the opposite outcome of non-poor diversifying into better markets.

“The rich may have less of a risk incentive to diversify, but they are in a superior position to self-finance this diversification. A well-functioning rural credit market could make the liquidity of the rich available for diversification by the poor; however, efficient rural credit markets are the exception, not the rule, in LDCs” (Reardon et al., 2000, p.276).
As highlighted by other studies, Reardon et al. (2000) also focus on the importance of assets for non-farm diversification that include among those factors highlighted previously such as education and access to infrastructure, information and financial capital.

“It is difficult to spur non-farm employment without simultaneously addressing the problems of smallholder farmers, and vice versa, that creating the conditions for smallholder development will require overall rural development emphasising development of the off-farm components of the rural economy” (Reardon et al., 2000, p.284).

The challenges that Haggblade et al. (2010) and Reardon et al. (2000) identify are similar to those identified in the literature about livelihoods and value chains: adaptability constraints to market dynamics, new skills acquisition and investment in new productive structures to adapt to new market, weak credit markets, disparities in economic power and access to information. All these might prevent small cottage enterprises in rural areas from accessing growing market niches. The authors also suggest that collective action among small businesses or support by advocacy groups (to sustain cooperatives’ formation for example) might facilitate market access and improve bargain positions of small firms. Similarly considerations are provided for employment where skills are essential.

Human, financial and physical assets are part of similar policy recommendations where investment in education, transport infrastructure and electricity and programmes to increase agricultural productivity are suggested. Social-institutional constraints (gender, cast, social status) are highlighted by Haggblade et al. (2010) and other studies (e.g. Winters, et al., 2009 and Raut et al. 2014), but somehow downplayed when it comes to policies.

A recent study in the mountain district of Humla in Nepal by Gautam and Andersen (2016) focused on the economic, social and demographic characteristics that influence households’ participation in off-farm sectors, instrumental to poverty reduction. They first establish the relationships between livelihoods activities and well-being (a composite index based on food consumption, sanitation, household material assets and savings). They found
that wage labour, migration, handicraft and tool making have negative and moderate effects on well-being compared to salaried job and trade which yield positive coefficients in their regression model. Given the results, they assume that trade and salaried jobs are higher return off-farm activities with potentially higher pro-poor effects.

Their following step was to analyse factors that determine households’ participation in those activities. They found that beyond education and financial investment capacity, networks associated with economic transaction outside the district of reference also predicts trade. At the same time affiliation to political parties or other formal organisations (e.g. NGOs and government) together with education, predict the likelihood of getting a salaried job.

The study confirms that higher returns activities enhance material well-being, and that preconditions regarding tangible but in this case also intangible assets are important. They added the relevance of networks into the equation as a factor pulling people into the high return sectors (Ibid).

3.4 The relevance of agency variable (trust and micro-constraints) in assets convertibility

As introduced at the end of section 3.2, this section explores the role of informal institutions and intangible assets to facilitate access to higher productive opportunities. So far “tangible” assets have been central to the discussion on economic participation, diversification and poverty reduction. From the conceptual work of Dorward (2009) and the observations of Mazibuko (2013) the important effects of “institutions and processes” on the ability of people to meet their aspirations with an assets-based at the centre, were also highlighted. The case presented by Zapata (2010), about Brazil’s small-holder farmers and their integration in the biodiesel value chain, also showed how public policy can influence the institutional environment and the institutional arrangements by shaping incentives for stakeholders in value chains. This is central to the analysis of governance in value chains as institutions shape availability of information and resources, incentives and disincentives of interaction between actors and they establish the basic rules of social transactions (Nicholson, 1993 cited in Zapata, 2010).
While the institutional environment works mostly at the meso- and macro-levels, at the micro-level advancement on the understanding of the ability of people to pursue their aspirations comes from Anderson (2012). His study linked theoretically and empirically the undefined concept of “intrinsic ability” from the work on poverty traps’ thresholds, to the concept of “agency”, and identified micro-constraints to the ability of people to convert productive assets into economic livelihoods (Anderson, 2012).

In his work the concept of agency has been empirically operationalised through a set of variables with the potential to affect households’ assets returns. The variables were grouped into social networks variables (he considered bridging and bonding social capital), trust and time constraints variables (Ibid, p.1397).

The concept of bridging social capital may explain whether a household is able to adopt different productive alternatives, while bonding social capital can help to understand households’ support mechanisms (ibid). Variables such as subsistence time deprivation or dependency ratios would potentially capture the intra-households constraints to undertake new productive opportunities or “to be agents of their own change” (Anderson, 2012, p.1401). For bonding social capital Anderson used an index of trust in the local community, while bridging social capital was expressed through the number of associations households belonged to.

From the results of his analysis (based on survey data available in South Africa) Anderson concluded out that together with poor households a subset of well-endowed households were also observed to have been unable to successfully convert capital, land and skilled labour into economic livelihoods due to those “binding micro-constraints”. The author suggests that policies should target not just asset stocks but also the social environment in which assets are employed. He also stressed the need for a conducive macroeconomic environment to sustain growth and generate employment opportunities, as asset transfers (e.g. financial capital or land transfers) alone may be ineffective when viable outlets are missing for assets (Ibid).
3.5 Social network, livelihoods and diversification: the role of informal institutions at the micro-level

Studies like Anderson’s (2012) and Gautam and Andersen (2016) cited above show that mechanisms associated with relational aspects and social networks, can cast light on the ability to control resources and produce outcomes for households. This was foreseen by the literature on diversification. For example, Dorward (2009) recognises that particularly in developing countries where markets are incomplete, social capital and the institutional arrangements affecting ownership, production and exchange often include the ability to establish or maintain relationships (p.138). Equally Ellis considers social networks as an integral component of the definition of livelihoods. The advantages of studies like Anderson’s is that dynamics associated with agency\(^\text{16}\) are observed through large scale surveys.

Yet, while some institutional dimensions of livelihoods\(^\text{17}\) seem to be more easily captured by research associated with livelihoods and assets, others are not. The operationalisation of social capital (given the different streams of literature associated with this concept) does not enable an easy identification of constructs, and country surveys may use different definitions. Furthermore, social networks and the importance of institutions may be very much context-specific and it can vary greatly across and also within countries (e.g. Winters et al. 2009).

Qualitative accounts mainly from sociological and anthropological traditions have given relevance to the social dimension of livelihoods and intra-households dynamics. Authors have highlighted the importance of kinship networks, for example, to secure income that originate from different activities in different locations (Ellis, 2000). Berry (1989) shows how African rural communities use kinship to access migration opportunities, jobs and entrepreneurial opportunities in urban areas, generating obligations toward the

\(^{16}\) As noted above, Anderson (2012) operationalised agency using trust and social networks as well as intra-household micro-constraints using variables such as time constrains and dependency ratios.

\(^{17}\) For example, a gender perspective that could affect access of women to potential income sources compared to men or a tenure system which governs access to assets particularly land for farming, skills acquisition or credit (Ellis, 2000, p. 291).
community of origin. This helps to reinforce the idea that diversification is not just an economic process but it is also a social process.

Following those accounts, quantitative studies looking at the micro-economics of the household have started to incorporate a “network” perspective and test hypothesis associated with various forms of social networks by measuring their effects statistically. A study in rural northern and north-eastern China\(^\text{18}\) Zhang and Li (2003) found that *guanxi* (social networks and personal relationships) play an important role in the selection of workers in rural non-farm employment, beyond the demographic and human capital characteristics that are normally considered in classical growth models. They found that social networks are particularly relevant in the presence of limited non-farm jobs opportunities and poor market information. *Guanxi* is found to be one of the most important contributing factors to non-farm employment next to gender (as males are more likely to work in non-farm employment). Therefore, accounting for social networks matters as they can condition returns to other assets. For example, education’s coefficients resulting from econometric models might be biased if the effect of social networks is not properly accounted for (Ibid).

The article, therefore, challenges the majority of the studies conducted in China that see young, well-educated, male farmers to have better chances of accessing the non-farm labour market. Their study is supported by extensive evidence from anthropology and sociology that shows the relevance of social networks to obtain resources, status and power and that characterise China as “a relation-based economy” (ibid, p.2). It also appears that *guanxi* tend to be relevant for well-paid jobs in the industry and service sectors, while those without networks obtain more “odd jobs locally” (Ibid, p.20). In fact, they argue that when there is a large surplus of rural workers, non-farm employers are extremely selective.

Along these lines (Zhang and Li, 2003) argue that kinship is more significant in rural areas and that social networks play a more important role in accessing non-farm employment in rural areas than in cities in the case of China. Yet, networks organised around social groups (kin, family, clan) are likely to accommodate their own members first particularly where jobs and

\(^{18}\) The survey was carried out in 1995 covering 787 households in 6 counties, 18 townships and 30 villages in Hebei and Liaoning provinces.
opportunities are scarce (Ibid). This helps these social groups to consolidate their position over time once niches have been established in the destination economies, creating barriers to entry for newcomers (Munshi, 2014).

Munshi (2014) noted that business activities and labour markets are “heavily networked” in developing countries. The implications are that those that enjoy strong social networks may have greater comparative advantage in securing jobs and business opportunities and policy should look at adopting measures to make market information more widely accessible and available. In fact, Zhang and Li (2003) argue that networks “are used in situations where formal institutions and channels are lacking” (p.20) and fostering formal institutions would “facilitate a more equitable pattern of non-farm development across regions” (p.21). They recognise that social networks create efficiencies in allocating resource where information is scarce, but may also create inefficiencies in the long-run, when the allocation process excludes “viable workers” from the labour market for example (Ibid, p.22).

Nonetheless, Munshi (2014) also explains how the “efficiency implications” of networks go beyond the simple hiring process in labour markets: “social connections solve information and commitment problems” in the workplace, increasing efficiency in the long run. This is because referred and new-hired people will “avoid the social sanctions they would face from their network” of not performing according to expectations (p.49).

Similar evidence (from an economic sociology perspective) is provided by Johnson who analysed credit markets in Central Kenya (Johnson, 2009). In this case personal relationships enabled people to manage their savings in more scrupulous ways and to be cautious in the decisions about how to meet their needs. She observed that even though the three different credit mechanisms available to people19 were all based on a market system with each form grounded on a different level of “depth” of the non-price element, there was a marked difference on the way credit was negotiated, assigned and used among organisations. Certain levels of efficiency were observed in terms of managing credit among participants but also in relation to the broader economic processes. The author, in fact, noted how cooperatives and semi-formal

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19 Three forms of credit organisation are identified: formal banking, co-operatives and semi-formal saving schemes, and NGOs (Johnson, 2009).
schemes’ interest rates were more stable during volatile macroeconomic times as interests were agreed among group members.

It is widely recognised that credit and labour markets are imperfect in rural settings, where it is also difficult to access information about business opportunities (as highlighted by Haggblade et al., 2010; Reardon et al., 2000). Personal networks might help to bridge market imperfections and assets constraints, supporting upwards mobility. On the negative side networks might constrain individuals as they could discourage independent mobility or perpetuate exclusion (Munshi, 2014).

In this context, the reason identified by Ellis (2000) on why and how people diversify might get a new light. Even though he recognised that the drivers identified are socially mediated he did not offer a perspective on how to see social networks operating, for example versus income smoothing fluctuations’ strategies, or on credit market failures and imperfections, knowledge transfer, so important for diversification.

A study on the diamond industry in India (Munshi, 2007) explains mechanisms of upward mobility through networks associated with this growing industry. Starting from the same premises that success in business requires knowledge of commercial practices (often tacit knowledge), capital and an ability to identify potential opportunities and take risks that are difficult to assess from the outside, he shows how a community of farmers in the state of Rajasthan, was able to move from farming to diamond polishing and cutting in a single generation. The growing diamond industry enabled these communities to participate, as existing business communities were unable to fill the gap of entrepreneurs. The commitment problems associated with that particular industry also favour long-term relationship building based on trust as often transactions are not based on contracts with high degrees of community networking.

These perspectives are particularly interesting because if SL and value chain approaches wish to tackle poverty and inequality while fostering rural (or wider) economic transformations, networks are certainly an important aspect to take into consideration, particularly in developing economies for inclusion and upgrading.
From the literature on value chains and market development it has been highlighted that rural households (and poorest smallholders in particular) need to overcome a number of constraints associated with market dynamics, skills acquisition and investment in new productive structures to adapt to new demands. They also have to overcome weak credit markets, asymmetries of power and information, coordination inefficiencies and lack of infrastructure. Access to higher value markets requires assets (human, financial and social assets) to start and to effectively participate over time. All these elements create entry barriers for accessing non-farm opportunities or growing market niches in rural areas and beyond, with negative consequences for both growth and distribution.

Social networks are an additional variable that can influence participation, income portfolios (and productivity). By linking network analytical techniques to livelihoods and assets metrics, the effects of social networks on poverty reduction, participation or access to alternative productive opportunities, can be empirically studied. Social networks are important because they can bridge the problem of inefficiency in underdeveloped markets, particularly information and coordination externalities that lead to high transaction costs, as well as overcome barrier to entries associated with assets endowments and knowledge that block insertion and participation in value chains.

Arrangements such as cooperatives or other forms of collective action among small businesses or households might improve conditions of market access and bargain positions, credit shortage and knowledge and information (Donovan and Poole, 2014). But social networks of various types seem to be equally important. From a critical realist perspective, understanding the processes - in this case the mechanisms through which households are able to change or to move to more productive livelihoods strategies - is more important that the outcome (enhanced levels of income) of the livelihoods strategies adopted. By understanding the mechanisms, policies can be designed to influence those mechanisms to bring about desired outcomes. Looking at social networks and more in general at constraints in “agency” as conceptualised by Anderson (2012), provides a “microscope” for analysing people’s livelihoods strategies inherently linked to decisions based on the assets that they have available.
Summary of key issues emerging from the literature

Following the approach of Ianchovichina and Lundström (2009a), inclusive growth is concerned with a “pace and pattern of growth” that would ensure a broad-based productive participation through processes of structural transformations. These are mutually reinforcing mechanisms and structural transformation is central because it represents a long-term quest that requires a focus on productive capacities, economic diversification, increased productivity and competitiveness to generate employment and productive opportunities.

Ianchovichina and Lundström (2009a) approach focuses on the importance of analysing bottlenecks of economic transformations and ex-ante analysis of constraints to economic development. This is relevant but other authors argued in favour of complementing these analyses with the understanding of the intrinsic characteristics of the economic process. “Investigating the socioeconomic processes” associated with growth (Ramos and Ranieri, 2013, p. 1). The focus on the “process” emphasises on how growth is generated and on the understanding of who is able to participate in the economic process and benefit from it (Ramos et al., 2013).

Considering these two perspectives of assessing inclusive growth, one cannot overlook the role of formal and informal institutions and their influence on the process of economic restructuring and their implication on productive participation, specifically for developing and transition economies. Economic restructuring means that resources are reallocated in the economy so they became more productive and this stimulates growth. The interaction between the institutional environment and the institutional arrangements create incentives (or disincentives) for economic agents. Understanding this interaction implies understanding how and why resources are (re)allocated in certain ways.

Chapter 2 and 3 argued that the framework developed to analyse value chains and its integration with the livelihoods’ framework, can provide a useful analytical framework at meso- (sectoral) and micro- levels, to understand processes as well as outcomes of economic transformations.

20 Particularly the focus on processes of globalisation, governance, competitiveness, value capturing, productivity and structural change.

21 To understand micro-dynamics associated with livelihoods and poverty reduction.
The GVC framework emerged in response to an increased complexity of global economic networks made of inter-firm and intra-firm relationships. This “chain” focus allows a strategic view about the integration within networks of trade and at the same time as the potential to dig deeper into socio-economic processes that influence how inclusion and upgrading opportunities are generated. Governance plays a central role in the GVC framework because it influences insertion in global networks of trade but also processes of economic participation - that is to say, patterns of inclusion, value-addition and productivity growth.

Nonetheless, the excessive focus on the verticality of the chain (lead firms and first tier suppliers’ relations) has diluted the analysis of the transformative role of global markets for local systems and how the local systems are capable to mediate processes of transformation.

As argued by Henderson et al. (2002) one of the “problematic issue for the [GCC/GVC] framework is the fact that commodity chains link not only firms in different locations, but also the specific social and institutional contexts at the national (sometimes subnational) levels, out of which all firms arise, and in which all – though to varying extents – remain embedded” (p.441).

In fact, given the GVC frameworks’ limited concept of institutions it is unable to adequately examine the role of socio-cultural processes. In brief, the framework developed by Gereffi et al. (2005) has analytical advantages but it is too narrowly focused when it comes to understanding governance.

Recent studies have started filling these gaps with concepts borrowed from the Global Production Network framework, such as the idea of “multipolar governance” that takes into account the role of other actors - the state, NGOs or international organisations; or the dynamism of power relations that accounts for the possibility for economic actors of changing positions of power in value chains. The focus on policies for sustainable incomes growth and sectorial strategies highlighted in Kaplinsky and Morris (2016) for example, are relevant to the discussion on competition, productive capacities, productive employment and opportunities for economic diversification.
An adequate insertion into global networks of trade cannot overlook the literature on rent allocation for economic restructuring, particularly relevant in transition economies. In fact, authors like Khan (2012) or Rodrik (2004 and 2008) have provided a pragmatic view of industrial/productive policies to tackle specific forms of market and coordination failures and to identify incremental changes in institutional arrangements that would improve economic outcomes (and not drain resources). The incremental approach asks if there are economic activities which would enhance social output or welfare, and if so, if changes in institutional arrangements exist that can solve problems of individual contracting that hamper sectoral development (Khan, 2012; Rodrik, 2004, 2008).

Figure 2: The tourism global value chain

In the value chain framework authors consider the role of other actors exogenous to the value chain governance which is made-up exclusively by the coordination arrangements between lead firms and first tier suppliers. Nonetheless, a more comprehensive understanding of governance is obtained by incorporating the role of formal and/or informal rules that constrain...
behaviour, which is provided by a better integration of the new institutional economic theory (NIE).

In fact, the core of the value chain framework as conceptualised by Gereffi et al. (2005), is based on one strand of the institutional theory - the transaction costs component that shape chain configurations. But other strands of NIE would enhance the understanding of governance. Policies, rules, regulations but also social structures, personal networks, affect economic processes and outcomes. For example, personal networks based on trust can influence the nature of information flows (as a matter of fact personal information does not have the same characteristics as the impersonal one). Relational contracting can provide important elements to sustain entrepreneurship such as finance, tacit knowledge and learning opportunities, but also efficiency of enforcement, through reward and punishment (Granovetter, 2005; Munshi, 2007).

The examination of “embeddedness” (intended here as both territorial embeddedness of GPNs and the social structures and networks upon which firms operate) through the analysis of institutions, add an important layer that can influence participation (inclusion and upgrading opportunities), allowing a theoretical bridge between the new economic sociology and new institutional economic literatures.

In fact, from the micro-perspective, development outcomes and their sustainability depend on broader economic processes and on governance structures (Dorward, et al., 2003; Bolwig, et al., 2010; Mazibuko, 2013). Therefore, “understanding of systems, processes, places and interactions between people, and how culture and power influence the actions of stakeholders” (Scheyvens, 2007, p. 242) become central to understand livelihood strategies.

At the same time, the framework developed by Dorward (2009) and other co-authors (e.g. Dorward et al. 2003, 2005, 2009) and the conceptualization of stepping-out (changing livelihoods activities and structures), stepping-up (improving livelihoods) and hanging-in (protecting livelihoods) for households involved in different economic activities and markets, have parallels with the idea of upgrading in value chains.

Dorward’s framework and related literature account for complex issues related to the interaction between institutions, markets, assets, livelihoods and
poverty and it involves analysis of interactions at different levels. It offers a better analytical framework for micro-level analysis of both processes and outcomes. It has the potential to bridge some of the concerns associated with poor people’s integration in value chains highlighted by Bolwig et al., (2010), to better understand processes of change and how they are locally mediated. Bolwig et al. (2010) stated:

“… there is a need for theoretical accounts and methodologies that can mediate between different arenas and levels of social process – that can link, for example household – and intrahousehold-level micro-analysis, with accounts of global and national processes… attention has to be paid both to the vertical links…. – and to the horizontal ones – the ways in which the impact and nature of integration into globalised systems are locally mediated” (p.178).

The analysis of the literature at the micro-level allows the identification of variables that can influence livelihoods’ decision-making processes. Variables to be used in the quantitative analysis in Chapter 7 are reported in the methodology chapter (sections 4.6.3 and 4.6.4) and in Appendix – F. These include demographic variable, asset variables (including social network variables), flows variables and variable such as time constraints that impact on the possibility to take full advantage of asset endowments.

Assets are an integral part of the livelihoods framework and there is evidence that assets endowments influence the successful participation in markets and value chains. Yet, institutions of various type also influence decision on economic livelihoods as well as decisions upon those assets that people have available, ultimately influencing the access to (and the successful and sustainable adoption of) specific economic opportunities. The literature review in chapter 3 have highlighted how mechanisms to broaden economic participation cannot be “treated” only as a pure managerial and competency issue and how diversification is not just an economic process but also a social one. The analysis in Chapter 6 and 7 in particular, will try to capture these important mechanisms by analysing the interaction between formal and informal institutions.
Chapter 4 – Methodology and Research Questions

Abstract
In this chapter, I discuss how I have developed the research questions, the research design and the motivation for adopting the design. This includes, the philosophy underpinning the research and a note on mixed methods; the case study design, and the fieldwork arrangements; the way in which I obtained trust and I accessed different stakeholders in the case study setting; the criteria I used to develop the tools to gather data and analyse them; and finally an overview on validity and reliability. In this chapter, I use the first person because of the personal reflections about the fieldwork and the adaptation undertaken to the many circumstances that emerged while in Bhutan. This is also the reason why I start presenting part of the context in this chapter. Some anecdotes may appear to be worth being reported on the findings section, but I believe methodological decisions need to be contextualised within the circumstances that drove those decisions.

4.1 Research questions

This research project was initially driven by a preliminary definition of a research question supported by the identification of “constructs”. Following Eisenhardt (1989), constructs were identified from the literature and used to determine the initial design. Furthermore, they provide an orientation to the researcher during the fieldwork. The objective and the initial research question were based on existing discussion about value chain governance. As such, the main research questions were refined from context-specific observations.

Feasibility of the investigation in terms of financing and accessibility to the research participants also influenced the choice of the research strategy and methods. Given the financial resources available and the limitations related to

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22 “What is the role that the tourism governance plays for poverty reduction and economic inclusion in Bhutan?” Following Creswell (2014, p. 141) “what” or “how” questions convey an open and emerging design more typical of qualitative approaches.
the use of local dialects and languages, I wanted to ensure an in-depth exploration of the case. It has to be noted that the initial intention and consequently all the arrangements prior to the fieldwork were put together around the perspective of conducting an action research project which was not possible to conduct after all.

Table 5: Research strategy

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<thead>
<tr>
<th>Step 1. Objectives</th>
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<tbody>
<tr>
<td>- Understand governance of the tourism sector;</td>
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<tr>
<td>- understand the context and the mechanisms associated with economic participation (economic inclusion and upgrading) and;</td>
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<tr>
<td>- their effect on livelihoods of poor households in rural Bhutan.</td>
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<tr>
<th>Initial research question</th>
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<td>What is the role that governance plays for economic inclusion and poverty reduction in Bhutan?</td>
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<tr>
<th>Step 2. Main research questions</th>
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<tr>
<td>1a. What institutional elements characterise the governance of the Bhutanese tourism value chain?</td>
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<tr>
<td>1b. How do these elements influence inclusion and economic upgrading opportunities in the tourism value chain?</td>
</tr>
<tr>
<td>2. To what extent are rural households able to diversify into higher productivity activities such as tourism?</td>
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Source: Own elaboration.

The case study design was chosen to situate the actors identified in their Bhutanese context. Case study is often used to tackle subjects about which little is previously known and about which existing knowledge is flawed (Gerring, 2004). The use of multiple tools of data collection was preferred to allow completeness of observations (e.g. Eisenhardt, 1989; Venkatesh, 2013), ultimately offering the potential for more reliable and valid results. From the interaction between the literature, constructs and context specific observations, the following research questions where identified:

1a. **What institutional elements characterise the governance of the Bhutanese tourism value chain?**

1b. **How do these elements influence inclusion and economic upgrading opportunities in the tourism value chain?**

Development outcomes for value chain approaches are mostly linked to the governance of a sector (Dorward et al., 2003). Therefore the “configuration” of the sector matters for influencing the terms of participation that ultimately impact on the widespread of benefits that an industry can bring. As such, it is
important to understand the governance and the power structures that underpin the operations of economic actors. In general, understanding governance helps understanding processes linked to economic participation (Gibbon et al., 2008).

2. To what extent are rural households able to diversify into higher productivity activities such as tourism? This question complements the previous one in the recognition that inclusion in value chains and markets do not benefit by default. Economic policies and growth oriented strategies driven by national interests or global processes can have adverse consequences for the disadvantaged in developing countries (e.g. Mazibuko, 2013). At the micro-level the literature reviewed on livelihoods has shown that assets are important elements to be taken into account. Yet, institutional dynamics are increasingly taken into consideration. Methods like network analysis can help unveil how people cope with and take advantage from certain levels of asset endowments and/or new economic livelihoods strategies. Networks metrics and their relationship (covariance) with a number of variables relevant to rural households (particularly demographic, flow and asset variables), can provide a clear picture of processes and outcomes associate with livelihood transformations.

4.2 Research philosophy

The objective of this research project is not to provide generalizations or to provide an interpretation of meanings through the accounts of the actors involved in social interactions. I wish to explore and to understand processes and mechanisms related to the case under examination with the adequate flexibility to consider different sources of information and report different perspectives. The literature review shows that the processes related to pro-poor and inclusive growth need to be understood vis-à-vis the system. How the system is configured and the way in which actors interact within it, influence patterns of upgrading in the economic and social spheres (see for instance Dorward et al. 2003). Therefore, identifying the mechanisms and the processes that generate the “objects, events and actions” is a central aspect to this research project.
For a critical realist the elucidation of the processes, characterised by complex interactions within socio-cultural-historical context, is where causal analysis lies. This is in contrast with the linear identification of empirical regularities and with constructionist ontology, where social actors may have no awareness of the mechanisms that can lead to social causality (Reed, 2009, p. 435). In fact, the realist approach replaces and rejects both the regularity model which is proper of positivism and experimental settings, and the imperative of interpretivist stances.

“...with one in which objects and social relations have causal powers which may or may not produce regularities and which can be explained independently of them. In view of this, less weight is put on quantitative methods for discovering and assessing regularities and more on method of establishing the qualitative nature of social objects and relations on which causal mechanisms depend.” (Sayer, 1992, p. 3).

Therefore, methods should be appropriate for the nature of the object under examination and the purpose of the inquiry (Ibid, p.4). In other words, in moving from ontology to epistemology we are able to remove those barriers that in experimental designs are related to protocols and procedures that in some cases offer only reduced representations of reality. In constructivism and interpretivism, the perspectives and the understanding of the social world as its members understand it, can limit the exploration because the knowledge of the subjects can also be limited (this proved to be very much the case of Bhutan as it will be explained below). The contribution of critical realism to constructivism is what Sayer (1992) defines as the “double hermeneutics”. The realist philosophy allows the hermeneutic moment which is essential in grasping social mechanisms but also the “adequacy of the understanding of the world” (Manicas, 2006, p. 4).

The concept of the double hermeneutic is therefore linked to another important feature of critical realism, retroduction. “A retroductive strategy involves the construction and the application of theoretical models that uncover the real and unobservable mechanisms or structures that are assumed to be
causing actual events and experiences” (Reed, 2009, p. 438). The logic of retroduction applied to the analysis of historical contexts, structural conditions and the identification of certain phenomena, enables the researcher to constantly compare his/her observations to theoretical frameworks and the knowledge available, identifying what could have generated the given phenomenon through a process that aims at distinguishing and valuing alternative explanations (Easton, 2010). It is the role of the researcher to provide an explanation by

“work[ing] back from the known phenomena located within [its] specified sociological contexts,... to the postulation and construction of theoretical models that identify and represent the operation of causal mechanisms or structures that interact in complex and unpredictable ways with other causal mechanisms or structures” (Reed, 2009, p. 439).

Meyer and Lunnay (2012), building on Bhaskar (1975), argue that from a critical realist perspective, the 'empirical' is the experience and the perceptions of the participant that need to be distinguished from the 'actual' and the 'real'. The 'actual' is defined as the event or the circumstance as they happened (which not necessarily reflect how they have been experienced), and the 'real' are the generative mechanisms (structures and social contexts) that naturally exist. Reed (2009) refers to the “real” as the unobservable structures and the powers of objects, where objects can be organizations, people and relationships. The question that arises from a critical realist perspective is therefore “why things are as they are”. The interaction between the three levels (the empirical, the actual and the real) generates emergent phenomena that exhibit properties and tendencies. Over time, the emergent phenomena may turn to be sufficiently stabilized to become social structures, institutions and organizations (Ibid). This is how the stratified ontology which is proper of critical realism is conceptualized. Analytically, the stratified reality can be explored separating the empirical from the actual and the real.

The concept of practical adequacy is related to the concept of stratified reality and it influences what is relevant knowledge: what can be known and
how it can be known. A realist approach seeks for inputs to theories which are practically adequate, which work in other contexts, which are consistent with other knowledge and practices. Theories should explain the situation under study by giving and account of what produced the phenomenon. However, theories are constructs that are underpinned by structures of the world as such the world can only be understood in terms of available conceptual resources, but the latter do not determine the structure of the world itself (Sayer, 1992, p.71). Reality is therefore very difficult to access and theories are closed approximations.

The above provide an understanding of what are the ontological and epistemological positions of critical realism. A critical realist’s ontology assumes that there is a reality that exists independent from the observer, a reality that in social systems is rarely accessible and therefore difficult to measure. As such, critical realists accept an epistemology which is socially mediated. Yet, interpretation of the social constructs is brought to a deeper level by critical realism, searching for “generative mechanisms that lie beneath the events and experiences that characterise our everyday lives” (Reed, 2009, p.438). Each layer of the stratified reality (as it is seen by critical realists also called layered social ontology), has distinctive objects and mechanisms with their own powers and capabilities. For critical realism the “generative mechanism” is the causal elements that need to be uncovered. The retroductive logic (together with the concept of “practical adequacy”) supports research methodologies and procedures that are instrumental to the in-depth understanding and the intensive exploration to uncover causal generative mechanisms (Ibid). As such, critical realism is relatively open to different research methods (Easton, 2010, p. 123).

It is clear that in every research project the choice related to the methodology depends on the research objectives. However, research philosophies provide the basis for what can be explored and how. They give the fundamental direction on where causation can be found. Critical realism wishes to uncover mechanisms that produce the effects through the exploration of structures and conditions. Case study research is intensive by definition and it is consistent with the critical realist ontology and epistemology. Easton (2010) provides an interesting example of how a critical realism philosophy can enrich
the ontological and epistemological underpinnings of case study design. A critical realist approach to case study needs to identify a research question that interrogates the phenomenon “in terms of discernible events, and asks what causes them to happen” (Ibid, p.128). This would allow a more informed selection of the case (or the units that make-up the case) allowing the identification of events. In the process of analysing the case:

“[t]he key entities involved, their powers, liabilities, necessary and contingent relationships are provisionally identified. Research then proceeds by capturing data with respect to ongoing or past events asking at all times why they are happening and taking into account the problems and issues associated with interpreting the empirical data back to the real entities and their actions. The research process is one of continuous cycles of research and reflection. The final result is the identification of one or more mechanisms that can be regarded as having caused the events” (Easton, 2010, p.128).

Events in the Bhutanese context will be associated with the interaction between economic actors in the tourism value chain for economic participation (inclusion and upgrading). As stated by Easton (2010) in exploratory research, entities may be chosen then accepted, modified or excluded to understand data unless theoretical frameworks help identifying the relevant actors. The value chain approach and the theoretical framework (based on new institutional economics) allow me to consider the core actors in the Bhutanese tourism value chain (tour operators, guides, accommodation providers and communities) as well as organisations and institutions associated with the functioning of the industry. The entities have also relationships (necessary or contingent) that become central because they “reproduce patterns of social interaction... that link and mediate between different cycles of institutional elaboration, reproduction, and transformation” (Reed, 2009, p.438). Therefore, the study of relationships can contribute to identify causal explanations of events. Hence, I will explore the relationships at work in the provision of tourism services in Bhutan and the space that these provide for economic inclusion and upgrading.
Overall, this would offer the possibility to describe issue of governance relevant to the tourism industry in Bhutan.

Another important feature that was evidenced by Meyer and Lunnay (2012) is the flexibility of critical realism in the use of logic. Retroduction can be complemented by deduction and induction reasoning linked to the application of different methods. This is also consistent with cases study which can be seen in a spectrum that goes from a positivist to a more constructivist/interpretivist epistemology, providing the flexibility to move between inductive and deductive logics and multiple levels or layers of analysis (Gerring, 2004, p. 342 and 345).

4.3 A note on mixed methods and the link to research philosophy

The use of multiple methods in case studies research is motivated by the opportunity to increase validity and reliability through corroborations and enhance the understanding of the case. Creswell (2014), states that a solid mixed methods research study needs to contain qualitative, quantitative and mixed methods research questions. Ideally, in a mixed methods research, it is important to define a research question that can be addressed with the integration of qualitative and quantitative data, so to emphasise and make it clear “what the integration [is] attempting to accomplish” (Ibid, p.151).

The dominant position of my study is qualitative: it is characterised by the identification of a general research question and several concepts (or “constructs”) from the literature and the formulation of a subset of questions evolving over time and which are context-specific, that also required high levels of flexibility in adapting the design once the fieldwork started. The research is qualitative also in its exploratory endeavour and in its willingness to understand interaction between actors so to understand what elements influence governance around issues of tourism development, productive inclusion and rural livelihoods diversification.

The qualitative exploration is enriched by a quantitative component associated with the interest of capturing the mechanisms “at work” related to market-based interventions and the interactions at horizontal as well as vertical levels, and their transformative power on income but also on participation. In my case the qualitative and quantitative data are not fully integrated on the same
“level” like in a “classic” triangulation. In fact, qualitative methods and quantitative methods in triangulation are normally applied on the same unit or phenomenon to corroborate observations and ultimately enhance validity and reliability. The mixed methods approach emerged from the late 80s and “triangulation” is one of the research designs from where mixed methods research originated. However, mixed methods have evolved into many derivations and approaches that changed based on the combination and the use given to qualitative and quantitative methods. These combinations are based on: expected outcome, how data will be used together, timing of data collection, single researcher or a team, “field” conditions, emphasis placed on each database (Creswell, 2014; Creswell and Clark, 2011).

Consequently, an attempt to formulate a mixed method research question can be found in question number two. The question tries to integrate the relevance of governance mechanisms with the quantitative data analysis at the community level. So, quantitative methods are embedded in the qualitative analysis to enhance the understanding of the case, providing a supportive role and exploring more in depth the findings from the qualitative interviews (Creswell and Clark, 2011). Creswell and Clark (2011) define the mixed methods case study design as a variant to the embedded design where researchers embed both qualitative and quantitative methods within a traditional design (Ibid, p.95). The advantage of the embedded design is that the two sets of results can be analysed and reported separately which would provide a practical advantage in the reporting of the findings. However, theoretical perspectives emerging from the analysis can also offer the space in which data can be discussed simultaneously, resembling a “transformative approach” (Creswell and Clark, 2011, pp.9 and 75) and a “retroductive” reasoning.

Figure 3: Mixed methods embedded design

Source: Own elaboration based on Creswell and Clark (2011).
My stance is different from the conventional dichotomy between inductive versus deductive reasoning. I did not use any preconceived hypothesis. Furthermore, inclusive growth and to some extent value chain, sustainable livelihoods and pro-poor market development are not theories. Consequently the analysis can flow quite easily into broader theories of social science. This means that I had a broader sense of the relevant theoretical framework through which I approached the case, but theories related to economic and social development become much clearer the more consistent with and relevant to the data emerging from the fieldwork they became (following the retroductive logic).

Another reason that pushed me to use a mixed methods case study is that the case of the tourism value chain in Bhutan can be considered an “outlier”, an extreme case in which quantitative or purely qualitative methods would have probably had limited range. In fact, using purely quantitative methods would have not made much sense given the absence of reliable and accessible quantitative data sources. Similarly, interpretive approaches through a single way (single hermeneutic) of interpretation would have denied the possibility of discerning causality especially in a context in which few knew “why things are as they are” (Easton, 2010; Reed, 2009). In fact, I found that among younger managers/officials there was not much interest to dig into the “why” of things. They tend to keep their routines without much critical reasoning. Conversely, senior official had a more critical mind and knowledge, probably also allowed by their ranking and authority that entitle them to speak more freely.

Critical realism offers a philosophical platform suited for this research project. It justifies the study of any situation (regardless of the numbers of research units) if the process involves thoughtful and in-depth research (Easton, 2010). Therefore, it is the role of the researcher to identify “circumstances” or structures without which something cannot exist. In this process “[t]he researcher moves between knowledge and observable events, recognizing that knowledge cannot be reduced to observable events” (Meyer and Lunnay, 2012, p.3). Finally, my “beliefs” influenced the choice of this specific philosophical approach, as I do not believe that the world is fully and solely socially constructed; reality does exist beyond and despite us. But, it is difficult for me to intuitively accept that the social world can be reduced to a cause and effect model based on the identification of regularities. Reality is complex and
deserves an investigation that goes beyond hypothesis testing and interview reporting, and this is particularly true in this research project where an “outlier” about little is known, is to be explored.

4.4 Case study research design

Case study research gives special attention to completeness in observation, reconstruction and analysis. Gerring (2004) noted how a case study may focus on few instances of a phenomenon (small-N for example) and the use of qualitative and/or quantitative methods. Although a frequent criticism of this design concerns its incapability to provide generalization, Yin (1994) pointed out that generalization of results, from either single or multiple case studies, is made to theory and not to populations.

Stake (2005, p. 443) makes an interesting distinction between intrinsic and instrumental case study. Intrinsic case study design draws on the understanding of what it is important about the case within its own world, while an instrumental case study illustrates how the concerns of the researchers and theorists are manifested in the case. Gerring, (2004) argued that “it seems justifiable for case studies to work on two levels simultaneously, the unit itself and some broader class of units” (p.346). However, this also configures a major challenge which is to look at what can be learnt. This happens by contrasting the realities of the case vis a vis the key issues identified in the literature.

The special attention to completeness in observation in case study research is matched with the possibility to use multiple methods of data collection and to approach the case under different ontological, epistemological positions. In fact, case studies strive towards a holistic understanding of cultural systems of action that refer to sets of interrelated activities engaged by the actors in a social situation “that incorporates the views of the ‘actors’ in the case under study” (Tellis, 1997, p. 2). Stake (2005) noted that “a case is both a process of inquiry about the case and the product of that inquiry” (p.444). As such, case study “facilitates the conveying of experiences of actors and stakeholders as well as the experience of studying the case” (Ibid, p.454).

The (re)construction of the case from the participants’ perspectives while contrasting the emergent knowledge (related for example to functioning of a
sector or the interaction between formal and informal arrangements) through the use of different empirical indicators and theories, allows the understanding of the “underlying causes of social process[es]” and therefore the possibility to assess their effects (Ackroyd, 2009, p. 537).

4.5 The selection of the units

In experimental research “[t]he selection of an appropriate population controls extraneous variations and helps to define the limits for generalizing the findings” (Eisenhardt, 1989, p. 537). On the contrary, case studies give in-depth data with limited claims to representativeness (Gillham, 2000), without any specific or predetermined “sample strategy”. However, the selection of the cases is important and it is grounded in the appropriateness to provide “balance, variety as well as opportunity to learn” (Sarantakos, 2005, p. 213). They must be selected so as to maximize what can be learned, in the period of time available for the study (Tellis, 1997). Theory and theoretical reasons provide the basis for the selection of a particular case (Yin, 2009; Eisenhardt, 1989). From a realist perspective Ackroyd (2009) argues that the reason for thinking that the discovery of a generative mechanism in case study is significant, can be conceptual as much as it can be empirical. “Case investigations that lead to the identification of the operation of generative social mechanisms are theoretically guided, but the precise operation of mechanisms is the subject of empirical corroboration” (Ibid, p.537). Therefore, the potential to purposively choose a case is to extent emergent theories or to fill theoretical categories in such a way that “it make sense to choose cases such as extreme situations” (Eisenhardt, 1989, p.537).

In the literature available from practitioners in local economic development, for example, these patterns emerge clearly. Methodologies employed by practitioners are normally rapid appraisals conducted by selecting and interviewing businesses from a sector, cluster or value chain, followed by important organizations (technology centres, knowledge providers, agricultural extension offices, training institutes, etc.). In this process, the outlier’s perspective is often overlooked, but specific attitudes, cognitive processes and behavioural patterns that differentiate the outlier from the majority can provide
greater insights than cases with similar patterns of behaviour and ways of thinking (Waeltring, 2014).

From a number of perspectives Bhutan and its tourism industry appeared to be an example of an extreme case. First, the philosophy of Gross National Happiness (GNH) drives the political and the economic choices through which Bhutan conceptualises and measures its development, complementing more traditional metrics (GDP). Bhutan is also one of the youngest democracies in the world and in its functioning it still centralised. Strict rules and regulations are applied in every industry (including Foreign Direct Investments - FDIs), to control social and environmental impacts and macroeconomic stability. However, Bhutan is in the process of “accession” to the World Trade Organization (WTO). This creates tensions between the need to advance in economic development through trade and openness to globalisation, and the holistic underpinnings of GNH philosophy.

Bhutan is also looked at as a success case in the South Asia Region and its policies of controlled liberalisation seem to aim at “leapfrogging” the development trajectory, intended to avoid negative externalities often associated with modernisation processes in the economic sphere, experienced by other developing nations. In tourism for example, Bhutan is often compared to Nepal as its counterfactual by many stakeholders.

It is within this context that a value chain approach (VCA) was chosen to disaggregate an industry and to define the aspects that are most important to analyse (Fritz et al., 2009). The value chain approach provides a framework for the analysis of different levels within the Bhutanese context (e.g. Gerring, 2004) and the flexibility to use different tools to gather data, which is also common in case study research (Eisenhardt, 1989).

In this research the core actors provide the sample and their commercial operations and relationships are the unit of analysis. These units would allow the identification of mechanisms associated with economic participation in the Bhutanese tourism value chain. At the community level the interest lies in the understanding and testing these mechanisms for livelihoods diversification and specialisation particularly in higher productive activities like tourism. The focus will be again on social relationships but they will be observed and analysed with different tools.
4.6 Crafting instruments and protocols

Before entering into the details about the design of each tool and the protocols applied during the fieldwork, it is worth noting that I did not use any preconceived hypothesis. Therefore, I did not enter the context with a “master” or a draft for any of the research tools applied. The units of analysis and particularly the instruments for the investigation were decided and crafted after preliminary observations and informal interviews corroborated with those people that I found knowledgeable about the topics I intended to explore.

In terms of how I developed my strategy, I initially follow the paper of Riisgaard et al. (2010), trying to identify local organisations through which
conducting the research project. An initial proposal was shared with and accepted by the Tourism Council of Bhutan. The organization decided to host me on an independent basis in their planning department. The Council is partner in projects related to ecotourism and community based initiatives in rural areas. One of these projects (the pilot for community-based tourism in Bhutan) was also briefly discussed in a paper from the Overseas Development Institute (ODI) in which the authors assessed SNV projects (Ashley and Mitchell, 2008). Given the initial intention of conducting an action research project, I was confident I would have given the opportunity to work in synergy with participants through collaborative research (e.g. Greenwood and Levin, 1998).

Yet, Bhutan is a young democracy (with the second Parliament having been elected only in July 2013), government agencies proved to be still very much embedded in hierarchical structures. Efforts are put in place to make processes within government organisations more participative. But organisations are still very much entrenched in authority.

Nonetheless, being part of a government organization had various advantages. It allowed me to observe from a privileged point of view, and to connect effectively with other related organizations such as tour operators, guides, hoteliers, local NGOs, development cooperation agencies and the UN.

In general, I tried to turn into an advantage the various situations in which I found myself involved. The idea of conducting action research was finally dropped and observations and notes collected were used to develop the main tools for data collection. Further details are provided in the following section. Table 6 provides an overview of the units of analysis based on the value chain framework, the research methods associated and the objectives.
Table 6: Methodology overview

<table>
<thead>
<tr>
<th>Objectives</th>
<th>Addressed research questions</th>
<th>Unit of analysis</th>
<th>Sample</th>
<th>Methods of data collection</th>
<th>Data analysis</th>
</tr>
</thead>
<tbody>
<tr>
<td>To identify governance mechanisms</td>
<td>1a. What institutional elements characterise the governance of the Bhutanese tourism value chain? 1b. How do these elements influence inclusion and economic upgrading opportunities in the tourism value chain?</td>
<td>Commercial operations and implication for inclusion and economic upgrading.</td>
<td>• Tour Operators (11)  • Hotels (11)  • Guides (9) (N= 31)</td>
<td>One to one Semi-structured interviews</td>
<td>Participant observation, used to inform the design of the interviews and integrate the description of the context when necessary and pertinent</td>
</tr>
<tr>
<td></td>
<td>2. To what extent rural households are able to diversify into higher productive activities such as tourism?</td>
<td>Institutional and policy context for inclusion and economic upgrading.</td>
<td>Civil Society and Public Sector representatives (N=9)</td>
<td>Review of policy and documents; one to one unstructured interviews</td>
<td>Extract empirical evidence from interviews through coding transcribes. Include context’s observations and review of policy documents</td>
</tr>
</tbody>
</table>

To test specific governance mechanisms identified and understand their effect on livelihoods activities (transformati ons, and possible specializatio n).

2. Social Networks for inclusion and economic upgrading (livelihoods diversification, specialisation).

Households involved in tourism services in Phobjikha valley (N=39)

Household survey by questionnaires on livelihoods and social networks

Previous research and participant observation used to inform the design of the survey and complement the description of the context

Network analysis and correlations based on the data collected from the survey. Complement ed with extracts from interviews and observations

Source: Own elaboration. The sample included in the analysis is composed by those people that have been formally requested to participate in the study and have signed the consent form. However, I have met and discussed issues informally with over a hundred people between consultants, public and private sector representatives and people for international organisations based or visiting Bhutan.

### 4.6.1 Participant observation

Participant observation was an effective initial instrument for this research project. Observations helped to start developing and refine research questions and a suitable research strategy. This method was mainly used to inform the development of the key instruments described in point 4.6.2 and 4.6.3 used for
data collection. Practical issues of participant observation included: gaining access to a specific setting; participating in everyday life and developing relationships; observing and gathering information through notes, records and files; analysing data and theorizing. Gaining trust became central in this process as I was also aware that the time spent itself was no guarantee to fully understand the complexity of social-life (Lewis and Russell, 2011).

The selection of a setting for participant observation depends on “whether or not an access to the specific setting can be obtained, the range of possible roles that the participant can assume, and whether or not this role will provide sufficient access to phenomena of interest” (Jorgensen, 1989, p. 41).

Jorgensen (1989) classify human settings been visible or invisible from the point of view of the general public and more or less open/closed to outsiders. In my case access was gained by seeking permission to participate, observe and work together with the planning division of the TCB. The support provided by the TCB was not always sufficient for gaining trust and access to what I thought was interesting and significant for exploration, but represented a very good platform from where to operate.

Bryman (2001) noted that the participant observer immerses him/herself in a group for an extended period of time, observing behaviour, listening and asking questions, methods which are considered central data collection techniques. In practice, participant observation is not just observing people at a distance. In fact, to understand a world “first-hand”, the researcher becomes part of a social world; “participant observation is… a mode of being-in-the-world characteristic of researchers” (Atkinson & Hammersley, 1994 p.249 cited by Silverman, 2006). The “here and now” of everyday life represents the research field, where the researcher starts the process of defining the problems to be studied, the concepts, and the appropriate procedures for collecting and evaluating evidence through an open-ended process.

In fact, the participant observer may proceed having an idea of what is to be studied before going into the field, or an interest may develop after the participant involvement in every-day-life of a group or community. Moreover, it is an ongoing process where the research questions can be re-evaluated during the early stages of the research and it may be necessary to change the direction of the project in response to unexpected findings (Jorgensen, 1989).
“The methodology of participant observation provides direct experimental and observational access to the insiders’ world of meaning” (Jorgensen, 1989, p. 16), making the insiders’ reality accessible and rejecting the distinction between subjectivity and objectivity.

In Bhutan, informal discussions occurring outside the formal setting of the office, proved to be more enlightening and interesting that any attempt to gather information in any other formal context. The issue of the donor-driven poverty reduction projects arose during an informal gathering23; the “economic leakages” issue caused by undercutting of the tariff despite regulation and by the dominance of the Nepalese and Indian traders, emerged by chance by meeting an Indian tour guide and was corroborated during a gathering of national tour operators’ managers attending a famtrip24 and after several traditional dances. The importance of family ties in business relations and informal “business groups” arose by chance during my visit in Phuentsholing and discussed over a dinner with a Bhutanese entrepreneur. These all emerged in informal settings and discussions. However, they have been included in more formal instruments to be further explored also in a manner consistent with ethical obligations. In fact, even though I never hid my identity or my position as PhD researcher and my relationship with the Royal Government of Bhutan, I thought it was necessary to reproduce all these issues in a more formal and standardised setting and the semi-structure interview items were created upon these observations, to comply with the formal ethical procedures.

Furthermore, constructing notes and records is part of the methodology of participant observation. No matter the technology used to collect field notes, “notes have to be reviewed on a regular basis, identified and labelled whenever possible as being related … to an emergent issue of study … [and] explaining how a fact or set of facts is related to the issues [under study]” (Jorgensen, 1989, p.108). Considering the above, I tried to be systematic, but I was literally overwhelmed by information and note-taking as everything seemed relevant and interconnected. Therefore, I decided to use observations and the interaction with participants to corroborate from different perspectives the

23 I was invited to drink a local beer - Druk 1100. It is the favorite drink of Bhutanese in informal gatherings. It is brewed by the Royal Army under a development project that involves discharged army personnel.

24 Familiarization trips (famtrip) which consist in inviting tour operator managers to experience tourism products and destinations.
relevant information emerging, a technique that proved to be important to reduce researcher bias (see Fine et al., 2011).

Venkatesh (2013) refers to Bourdieu and the scholastic fallacy that denies or is unable to understand the existence or the importance of unwritten rules, simply because the actors are failing to state or unable to report these rules of the game. The constant interaction at TCB helped me to understand a number of unwritten rules governing tourism that would have been rarely spoken or known by people and that thanks to the observations were systematically included in the interviews²⁵.

At the same time, I also needed a more privileged position to understand the “community level” that I finally found in a local environmental NGO, the Royal Society for Protection of Nature (RSPN). The project implemented by the RSPN was the only one under implementation during the time of my stay. The TCB was partner and the project area was relatively easy to access. After the first visit that lasted approximately ten days (in May 2013), I started building a professional relationship with the project officer of the NGO, supporting her work whenever possible. The project ownership belonged to the RSPN which was granted funds by the Japanese Development Cooperation Agency (JICA) through a Japanese Environmental NGO (JEEF). Given the difficulties to interview and interact directly with people in rural areas, I developed a survey by questionnaire, relying on the project officer feedback (and other personnel of the NGO) to corroborate my observations and provide translation when needed. Following Lewis and Russell (2011), I tried to contribute as much as possible to the organization and to the project objectives to build trust.

4.6.2 Interviews

**Design, sampling and application**

The objective of the interviews was to collect data systematically on governance and coordination through which I could identify patterns of economic inclusion and upgrading. Following a similar approach used by Uzzi (1997), I combined the participant observation (in my case conducted in an

²⁵ I found that stakeholders did not attach much relevance to issues which were important, partially because they were part of their routines and also sometimes for lack of awareness.
organisational setting) with interviews to chief executive officers or general managers of tourism companies and national guides in Bhutan. Most of the “headquarters” of tourism companies are based in the capital city Thimphu. This is because most of the administrative processes regarding visa and licences need to be undertaken through different government agencies in Thimphu.

Figure 5: Inter-firm and institutional relationships

Representatives of tour operators were all interviewed in Thimphu. Hotel owners and managers were interviewed in Thimphu (centre-west), Phobjikha (centre), Paro (west), and Phuentsholing (south-west). Paro (where the international airport is located) and Phuentsholing (the main entry point by road from India) represent the two main access points to Bhutan and consequently important tourism hubs. Guides were mostly interviewed in Thimphu.
Studying firms at the level of CEO and GM in Bhutan is important as they are involved in all key aspects of the business and consequently they have first-hand knowledge of the firm’s strategies. They are also the decision makers and they normally supervise routine and non-routine operations. Other managerial positions would have not suited the scope because they lack the encompassing vision of the business operations and they fear that disclosure could eventually put them in the position to be blamed by superiors. I selected the tour operators (private companies) from the list available at TCB (more than one thousand tour operators are registered for operations at the Trade Division of the Ministry of Economy).

The companies were selected based upon two main criteria, the number of tourists held (market share) and the variation of the market share over the years. The market share would have worked as an indication for the dimension of the company. All companies are involved in more or less tailor-made travels, meaning that they handle not big numbers of tourists. At the same time the annual changes in the number of tourists were more likely to indicate how successful (or unsuccessful) would have been the strategies and operations of
a particular company, or issue regarding the environment where a particular company operates.

This second criterion was thought relevant because companies’ experiencing downturns or upturns can potentially highlight how issues of governance or power asymmetries in markets could have impacted their business. Additional criteria included international markets to which they refer and the gender of the CEO or GM. The idea was to guarantee a proper representation of the industry and to minimize the likelihood that inter-firm coordination would have been biased by the size of the company or the specialization on specific markets. Other criteria such as location (most tour operators are based in Thimphu with few exceptions), ownership (all the companies must be Bhutanese owned), age of the company (difficult to retrieve given the records available), would have not made much difference in the case of tour operators.

The basic criteria for ensuring the diversity of the guides interviewed included: junior/senior, gender, freelance/employed and “pure” guides/or guides holding a tour operating licence. In the case of tour operators and guides it was very difficult to arrange appointments for interviews. In many occasions meetings were planned a week in advance and cancelled the day of the interview, making it very hard to plan. I always gave a follow-up call but in most of the cases people would not pick-up the phone, forcing me to pass to the next “best possible candidate”.

A snowball strategy was employed as an “back-up” strategy to contact and reach the target sample (see Atkinson and Flint, 2001). In fact, I asked the guide association’s president and other officials at TCB to provide access to potential participants that were matching the criteria established for sampling. In some occasions I followed other respondents’ suggestions. Using referral through personal connections both in organisations and within peers, helped to build trust with participants, avoiding lack of response or cancellations of appointments.

For hotel managers it was easier to schedule appointments. Furthermore, in this case I tried to get perspectives from managers based in different locations. In Phuentsholing I was able to plan the interviews in advance through the support of a TCB officer located there, who arranged a working agenda with
the general managers of all the hotels with a “tourist standard” (three stars and above) and some at lower standard. In Paro, Thimphu and Phobjikha, I also interviewed managers from different category of hotels.

Even if the TCB employs information systems to record and control the operations and the flow of tourists generated by tour operators, the full potential of these information systems is not at all exploited. The gap in the use of information systems is problematic not only to select suitable samples but also to describe the evolution of the sector. It is impossible at this stage to have a reliable overview of the supply-side of the tourism industry (see section 6.1). This is partially due to lack of coordination between government agencies. At the time of the fieldwork, the licences were issued by the Trade Division (Ministry of Economic Affairs) upon payment of an annual fee. In the case of hotels, TCB would assess their category after the licence has been issued, but the hotels can operate uncontrolled if the construction is finalized. There is a checklist for determining the category but there is no need for an assessment before start operating.

This also means that neither the licence nor the certification of the category would have provided a valid year for the start of operations. For tour operators and guides is less problematic as the date of the licence can be taken as the date to start of operations. Guides need to pass an examination after a compulsory training delivered by private organisations, while tour operators need to provide only a proof of address. It was not possible to locate the person at the Ministry of Trade that would have been able to retrieve this information and reconstruct the supply-side of the tourism sector in a reliable way and proceed with random sampling.

The set of questions was developed by matching issues identified in the literature with issues relevant to the context and consequently to the respondents. This procedure acquires significance with business people. In fact, if questions are seen as salient, the interviewee can expect to learn something about the business environment or about other companies in their industry, and they are keener to share information with the interviewer and more likely to dedicate time to discussion (Daniels and Cannice, 2004). The set of questions was developed after preliminary observations, informal interviews with individuals with a strong understanding of the context (SNV national and
international staff, UNIDO consultant, as well as other national stakeholders) and after consulting documentary sources. A presentation was held after two months upon my arrival in Bhutan with preliminary ideas and initial research hypotheses to the senior management of TCB.\footnote{A presentation held on 21-05-2013 based on preliminary observations and informal interviews. Question where posed to the senior management to understand key issues and prepare the questions for the interview items.}

The interview items were drafted based on the feedback received. To prevent confirmation bias, direct questions about the issues identified were avoided and more general questions were asked about coordination among actors as well as between actors and institutions. Bloomberg et al., (1993) argue that appropriate questions are always contextually situated and here is where the relevance of using participant observation lie, in locating the issue of interest in their natural context (Haglund, 2010). This might create a tension between internal and external validity but the trade-off is the likelihood to avoid bias. Questions were formed around different topics highlighted in Figure 6. The list of participants interviewed is provided in Appendix – A.

During the interviews I noticed how different aspects acquired different relevance to people. While I started identifying emergent issues, I avoided introducing biases by maintaining myself neutral also in my comments. I was
often requested to provide an overview of my thoughts on the industry and this happened so often that it became part of the protocol of the interview. The interview questions are open-ended and interview items were developed with the intention to be used as a “plot”. I noticed that even if people had similar positions and roles (CEO or GM), their background, knowledge and language changed significantly, impacting in their argumentation. Therefore, the style of the questions had to be adjusted to the different background and be broadly understandable. Items were shared with colleagues to get feedback on the appropriate use of the English language and their content and context relevance. After the first application the items were further improved but without substantial changes. The above technique served respectively as pre-pilot and pilot with the aim to improve the questions order as well as observing how the subjects responded and how I was managing the interview (Gillham, 2005). Interview items can be found in Appendix – B.

In every case, I would have used the items to stimulate the discussion only if the interviewee would have proceeded with hesitation. If the interviewee kept a conversation based on the topic, I would have used the items to guide the conversation. This also had an impact on the length of the interviews, lasting from one to two hours depending on the interviewee. However, this is exactly one of the reasons why I chose this method instead of a large scale survey (considering the number of guides and tour operators). Face-to-face interviews generate trust (through professional appearance and proper research protocols and ethics), and give space to the possibility to learn and to go in-depth into complex issues. In this way I would have had more chances to understand why things happened the way they happened. Furthermore, a survey would have probably not elicited response, or would have been passed to lower-management personnel, preventing what I considered a proper exploration.

Furthermore, addressing the different categories of actors (core tourism stakeholders) with an interview containing almost identical items, increases validity through the corroboration of responses between respondents, favouring triangulation (Fritz et al., 2009). I contacted CEOs (or GMs) and the guides by phone or in person, sometimes introduced by the secretary of TCB, alternatively introducing myself directly as a PhD student attached to TCB, working on issues related to tourism development. I always presented the purpose of the
research and I asked if they were willing to participate. I always tried to provide
a presentation of my objectives before handing an information sheet, and offer
anonymity before handing the consent form. I also highlighted that the research
project could have helped the tourism industry in Bhutan providing advice for
improvements from an independent perspective.

Therefore, I always emphasised the independence of my research project.
In general, access to informants was more difficult than expected. I found that
the Government agency would have been not a good “gatekeeper” as the
institutional support was “just fine”. The outcomes of a request of support would
have depended more on the persons I was seeking support from, based on
their networks, and partially on their interests. What I tried then was to
differentiate the gatekeepers by building my own network, building trust and
friendships by showing to relevant people from different organizations that I was
genuinely willing to contribute to their work.

The TCB and the tourism industry were not immune to criticisms, but in
general I did not find in the media any difficult controversy. The press would
mention tourism once in a while without much scrutiny or without emphasising
any policy or institutional failure. This was an advantage as I did not feel any
pressure from stakeholders. This enabled the capacity to present the research
(and myself as a researcher) as neutral and non-threatening, whilst ensuring a
truthful representation.

A note on interviews’ data analysis: thematic analysis

Thematic analysis was used to analyse the data from the interviews. Yet,
the themes under which the different items are grouped in the questionnaire
were not intended for the analysis and do not fully reflect the themes that finally
emerged from the data analysis (c.f. Braun and Clarke, 2006, p. 94). Thematic
analysis is a technique that enables researchers to move beyond counting
explicit words or phrases and focus on identifying and describing implicit and
explicit ideas within the data – the theme (Guest et al., 2011). In thematic
analysis the “keyness” of the theme is related to the research question. Yet, it
necessarily follows the ontological and epistemological positions of the
researcher (Braun and Clarke, 2006).
In fact, by taking a critical realism approach this research looks for “generative mechanisms” that influence the governance of the tourism industry that can influence economic inclusion and upgrading in the tourism value chain. The analysis therefore takes into account the ways individuals make meaning of their experience as well as the way in which social context influences these meanings and behaviours beyond the semantic of the participants’ narrative. This enables to pick “latent” themes going more in depth into the stratified reality. This is going to provide not only individual accounts but a support to theorise the structural conditions and socio-cultural contexts related to those accounts (Braun and Clarke, 2006, p.85).

Given also the exploratory orientation of the research design, the specific analytic categories (codes and their repeated patterns - themes) were not predetermined but arose following two stages: familiarisation with the data and generation of initial codes and themes that were refined once the initial codes were applied to the corpus of the raw data (Braun and Clarke, 2006). However, despite the strong “data-driver” orientation of the coding, the “going back and forward” from the literature combined with the knowledge of the topic and the context, and the “routine” of comparison and contrast of concepts, codes and themes from the interview data, reflect the retroductive logic (e.g. Glynos and Howarth, 2007) that is consistent with critical realism. The resulting narrative in section 6.2 intends to provide a clear description and analysis of “what is going on” in each theme using a combination of different length of extracts from transcripts that facilitates the analytical claims about the data and their link to theory, including their relevance as governance mechanisms. Since the focus is on economic inclusion and upgrading, qualitative data were organised according to what was relevant in terms of context and mechanisms for that particular outcomes. Each section in 6.2.1 describes a theme and provides information about the relationships among them.

4.6.3 The household survey and nodes’ attributes data

Design, sample and application

Participant observation can also be employed during the preliminary stages of scientific inquiry (Jorgensen, 1989, p. 7). In my case preliminary
observations to support the development of a household survey took place during two project-site visits. A total of four visits of one week each approximately were conducted with the personnel of the RSPN to the communities in Phobjikha Valley. The first took place in May 2013 during ten-days training on housekeeping, cooking and guiding skills offered to the community-based ecotourism project. It was not the first time for local households to host people from Thimphu or from abroad as the NGO collaborated for more than ten years with international donor agencies, implementing conservation projects. The current project on ecotourism was financed by JICA (Japanese Cooperation Agency) through a Japanese Environmental NGO (JEEF) and implemented by the JEEF and the RSPN. Trainings and financial support for project implementation were given to a selected number of households between November 2012 and November 2013 to improve the quality of the services and the facilities. The direct financial help was given to buy material such as mattresses and linen as well as for the construction of new toilets finalized in December 2013.

Image 2: Map of Gangtey-Phobji valley

![Map of Gangtey-Phobji valley](image2.png)

Source: Own elaboration based on Google Earth. Households and tourism stakeholders are indicated with the yellow “placemarks”.

This first visit was a good occasion to observe the dynamics taking place around the project. I used mainly participant observation and informal interviews
with a number of relevant stakeholders. These included the JEEF and the RSPN officers, the Tourism Council of Bhutan representatives, the principal of the primary school and the manager of a luxury hotel. The interaction with the households was limited as the language acted as a barrier, but sporadic translations were possible from a representative of the Tourism Council of Bhutan.

It was observed that roles and activities within the households were exchangeable at a point that everyone knew exactly the resources available to their respective families. It was also possible to observe that the farmers involved in the community-based ecotourism project were not the sole benefiting from tourism. 11 additional households were benefiting from tourism directly in addition to the 28 involved through the development project. Observations also influenced the decision to employ social network analysis.

A survey by questionnaire on Income and Expenditure (I&E) at the household level developed by the Well-Being Research in Developing Countries\(^{27}\) (WeD – University of Bath), was adapted to collect data on livelihoods strategies at the household level. The “I&E” survey was designed to capture data on different types of incomes (self-employment, wage income, and in kind), expenditures (production costs, food and non-food items), credit and saving behaviour as well as subjective indicators as global happiness and life domain satisfaction.

The I&E is based on three categories of data: having (material and human resources), doing (what people can do or cannot do with those resources) and thinking - how people think about what they have and can do with what they have, and also how people judge, assess and feel about what they have or do not have (Velazco, 2006). The survey was designed to capture information on seasonal variations on income and expenditure over one year. The instrument was piloted and applied among others in Thailand and Bangladesh to identify empirical data to address the conceptual issues related to livelihoods and well-being (Ibid).

The selection of this particular instrument to be adapted for my research objectives is related to its capacity of capturing flows deriving from different

\(^{27}\) A research team established in 2002 for an ESRC funded research project at the University of Bath http://www.welldev.org.uk/research/methods-toolbox/toolbox-intro.htm
livelihood strategies and activities which can easily accommodate income and expenditures derived from the participation in non-farm activities including tourism through the direct provision of different tourism related services or indirect participation through agricultural linkages. Furthermore, the survey would have been able to capture a number of other patterns that can be analysed vis-à-vis the different livelihood strategies. These are gender, savings and borrowing, investments, migration, assets and time use, which are all aspects relevant for the Bhutanese rural context (drivers of rural transformations and poverty reduction are provided in sections 5.1 and 5.2).

Table 7: Questionnaire’s sections

1. **Household socio-demographics.** This included questions related to gender, education, age, family members, as well as assets such as land, livestock, number of houses and rooms, use of mobile phones and internet. In addition, questions probed the role of the household in community and development projects.

2. **Income.** This included questions on income from different streams such as crops and non-crop agriculture as well as any professional or enterprise activity. Income from wages and salaries from rents and transfers were also included in a separate section.

3. **Expenditure.** Data related to expenditure were collected only for non-food items and specifically asked if they were tourism-related, and the percentage that could have been associated with tourism-related activities. Agricultural and livestock expenditures were also included.

4. **Savings and credit.** This included borrowing from a number of sources such as other members of the community which proved to be relevant data also for the network analysis.

5. **Migration patterns and remittances.** These patterns were included because all the documents from the Government pointed at rural-urban migration as a current phenomenon.

6. **Need domain satisfaction and happiness.**

7. **Network related questions.** These questions were alternated within the main sections of the questionnaire.

Source: Adapted from Velazco (2006).

I also found the instruments “culturally” appropriate considering that WeD instruments were tested and applied in Thailand and Bangladesh. In fact, Bhutan is a member of the South Asia Association for Regional Cooperation
Similarly, Thailand is a Buddhist country culturally, politically and commercially interconnected with Bhutan.

In the case of the Bhutanese context, I found the survey particularly useful since it could be administered face-to-face allowing higher reliability of data and an immediate follow-up on the responses. The RSPN suggested not to translate the survey but to administer it with a contextual translation from English. This facilitated the explanation of concepts that otherwise would have not had direct translation to Dzongkha or any dialect spoken in the valley. Especially in the lower valley, in the Phobji Gewog, some households did not speak proper formal Dzongkha either.

A second visit was held for three days at the end of November with the RSPN field coordinator and the programme officer to finalise the details of the survey and planning its application in December 2013. The sample size was determined, attempting to survey all the households involved directly in the provision of tourism services or linked to hotels in the valley though the provision of complementary services and goods. In this case the sampling is purposive and a snowball technique was also applied here as a method to reach the targeted sample. I used brief informal interviews to understand hotels supply chain and the linkages with the local suppliers. Some of these interviews were conducted during the second visit, trying to identify those traders and producers in the community that were providing different services and goods to the tourism industry that could have been added to the sample.

The snowballing strategy in this case resulted from the exploration of supply chain relationships of hotels operating in the valley. In fact, hotels belonging to foreign chains or to external members of the communities (only two at the time of the survey) were asked to indicate with whom they were working in the communities to complement their services. I tried to reconstruct their supply-chain associated not only to tourism services but also handicraft, crop and non-crop provisions. Once these “providers” were identified, permission was requested to conduct the full survey with the new participants identified. This added three more community members to the original sample, who were providing traditional hot-stone baths, meals and generic “communitarian experiences”.

(SAARC).
The households of the final sample were scattered over two Gewogs and nine villages that compose a substantial part of what is known as Phobjikha valley (see Image 2). After having reconstructed and mapped the sample over four visits in 2013, I applied the survey by questionnaire between December 2013 (day 9 to 14) and February 2014 (day 16 to 19) immediately before the NGO launched officially the community-based sustainable tourism initiative (CBST).

Since, the survey by questionnaire was structured around farming and non-farming activities to gather socio-economic and households’ management information, both household heads and spouses together were asked to answer the survey when possible and without interfering with their daily activities.

The RSPN advised that it was likely that the households had records of the information because they were trained on bookkeeping as they benefited from other development projects that required monitoring of such data. Regarding the timing for the application of the survey it was agreed that given the seasonality of farming and non-farming activities, December would have been a good month to interview the families. December is in fact considered low season for tourism in the valley and agricultural activities are limited given the intense cold.

A test was conducted in November in a village near Thimphu. It was not possible to fully test the reliability and validity of the survey with an adequate sample size. The testing was limited to check if the questions and the information could have been easily translated, the translation understood as it was intended to be, and the questions meaningful to the people interviewed. A general-shop owner in the village agreed to be interviewed and a translator from TCB administered the survey. The interviewee turned out to have English skills and gave suggestions on how to improve some questions. Overall, the translator from TCB was able to administer the questionnaire without any previous training or briefing in a reasonable time (approximately one hour).

A number of bureaucratic procedures were also undertaken with the National Statistics Bureau and with the dzongkhag (district) Administration. The National Statistics Bureau had to give authorization for the survey and provide feedback on the instrument, while the Dzongkhag had to be informed about every research activity undertaken in its administrative domain. In both cases
the TCB supported my applications that were sent with the recommendations of the directors.

I was given support by a specialist attached to UNIDO. The officer had already surveyed the households for a training needs assessment report and was a valuable asset for the application of the survey. I shared the survey beforehand and conducted a meeting to brief and familiarise him with the topic and the objective of the survey. The NGO also suggested taking additional support from the community through a student who was initially employed as a guide and later as interviewer.

During the application of the survey\(^{28}\) I changed constantly location, staying overnight and spending time with different families getting to know as much as possible about their habits and thoughts about their everyday life. The data collected through the survey were not anonymous and GPS coordinates were collected. To anonymise the data, a code was given to every household in which the first two numbers indicated the community and the subsequent others indicated the household.

I had to adapt the ethical requirements to this particular setting. In fact, most of the households were illiterate and it would have made no sense to hand an information sheet in English or translated. Therefore, I printed every survey with a front page with the same content of the information sheet and consent form. The translator read the text to the household in their local language and they agreed or disagreed to take part in the study. By ticking a box the translator would have had to confirm that the interviewee understood and was willing to participate in the study. Furthermore, every survey was recorded (recording also the consent given to participate) and at least one photograph was taken with the participants.

For the network data, detailed in the following section, I followed the ethics procedures described by (Borgatti et al., 2013, p. 40). The main issue with personal network research is that participants can name any other person (or organization) not part of the study and from which authorization was not given, in other words they were not intended to be respondents. In my case participants and “non-participants” could have be anonymized by associating a

\(^{28}\) The survey was applied in December 2013 (from 9 to 14) and February 2014 (from 16 to 19). A second round was also conducted between December 2014 and February 2015 on the same set of households.
nick name or codes to the “nodes”. Furthermore, I was dealing with households’ support networks and not with firms’ innovation or R&D strategies. This lowered the “sensitivity” of the information that I considered could have been handled by respecting issues of privacy through coding.

The questionnaire generated a wide dataset on a small sample. Not all variables were used in the analysis. Table 8 describe the selected variables and the rationale for those variables. Appendix – F provides a summary of the variables. Data entry was done manually and compared at least twice with the original records. Data were internally validated by inspecting them during data entry and when inconsistencies were found explanations were searched in the survey notes. Posterior questioning to the research assistant that administered the survey or follow-ups with the respondents were also used where inconsistencies arose and notes were not providing any explanation.

Table 8: Selected variables for the study

| Flow variables and perception of wealth | • Total Income. Continuous variable  
• Incomes by livelihood activity (various type of income from potato, tourism, handicraft, livestock farming, etc.). Also aggregated by category (agricultural, non-agricultural.). Continuous variables.  
• Households’ perception of relative poverty/wealth. Scale variable (from 1 to 7).  
• Number of tourists received. Continuous variable.  
• Total non-food consumption (total non-food expenditure). Continuous variable. |
|----------------------------------------|---------------------------------------------------------------|
| Demographic                           | • Gender of household head. Dichotomous – 0male/1female.  
• Role in the community of any member of the HH. Dichotomous (0=no/1=yes).  
• Membership to the CBST project. Dichotomous (0=no/ 1=yes).  
• Dichotomous livelihood activities (potato 1=yes/0=no; handicraft yes/no; etc.). |
| Agency variables                      | Similar variables have been employed in the study of Anderson (2012). Please refer to section 3.4 for the idea of agency. Anderson (2012) considers a group of variables for agency including some that are usually associated with social capital. |

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• Time constraints\(^{29}\) (ratio variable between total number of hours employed for subsistence activities generating no income to those that generate income). Continuous variable.

• Migration ratio (ratio variable between members living outside the household and the total number of people that form the household). Continuous variable.

• Total number of activities undertaken by the households in agricultural (crop and non-crop) and non-agricultural activities. Continuous variable aggregated and disaggregated.

• Number of members living in the households. Continuous variable.

<table>
<thead>
<tr>
<th>Assets variables</th>
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<tr>
<td><strong>Social Capital</strong></td>
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| Network variables (the meaning of these continuous variables are explained in Appendix – D):
  • Betweenness centrality.
  • Out-degree.
  • In-degree.
  • Degree.
  • Network structures – measure of structural holes (efficiency and constraint) and density (out degree density and clustering).

<table>
<thead>
<tr>
<th><strong>Natural capital</strong></th>
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| • Land Operated in acres. Continuous variable indicating land under cultivation (either owned, rented-in or both).
• Total land owned in acres. Continuous variable.
• Land under potato cultivation. Continuous variable indicating the acres of land cultivated exclusively under this specific crop.
• Land under cultivated with other crops.

<table>
<thead>
<tr>
<th><strong>Human capital (knowledge and skills)</strong></th>
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| • Capacity building attendance. Dichotomous (0 no capacity building/1 at least one capacity building event attended in the last year).
• Education recoded as dichotomous by gender. (0=no education/ 1= any level of education).

<table>
<thead>
<tr>
<th><strong>Financial capital</strong></th>
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| • Total Financial Capital (sum of unearned transfers, borrowing and savings). Continuous variable.

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<tr>
<th><strong>Physical capital</strong></th>
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| • Number of Livestock. Continuous variable.
• Total operational costs. Continuous variable.

Source: Own elaboration based on survey data. Appendix – F provides descriptive statistics of the variable used for the study.

\(^{29}\) The question in the survey asks **how many hours on average per day you or the members of your family work in a specific activity** a previous question asks which members of the family are involved. The questionnaire records also the number of people involved and if the households hire or exchange labour. The measure obtained is very accurate and represent a better measurement than those used by Anderson (2012). To obtain time deprivation and time effort, the average numbers of hours a day per individual are multiplied by the number of people involved. The sum of the number of hours for all the activities provides the total number of hours dedicated to the activities by the household. The numbers of hours spent on activities that generate zero income are accounted as time deprivation. Those hours spent in activities that generates income (no matter how much) are consider as a proxy for effort.
The survey was conducted twice, with a second round conducted between December 2014 and February 2015. In total 78 household questionnaires were administered (N=39 for each time period). For the purpose of this research only the first round of data was used and analysed with different software packages (R, Stata, SPSS and UCINET).

4.6.4 Network analysis

Value chain approaches can identify actors in a specific sector, unveiling the associated governance structures, as well as opportunities for poverty reduction and productive inclusion. Yet, network analysis can help identify relationships and interactions “behind the scene” of a given value chain, providing a more in-depth exploration. An overview of the applicability of social network analysis (SNA) to supply chain context was given in Borgatti and Li (2009). As an example, SNA can provide metrics that can be used to explore power (betweenness centrality) or the prestige and influence (out-degree and in-degree centralities) of specific actors in the chain.

The important feature of the network perspective is that it adds comprehensiveness through the collection of relational data. Attributes associated with social units (in this case, households’ assets or incomes) are considered as arising from the structural and relational process in which they are embedded. “[N]ode’s achievements or performances are in part also a function of the resources that their social ties enable them to access” (Borgatti et al., 2013, p. 8). As such, networks variables can be used as explanatory of other variables (Giuliani and Pietrobelli, 2011).

From an inclusion perspective and for processes of rural diversification and specialisation this can have major implications. From the configuration of the network, a certain flow of knowledge and information can be assumed, leading to specific patterns of diffusion between community members (see for example the study on the diffusion of microfinance in rural India of Banerjee et al., 2013). Giuliani and Pietrobelli (2011), referring to the design and evaluation of cluster programmes, highlight that there are no optimal network configurations. However, the evaluator can design cluster policies to aim at
specific network structures. If the objective is to promote economic empowerment through collective action, it makes sense to look at creating *cliques*, cohesive groups that promote trust and collaborative behaviour (Ibid). In relation to knowledge and information, the local *clique* configuration can serve as generator of quality knowledge creating opportunities for adoption and diffusion of this knowledge and therefore possibly of economic and social upgrading. *Density* for example can be an indicator of the local networking processes at the individual or households levels.

The relevance of certain actors and inequality in the terms of participation or access to opportunities in a productive network can be assessed by looking at how demographic characteristics of an actor, or other flow and asset variables, covariate with the different centrality measures (e.g. Rico García-Amado et al., 2012). For example, the importance of gender in a specific network can be analysed in relation to centrality measures. Measures of network structures (i.e. *structural holes* or *densities*) could highlight weak ties and the bridging role of specific actors that can facilitate connections with distant actors and promote diversity of information and the adoption of new ideas (Giuliani and Pietrobelli, 2011).

The use of specific algorithms can be also useful to understand structural advantages in exchange relations. The *core-periphery algorithm* seeks to identify a set of actors who have a high density of ties among themselves, the core. In theory, the actors in the core are able to coordinate their actions and this gives them a structural advantage in exchange relations with actors in the periphery (Hanneman and Riddle, 2005, p. 280). From a gender perspective this algorithm can be used to visualise whether female-headed households are more central or peripheral in productive networks (Borgatti and Everett, 2000).

From a value chain perspective the importance of a well-organized local value chain coordinated by or organized around one or more lead firms can also have relevance for poverty reduction and diversification to connect to global markets or to organize the local supply-chain. In this case the desirable output can be a *hierarchical network* where the centrality of a firm can be increased (Giuliani and Pietrobelli, 2011). In situations where there are donors operating and technical assistance activities in a locality, this central role can be covered by NGOs, for example by supporting market linkages.
In this research a wide range of attributes data for each node (household) have been collected through the survey detailed above. To prepare network questions and collect relational data, I have made extensive use of teaching material related to UCINET$^{30}$ authored by Borgatti et al. (2013, 2002) as well as inputs from online courses available on Coursera on SNA and the resources provided in their syllabus$^{31}$. Networking with authors and practitioners provided feedback on the design. Field observations and consultation with the local environmental NGO provided valuable feedback on the context. This is very important to support “observational” network analysis.

Issues related to limitations of network research will be discussed in the research design section as well as in the data analysis and the reporting sections, and whenever the opportunity to explain methodological decisions arises. Limitations of network analysis through relational questions are pointed out by Borgatti et al. (2013) and they are associated with reliability and validity of design, data collection, data mining and analysis. Despite the more reductionist stances I have taken to study the network configuration and their relations to attributes data, the methodological decisions are associated with the likelihood of accomplishing my objectives given the circumstances and time available.

The objective of SNA at the community level was to complement and test some hypothesis emerging from the qualitative study related to mechanisms for economic participation. The SNA aims at understanding: how support networks work among community members; types of social capital; if households refer to public and private organisations and how they are linked to the market; how the configuration of the network differs in relation to different livelihoods activities$^{32}$. Collecting data on different livelihoods allows a comparison that can uncover intra-community relations and possible specializations around livelihoods activities (Girvan and Newman, 2002; Rico García-Amado et al., 2012).

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$^{30}$ One of the software available in the market to analyses network data, available at http://www.analytictech.com


$^{32}$ Tourism is not a traditional activity. Members of rural communities are mainly involved in potato cropping. Before the introduction of potatoes in the 1980s, most of the families in the valley were semi-nomadic.
**Design and sampling**

The normal procedure to collect data for SNA is to get information on relationships from a whole network (a community for example). However, this is not always feasible. There are two basic approaches to “bind” a network as defined by Borgatti et al. (2013): emic and etic approaches. The emic approach relies on relational criteria to determine who is in or out of the network. The etic approach imposes arbitrary boundaries based on the needs of the researcher and it relies on attributes of the nodes\(^{33}\) (Borgatti, 1998).

Empirical data on networks were collected through the survey-based instrument described above, following an etic approach. The sample was purposively selected by including all the households in Phobjikha valley providing tourism services that included the group of households involved in the community-based ecotourism project (28) and all the other households (11) involved in the provision of different tourism services (N=39). As such, field-studies that do not involve any controlled experiment and randomisation of sampling are considered observational studies (e.g. Jackson, 2010).

As mentioned above a snowballing method of contact was used as result of the exploration of supply chain relationships among hotels operating in the valley. In the case of Hotel4 that started operations in mid-November 2013, the manager agreed to be interviewed but he could not specify with whom the hotel was linked in the community. The guesthouse (Hotel3) whose owner is not a member of the community was closed during the period of the survey, but linkages were spontaneously mentioned by others households\(^ {34}\). In the case of the Hotel2, it was not possible to apply the survey on livelihoods but it was still possible to interview the manager and reconstruct their supply-chain in the village. The design of the SNA tools was complemented with the insights of the personnel of the NGO and observations and review of secondary sources, providing the possibility to detail the context and providing information on mechanisms of rural diversification and specialisation. SNA and survey data are also triangulated with data emerging from the interviews.

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\(^{33}\) [http://www.analytictech.com/networks/data.htm](http://www.analytictech.com/networks/data.htm)

\(^{34}\) This is the case of the manager of Hotel3, closed during my field visits.
Type of nodes and data collection

Relational data are generally collected by asking about the relationships between actors. There are two main techniques: a roster-recall, in which the name of the other actors are predetermined and from which the interviewee has no other options than to choose those names; or a free-recall with a fixed or free choice, where the interviewee has the freedom to name a fixed number of actors or anyone with whom he/she interrelates (Giuliani and Pietrobelli, 2011). The free-recall with a fixed choice was chosen because it provides more flexibility to the respondents to name anyone important to them beyond the project run by the NGO or the sample that was chosen for the study.

This opened up the possibility to analyse the network data in two ways: as whole-network and as ego-network (I asked each person about their own network beyond the selected sample). Different organizations (Government extension offices and the local NGO) were also named following relational questions and where included in the network analysis to understand their importance in relation to livelihoods strategies, providing an indication of their supportive capacity to the households in their everyday farming and non-farming activities.

Alters’ attributes were collected only when they were part of the list of “egos” of households in the sample (all the households in the community working in tourism). In fact, for the “whole network configuration”, I managed to collect information on attribute data from every household (node) in the community that was offering tourism services. For the both “whole-network” and “ego-network” configurations I was able to retrieve information on kinship, affiliation and location of alters.

For the survey and the network questions, 100percent respond rate was achieved for my sample. I approached the households face-to-face and this provided greater opportunity for establishing a rapport with the respondents. It was also particularly useful when respondents needed further explanations about the questions, increasing the ability to maximize elicitation (see also Borgatti, et al., 2013, p.55). It is worth noting that both livelihoods and relational questions were administered together in the same survey and they were alternated to avoid survey fatigue.
Considering the research questions, I was interested to explore multiple relationships related to economic livelihoods. Two sets of relational questions were asked: One type related to seeking support. The other type of questions were related to the trade of tourists, handicraft and agriculture products. Tour operators, based in Thimphu and named by the households, were grouped in a single node. Tour operators were treated as a single “external” actor. The list of relational questions and their corresponding rationale can be found in Appendix – C.

**Data management and the choice of indicators for network analysis**

Two main operations were conducted before starting data analysis. The questions used to collect relational data were aiming at identifying nodes (households) who provided assistance in production and marketing as well as to identify those relationships used to facilitate the trade of tourists and other goods. As such the relationships were transposed to follow the resource flows – advice/information; products/tourists – (Borgatti et al. 2013, p.73).

The questions in Appendix – C identified different networks: four related to assistance in production and marketing; and the others related to the trade of tourists, vegetables and handicrafts. The networks were aggregated to match the more general question “to whom do you relate if you need assistance for production and marketing for the different productive activities” (see Borgatti et al., 2013, p.79). The “multiplex” network combines all the relationships emerging from the questions 1 to 6. The productive network obtained is provided in Figure 7.

Few relationships were removed such as the one linking the Health Unit with one actor (Hotel1) which is not significant for the analysis. Few ties were also reversed (with Hotel2 and actors 11023 or 12038) to better reflect the flow of resources from one-another. The single node “TOs” identifies professional operators in tourism. TOs were coded as a single actor even if interviewees referred to different names of different TOs based in Thimphu. The reason for this choice is that they are external to the community. By creating a single actor it is possible to see their “aggregate” importance as brokers for the households in the valley, a role that otherwise would have been “diluted” if taken as
individuals. The concepts related to the indicators and network statistics used in the analysis in section 7.2, are detailed in Appendix – D.

Figure 7: Multipurpose livelihood network base on ego-networks

Source: Own elaboration. Anonymised network obtained with UCINET.

4.7 Research validity

Strategies to deal with validity, reliability and ethics have been highlighted to different extents for each method. However, a final consideration needs to be provided in relation to the overall research strategy/design. Yin (2009) presents four types of validity for case study research:

Construct validity is about developing a sufficiently operational set of instruments to capture accurately the concepts to be measured. The “tactics” highlighted by Yin (2009) are associated with the use of multiple sources of evidence, establish a chain of evidence and have key informants review draft of the reports. In this study I make use of multiple sources of evidence from different levels in the tourism value chain. In general, the development of every instrument has been supported by the review of secondary sources. Pre-tests and tests have been conducted. Preliminary ideas/findings were discussed with relevant key informants. In the case of network structures, I discussed the findings with the officer of the NGO in charge of the project and her counterpart at the TCB. In the case of interviews, an open discussion was held with the director at the TCB.
Internal validity relates to the consistency of findings on which we base claims to knowledge. From a realist perspective Ackroyd, (2009), on the logic of discovery in case study research, argues that the reason for thinking that the discovery of a mechanism is significant, is conceptual as much as it is empirical. “Case investigations that lead to the identification of the operation of generative social mechanisms are theoretically guided, but the precise operation of mechanisms is subject to empirical corroboration” (p.537). In this study the technique used for the interviews provides the identification of constructs that are evaluated from different points of view using the same items for different stakeholders.

External validity deals with the problem of knowing whether the study’s findings can be generalised beyond the immediate case study. I have already discussed the value of approaching the case study research as intrinsic and instrumental, and the relevance of analytical generalisations to broader theories from exploratory case studies. I have also claimed that I did not use any hypothesis or theory when I approached the case. The analysis drove me to take into consideration specific theories of social science to frame the discussion. However, the logic used in this research and associated with the use of mixed methods enables the display of a rich account related to assumptions, practical approaches and results. This has the potential to enable the reader to interpret and make informed decisions on his own about generalizability (see Arksey and Knight, 1999, p. 56).

Reliability is about replicating findings and conclusions by following the same procedures as described by an earlier investigator. The goal of reliability is to minimise the errors and biases in a study (Yin, 2009). Yin (2009) also refers to two main techniques associated with reliability: the use of a case study protocol and the development of a case study database. This is the reason I detailed all the methodological decisions taken and created several detailed databases of the people interviewed and surveyed.
4.7.1 Ethics

The research protocol, ethical considerations and the risk assessment was reviewed and approved by the Doctoral School\textsuperscript{35}. There were no relevant changes during the fieldwork that would have impacted the ethical requirements. Data collection took place in the participants’ workplace, home (in the case of community members) and TCB premises with the full consent of individuals and organizations. As stated in the ethics application form, I always tried to prioritise the safety of the participants, and I have regularly reconsidered the implications of the research and its potential impacts. This pro-activeness can be seen in the application of the survey by questionnaire and the ethical considerations about network analysis that was not initially planned. Overall, I have always been fully transparent about my work. I never hide the nature of my research. I have found that maintaining an honest, straightforward and transparent approach in my dealings is a good strategy to avoid risks and backfires as well to gaining trust from the participants.

Table 9: Research activities and ethical issues

<table>
<thead>
<tr>
<th>Research Activity</th>
<th>Ethical issues</th>
</tr>
</thead>
<tbody>
<tr>
<td>Access to documents from government and companies.</td>
<td>Confidentiality and anonymity. Informed consent.</td>
</tr>
<tr>
<td>Conduct interviews with private/public leaders/decision-makers.</td>
<td>Confidentiality and anonymity. Informed consent.</td>
</tr>
<tr>
<td>Fieldwork - “Uninvited observations” and disclosures.</td>
<td>Protection of privacy.</td>
</tr>
<tr>
<td>Fieldwork - Use and role of gatekeepers.</td>
<td>Possible pressure exert by gatekeepers to meet their demands of disclosure.</td>
</tr>
<tr>
<td>Fieldwork - Use of participatory methodologies in the communities.</td>
<td>Possible expectations to sustain and obtain changes that could not necessarily meet the views of all the parties involved.</td>
</tr>
</tbody>
</table>

Source: Own elaboration.

\textsuperscript{35} My research in Bhutan started at another UK higher education institution. Prior to the fieldwork - that started in April 2013 - I submitted the draft methodology and the research protocol to the “Ethics Committee” of that institution, which was approved in February 2013. When I decided to continue at SOAS - University of London, the same documentation was submitted, reviewed and re-approved for admission purposes.
Yet, organizing and undertaking fieldwork in developing countries can be challenging. Even if technologies help to minimize uncertainty, it is not always possible to plan in advance. Risks that were included in the pre-assessment proved to be not always well “calculated”. Below are some reflections upon the points highlighted in the ethics application:

a. Language barriers. English is considered very common in Bhutan and it is thought as a second language in primary and secondary schools. However, this information proved to be unrealistic in rural areas where household heads and spouses were mostly uneducated. Children receive education in English and Dzongkha but they were either too young or too shy to act as interviewees or even translators. This justified the use of research assistance. Therefore, most of the interaction was mediated through translation in rural areas. In general, I found Bhutanese people very keen to joke and with a good sense of humour which helped in many cases to “break the ice” and have a pleasant interaction.

b. Communicating with the participants. Handling issues of confidentiality is important to create confidence and an appropriate environment for interviews and other data collection techniques. Bhutanese are quite intimate about their ideas and they always try to maintain certain balance on their judgments in order not to offend or openly criticise others (especially authorities). This proved to be a great barrier to the understanding of what was really going on.

c. Interaction with the overall environment. Being culturally sensitive proved to be much more important than confidentiality to establish trust. Bhutanese are very proud of their culture. For Bhutanese people family and friendships have priority above all. Living and sharing everyday life moments with them created invaluable confidence and friendships. Being invited to pujas\(^{36}\) or important family events such as funerals is an honour and a sign of great consideration and respect that cannot be missed. In term of risks, I probably underestimated the situation about hospitals, hygiene, road conditions, accessibility to rural communities and the feeling of vulnerability associated with the fact that “everything is fine... until something happens”.

\(^{36}\) Pujas are religious rituals of offering and devotion to Lord Buddha. They are social events that involve also family and friends (Chadha, 1982, p. 3).
d. Research Independence. I overestimated the expectations that the Tourism Council of Bhutan had about the results of my work. They openly state in their policy documents that independent, valid and reliable research is fundamental for their decision-making processes and allocation of resources. However, this demonstrated to be more a “mission” statement than a fact. It took a long time to establish trust in the organisational contexts I used. This was not a personal matter but an overall attitude of public officers and turned to be an advantage because I gained more independence. I could develop more effectively relationships with third parties. It was hard to network and to demonstrate my genuine interests in the research topic (mistrust is a common feature among Bhutanese), but I finally managed to find valid and genuine collaborations without the need to grant any favour, choosing what I felt more relevant to be studied.

4.8 Conclusion of the chapter

To avoid common criticism of case study and qualitative research in general lacking systematic rigour, I provided extensive details regarding the methodological decisions taken and some account of the context that deeply influenced all decisions about applications of different methods and tools while in Bhutan. I also tried to be reflexive about my role as a researcher in the attempt to reduce bias.

The main point to be addressed in these conclusions is how the empirical analysis of the thesis builds on the insights provided in this chapter. There are four elements to be taken into consideration to clarify the links:

1. The philosophical framework. Realist research aims at accounting for “key social processes that are at work beneath surface appearances” (Edwards et al., 2014, p. unknown). The issue is to bring into focus the mechanisms that are at work (which might not be necessarily self-evident) in relation to specific outcomes. Therefore, in critical realism the context is important and history matters. Consequently, by following Edwards et al. (2014), chapter 5 provides contextual factors describing driver of poverty reduction and those affecting inequality, labour markets and economic growth. It also provides a description of cultural norms that characterise the Bhutanese society, offering a contextual
“frame” to fit the analysis of chapters 6 and 7. The first part of Chapter 6 complements Chapter 5 by narrowing the focus to the tourism industry, providing an historical reconstruction of its evolution integrated with the analysis of interview data and observations. The Context Mechanism Outcome (CMO) framework in the tradition of realist evaluation is synthesised at the beginning of section 6.2. Overall, chapter 6 describes the governance of the tourism value chain in Bhutan using policy documents, reports and interview data, and it answers the first two research questions, highlighting the mechanism associated to formal and informal institutions.

Section 6.2 aims at isolating those contextual elements regarded as relevant for the “mechanisms” to emerge that could explain the outcomes of economic participation (economic inclusion and upgrading). The data analysis follows the retroductive logic typical of critical realism (e.g. Edwards at al. 2014). The analysis involves combining data in tandem with theories identified in the literature (mainly new institutional economics in this research) that are relevant to produce the most plausible accounts of the mechanisms that caused the events (i.e. economic inclusion and upgrading). By drawing on existing theories, the section provides the opportunity to understand the relationship between the mechanisms and the context in which the mechanisms operate (ibid). In addition, “multiple theoretical lenses can be considered for what they tell us about the various and stratified influences that are affecting the things we observe” (ibid, p. unknown) and this is the reason why additional theoretical constructs from trust and networks literatures that link to new institutional economics are integrated in the analysis and discussion. This process is also reflected in the technique used to develop the narrative in section 6.2. It used different extracts from interview data, linking them to theoretically relevant constructs. This helped to theorise the context and the mechanisms, linking them to the outcomes (i.e. CMO framework).

Chapter 7 follows a slightly different logic yet compatible with a critical realist approach since it seeks to complement the evidence provided in the previous chapters. It first describes the rural context in which the survey is applied, while the analysis and the discussion complement those in chapter 6, providing corroboration of the mechanisms at play, focusing on the impacts on livelihoods' diversification and specialisation. This enables confirmation of the
importance of social networks in influencing opportunities, and the potential implications for poverty and inequality, given that social networks lead to significant opportunities for some, but also create barriers to entry for others.

2. The embedded case study design. The commitment of critical realism to “thick” explanations makes case study a particularly relevant design (Edwards at al. 2014). The “embedded design” chosen uses different units that facilitate the identification of “reproduced social patterns” (ibid). That is to say, they serve the purpose to identify mechanisms at work and to disclose how they operate. The broader case in this research is conceived as the tourism industry within the peculiar Bhutanese economy. This is where the “clue” of generative mechanisms and the theorisation of the context and the mechanisms are conducted. The embedded units (see table 6 for the units considered in this research) served the purpose to isolate (in chapter 6) and test (in chapter 7) the mechanisms, given the key contextual factors identified (i.e. a small market rich of transaction costs and economic relationships underpinned by strong socio-cultural norms). Different methods can be used to investigate the units and they can be explored following different yet complementary research questions (Yin, 2014). This is why there are two research questions that address the commercial operation and the institutional and policy context from one side (see Table 6) and a third research question that addresses the social networks at the community level. They complement each other to understand the processes (governance mechanisms) and outcomes (impacts in terms of livelihoods).

3. The use of mixed-methods. The use of multiple methods is justified by the discussion provided in the two previous points. In fact, the use of multiple methods supports exploration and corroboration, to dig below the surface of “what is going on”; this approach is also called “embedded” because the quantitative analysis is embedded in the qualitative one. Hence, interview items used to answer the research questions 1a and 1b are not aiming at measuring but at exploring relevant mechanisms that characterise and influence the economic process. The main theoretical assumption from the literature review is that the coordination of economic activities is not merely a matter of price-mediated transactions, and that institutions are also important because they influence how economic growth is generated and how its benefits are distributed. This represents the novelty of this research conducted in Bhutan.
Measuring and/or refine theoretical concepts were not the objective of the research questions 1a and 1b. Therefore interpreting further the mechanisms and the constructs that are identified through this research (starting from specific theoretical lenses and debates for example) can well be follow-up research to this. Measurements were conducted at the community level using an already well-tested framework (the livelihoods framework) and instruments (questionnaire survey).

4. **The choice of the methods.** As mentioned earlier in this chapter, the suitability of the methods was partly determined by practical issues faced during the fieldwork in Bhutan (particularly access to informants as well as access to observations, and ethical considerations). Previous to the fieldwork various methods were considered to address the research questions including an observational approach (particularly ethnography in organisational contexts), action research and reality checks (particularly for understating the benefits the households would have been able to capture from participation in various types of market-based livelihoods). The data would have cast light on practices that would eventually favour changes in policy and practices (i.e. a transformative approach). However, given that the overall objective of this research is to understand governance mechanisms for inclusion and upgrading, and considering also the ethical requirements, interviews were considered the best method to be deployed in this context.

The reasons for discounting alternative methods were as follows. Embedded organisational ethnography and action research would have been interesting transformative methods (particularly to address issue of economic inclusion as well as reduction of poverty and inequality), but they would have been limited by the mostly centralised mentality and the non-participative nature of the research and institutional environment. Observations would also have been limited by the organisational context and the often difficult access to certain managerial practices (including key meetings) and would have challenged the ethical requirements. Observations would have provided a less diversified exploration, based only on the interactions with government officials in one organisation and only to some extent with private sector actors.

Interviews were finally chosen as they would have served the purpose to link the questions to constructs identified in the literature (inclusion, upgrading,
institutions and regulations, markets dynamics, poverty reduction, networks) and obtaining perspectives from different actors on the same set of issues more systematically. This is a technique used by the World Bank for governance analysis in the area of public service delivery, when bottlenecks to the proper delivery of services need to be identified and addressed (Fritz et al., 2009). It proved to be a useful technique also to understand sectoral governance and issue of inclusion and upgrading.

To complement the exploration through the interviews, the survey was chosen to capture the impacts of the adoptions of different livelihoods strategies for the weakest elements of the tourism value chains (i.e. rural communities). The way in which the survey links to theory is explained in section 4.6.3 and table 7. The survey wish to capture constructs related to the livelihoods framework. The decision to include relational questions to the existing survey and to use social network analysis was taken once preliminary results emerging from the interviews showed the importance of social relationships. Data were collected to understand how network characteristics and structures related to more typical asset and flow variables used in standard analysis. By adopting this technique, chapter 7 is one of the few empirical studies available using social network analyses to understand the relevance of social networks for rural livelihoods diversification. Social network analysis in addition, allows the link to social capital theory (e.g. Dasgupta and Serageldin, 2000) and to unexplored links in the literature of rural development and poverty reduction (e.g. Anderson, 2012; Ellis, 2000). Measurements like cohesion can be used as a proxy to determine levels of trust in a community.

Alternative methods that were considered but not applied for the analysis in the communities were reality checks. This method was discarded because of the impossibility to speak and interact in local dialects, to spend a considerable amount of time with each household, and to travel easily to the study area. In addition even though it is a powerful method to understand transformations within the households or a village in relations to development interventions, it is still used mainly in the grey/practitioner literature in the context of project evaluation by international development organisations.
Section III – Context, Data Analysis and Discussion

Chapter 5 – Background analysis and profile of economic actors in Bhutan

Abstract
Following the work of Ianchovichina and Lundström (2009a) reviewed in section 1.3, the objective of this section is to explain factors of growth and drivers of poverty reduction in Bhutan, productivity and employment dynamics, major challenges and opportunities for economic transformation and diversification. This section uses mainly secondary source (government and multilateral agencies reports) and it will shows how India plays an important role in the economy of Bhutan. It will also show how meso-level organizations are being created to support decentralization to enhance participation and control from the bottom-up. Yet, administrative centralisation is still very strong.

5.1 Introducing the poverty context in Bhutan

The objective of this section is to understand how poverty is understood in Bhutan, what have been the drivers for poverty reduction and to describe the livelihood system for rural households. Poverty measures in Bhutan have been influenced by multidimensional approaches to estimate welfare. Bhutan is famous for its Gross National Happiness philosophy (a non-traditional holistic approach to development) and index. Since 1961, Bhutan implemented coordinated efforts towards development through eleven consecutive five year plans (Phuntsho, 2013).

Santos and Ura (2008) and more recently ADB and NSB (2013), highlighted how the country has made significant progresses in key development parameters such as drinking water and sanitation, protecting and managing the country’s natural resources, provide basic health-care and access to primary education. They also highlighted how the Government improved
connectivity by building roads and by providing electricity in rural areas, which expanded the reach of telecommunications.

Bhutan was committed to the Millennium Declaration and the implementation of the Millennium Development Goals and now adheres to the Sustainable Development Goals (UNDP, 2014). Therefore, different approaches to measure poverty and welfare coexist framed under different technical assistance programmes. The Royal Government of Bhutan seems to favour complementary use of consumption and multidimensional poverty measures which use different techniques for data collection and analysis.

In recent years various reports on poverty have been released: the Bhutan Poverty Assessment (NSB, 2014a), the Millennium Development Goals – MDGs – Report (UNDP, 2014), Bhutan Living Standards Survey – BLSS 2012 – (ADB and NSB, 2013) and Bhutan Poverty Analysis (The World Bank, 2013), An Extensive Analysis of the GNH Index supported by IDCR (Ura et al., 2012), the Bhutan Multidimensional Poverty Index (BMPI) edited by the National Statistics Bureau of Royal Government Bhutan (NSB, 2014b). Multidimensional approaches in Bhutan find their methodological foundations in Alkire and Foster (2011). This was initially applied in Bhutan with data of the 2007 Bhutan Living Standards Survey by Santos and Ura (2008).

Yet the overlap of the two main approaches to identify the “poor” is small (NSB, 2014a). For example from a district/geographical perspective, the need for intensified poverty reduction efforts is recommended in the districts of Gasa, Mongar and Wangdue Phodrang where poverty rates according to the index are higher (NSB, 2014b). But the consumption poverty report identifies other districts to be poorer. Gasa and Wangdue Phodran are actually among the better-off in consumption poverty reports, especially Gasa with the trade of the Cordycep and Wangdue Phodran with general trade and hydropower investment spill-overs (NSB, 2014a, p.8). In effect, there is little overlap between the two measurements and only 3.2 percent of the Bhutanese are multidimensional and consumption-poor at the same time (NSB, 2014b, p.17).

A constant feature of these studies (multidimensional or consumption based analysis) is that poverty in Bhutan is mainly a rural phenomenon.

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37 The cordycep “is one of the highly valued medicinal fungi that grow in the Tibetan Plateau of China and alpine grasslands of Nepal, Bhutan and India” (Shrestha, 2011, p.103).
although population in urban areas may also experience levels of deprivation. In Bhutan, 66 percent of the population reside in rural areas (The World Bank, 2013). All the reports acknowledge that Bhutan does not experience high patterns of extreme poverty. From a consumption perspective the population under the international norm of USD1,25 per day is less that 2 percent in 2012 (NSB, 2014a) and therefore poverty reduction strategies are aiming at halving poverty instead (Santos and Ura, 2008; ADB and NSB, 2013).

Table 10: Comparison of recent poverty and deprivation indicators

<table>
<thead>
<tr>
<th>2012 Income poverty</th>
<th>2012 Multidimensional poverty</th>
<th>2012 GNH Index Not-yet-happy</th>
</tr>
</thead>
<tbody>
<tr>
<td>National monetary head-count ratio</td>
<td>National MPI head-count ratio</td>
<td>National head-count ratio</td>
</tr>
<tr>
<td>12%</td>
<td>12.7%</td>
<td>59%</td>
</tr>
</tbody>
</table>

Source: Adapted from The World Bank, 2013; NSB, 2014b; Ura et al., 2012.

5.2 Livelihoods strategies and drivers of poverty reduction

Both the National Statistics Bureau (ADB and NSB, 2013) and The World Bank championed the role of trade for poverty reduction and for increased productivity. Rural and regional development are seen as priorities through the expansion of access to credit, access to markets for vegetables and crops, development of livestock for the poorest families, to improve incomes and nutrition. Hence, recommendations span from trainings in entrepreneurship to initiatives that would provide rural people access to markets at favourable conditions (The World Bank, 2013).

Multi-dimensional poverty reports suggest (among other interventions) the need to diversify agricultural employment, encouraging industry and service sector expansion that would increase employment opportunities beyond agriculture (NSB, 2014b, Ura et al., 2012). The NSB report (2014a) stresses the potential contribution from agriculture to poverty reduction, but also noted how compared to the survey in 2007 “most rural households in the bottom quintile now rank wages and salaries as their main source of income” (p.47). In 2007 poorer households indicated “own farm” as main source of income. It seems that job creation in the rural areas has been pro-poor but the study is not able to
distinguish from where the employment opportunities come from and whether this has created a new type of poverty associated with informal and precarious employment. Yet, a shift to high-value commercial crops has been observed and it is believed to have been pro-poor. This is perhaps the reason why “own farm” is now the “second-ranked” among sources of income.

Data provided by FAO and cited in the report (NSB, 2014a) show the rise in production value per acre. Furthermore, Bhutan was able to take advantage of trade agreements with India and Bangladesh, “shifting to crops more suited to its comparative advantage” and suited for those markets (p.47).

Regarding trade agreements, Bhutan has a free trade agreement with India, renewed in 2016. India represents the largest trading partner, ensuring tariff-free trade across 16 land, air, and sea routes. “In 2008, Bangladesh signed a 10-year bilateral trade agreement with Bhutan, opening new routes through eastern Bhutan and expanding preferences to Bhutan for duty-free exports for 74 items, of which 49 are agriculture-based” (NSB, 2014a, p.48). Bhutan is also exploring bilateral agreements with Thailand and Nepal and it accession to the WTO has been on the Government agenda for quite some time. Particularly, the accession to the WTO system in Bhutan is not free from controversy (e.g. Wangdi, 2010), and it is a recurrent theme in national newspapers. Recently the Cabinet decided that Bhutan will not join the WTO. The Prime Minister argued among the motivations that the lack of expertise to benefit from WTO would be problematic; that Bhutan’s largest trading partners is India who is a members of WTO “and so joining WTO would not make a major difference”; but also reiterated various times in the interview that “a liberal global market can threaten GNH” (Lamsang, 2017).

Regarding agriculture the area under cereals has been on the decline, substituted by fruit and vegetable crops. Agricultural exports have grown at 22 percent annually while non-agricultural exports have stagnated. Despite the fact that agricultural exports are rising fast, facilitated by trade agreements, a more recent report from Asian Development Bank (ADB, 2015) warns about the decrease in the share of agriculture to GDP as well as the high dependence on imports from India of agricultural products. The central argument is that commercial agriculture could help to counterbalance income disparities.
associated with rapid economic growth, making economic growth more inclusive and providing employment for youths.

Furthermore, agriculture will make poverty reduction more sustainable as trade in agriculture seemed to be contributing substantially. Self-sufficiency (not just in agriculture) has been a recurrent theme of the latest two five year Plans. Food imports from India have been rising over the years and, given the parity of the Ngultrum with the Indian Rupee, consumer inflation rising in India automatically impacts Bhutanese customers (The World Bank, 2014, p.1). Petrol and other imports in Bhutan are subsidised (petrol in particular is subsidised by the Government of India) and any delay on the renewal of this sort of agreement can potentially impact immediately on the Bhutanese people.

In agriculture, “the principal export crops of oranges, potatoes and apples account for nearly two-thirds of all agricultural exports” and they are considered pro-poor. A significant share of the cash income of the farmers in poorer deciles comes therefore from oranges and potatoes (NSB, 2014a, pp.49-50). However, there are vulnerabilities associated with the introduction of new crops and the management of existing one. These are made-up by a mix of structural and cultural bottlenecks that include underdeveloped value chains and strong dependency on the Indian market (as will be highlighted in more details for potato cropping in section 7.1.2). The Bhutanese Food Corporation supports farmers in marketing their crops. In the case of potato for example, prices fluctuate considerably, affected substantially by trends in the Indian market. So, between 2013 and 2015 prices followed a “roller-coaster” trend. They doubled between 2013 and 2014, but 2015 was a particularly bad season, particularly for potato farmers given the Government of India’s initiative to change banknotes (e.g. Gyelmo, 2017a)

Pests, disease control and wildlife conflicts are some of the vulnerabilities and farmers are the first to be exposed to the strong environmental stewardship of the country. Other bottlenecks are associated with production and marketing despite the efforts of the Ministry of Agriculture (MoAF). In fact, the MoAF provides agricultural extension in rural areas (so called Renewable Natural Resources - RNR - offices) and through them fertilizers, seeds and expertise to improve quality and quantity of crops as well as information on market prices. All the reports recognised the efforts of the Agriculture Ministry’s RNR extension
services, for the provision of those services that helped farmers in raising their earnings.

However, the introduction of new crops is always seen with some reserve by farmers and the RNR extension offices often have to use “experimental allotments” to demonstrate the suitability of the new crop first and “it takes time to convince farmers” to change crops or methods. The reason is obviously related to the fear of losing the harvest due to lack of knowledge in producing new crops or engaging in new productive methods/activities. In this context social protection measures associated with agricultural production, such as insurances and/or targeted micro-credit programs are indicated in various reports (e.g. NSB, 2014a; The World Bank, 2013) as important steps to safeguard rural livelihoods and to increase the poverty-reducing potential of commercial agriculture.

The organic approach proposed in agriculture is somehow related to environmentalist Buddhist values. However, despite Bhutan having a National Organic Programme, in commercial terms there is still no certification agency in Bhutan for organic produce to date even though this is improving. Regarding meat processing, there has been a very recent the debate around the opening of slaughter-houses by the Government in Bhutan. Some parts of the society opposed the Government decision from a Buddhist ethics perspective (e.g. Miyamoto, 2016). Yet, meat is imported and Bhutanese animals are taken to India to be slaughtered. With this system meat is normally re-imported with very low quality standards. These are all important aspects that are related to tourism given the possibility to increase interlinkages between sectors and reduce dependency on imports.

To reduce vulnerabilities associated with crop and non-crop farming a government initiative was introduced to comply with the 10th five year plan’s objectives of reaching food self-sufficiency and improving rural livelihoods. The initiative “One Gewog Three Products” allows the identification of three commodities for production and marketing to leverage on the diversification and specialization potential of each region in Bhutan (NSB, 2014a)

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38 Field notes 24/08/2013 Ura (eastern Bhutan) mushroom festival.
39 http://www.nop.gov.bt/
40 Pelden, D., 2013, personal communications about rice production, 10-07-2013.
The rationale of the initiative is to produce in a coordinated way to overcome other sources of vulnerability of the Bhutanese commercial agriculture: the limited availability of land and its fragmentation which hamper economies of scale. Despite the fact that traditionally land in Bhutan follows a matrilineal inheritance system (a traditional institution to avoid fragmentation), land holding is more and more fragmented given the institutional changes as result of modernization. The Royal Government has also granted land to about 61,339 beneficiaries (over one acre per head) under the Kidu program for socio-economically disadvantaged groups during 2009-2013 (National Land Commission cited by NSB, 2014a, p.78). The report claims that small land holdings are a constraint to agricultural production and this despite the efforts of the Government to encourage cooperatives and other forms of association among farmers.

Another feature associated with agriculture productivity and the matrilineal inheritance system is that educated young men migrate to urban areas leaving behind elderly and women with their children. Beyond the social implications that this phenomenon might have\textsuperscript{41}, it has repercussion for the availability of the labour force for agriculture, resulting in the “feminization” of the agricultural sector (The World Bank, 2014, p. 10). In fact, migration is not generated by the “push” of surplus of labour in agricultural sector, but agriculture is simply unattractive with negative consequences on agricultural productivity (NSB, 2014a, p.112).

These observations were also confirmed in areas identified by the Tourism Council for developing community tourism initiatives. In Nabji Korfu (point of entry of the Royal Manas National Park), an officer of TCB that participated in the baseline survey remarked in a conversation about the project how “sad” was to see so many women with their children and elderly left behind\textsuperscript{42}.

\textsuperscript{41} For example: “comparison by marital status of the heads of households show heightened poverty incidence for female-headed households (compared to similarly placed male headed households) for the never-married, married, and divorced. Only for the widowed is the poverty incidence smaller” (NSB, 2014a, p.22).
\textsuperscript{42} Gyeltsen, S., 2013, personal communication on the support given by SNV and TCB to community based home-stay and campsite initiatives, 25-11-2013.
Rural roads were another important objective of the 10th Five Year Plan with capital expenditures that reached a cumulative amount of 18 percent of GDP. The study reported that nearly 4,000 kms of farm roads have been built\(^{43}\) a significant increase from the baseline of 2007 (NSB, 2014a, p.52). A baseline survey for market-based intervention associated with tourism in Eastern Bhutan shows that improving accessibility is a priority for local people\(^{44}\) even before the provision of technical assistance for income-generating activities such as tourism (TCB, 2009) as they provide access to a wider range of opportunities and services (NSB, 2014a).

The implication of a good road system is related to the logistics of agricultural products, providing accessibility to develop other important markets such as tourism. Logistics in agriculture however need to improve broadly. Lack of refrigeration or storage facilities is a major constraint in agriculture. Yet, Bhutan will have soon to compete with regions of north-east India with a similar climate (NSB, 2014a). Observations and interviews related to potato cropping in the Phobjikha valley that will be reported in more detail in chapter 7, reveal that everything that is harvested is immediately brought to auction for export.

Regarding entrepreneurship and job opportunities related to agriculture and farming, there is an overall stigma associated with working the fields among the young generations. The educated young privilege office jobs more than agriculture\(^{45}\). The ambition is to become a civil servant and possibly a _Dasho_\(^{46}\) and the Government is the preferred and still by large the first employer in Bhutan. The Unemployed Youth Perception Survey (Khilji, 2014) shows that in terms of preferred employment, 50.3 percent of the respondents prefer to work for the Government, while 32.4 percent preferred public corporations. 77.3 percent of youth prefer desk jobs as non-desk jobs are associated with poor working conditions, low salaries, and low social status. This certainly poses some questions on the quality of jobs created outside the Government.

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\(^{43}\) Rate of BTN 3 million per km.

\(^{44}\) "The people of these two communities feel that allowing tourists to visit their communities will not only benefit them economically but also it will create employment opportunities. They also feel that better infrastructure will slowly come up… Out of the survey questions, some people in Merak and Sakten were asked on road and tourism and all said they would still prefer road and electricity over introduction of tourism if they have to make a choice." (TCB, 2009, p.7).

\(^{45}\) This emerged from a presentation followed by a focus group in which I participated with expatriates working in different development organisations, Bhutanese farmers’ representatives and students (New Development Paradigm, 2013).

\(^{46}\) The meaning of _Dasho_ is comparable to the British title of Lord and/or Sir.
and Government related organisation. Some of them were indicated as pro-poor (see discussion above based on ADB and NSB, 2013). Most respondents indicated as preferred areas of work finance, education, hydropower, tourism and hospitality.

In general, migration is often seen as a positive driver for poverty reduction. A migration rate of about 1.2 percent a year out of rural Bhutan was reported by the Bhutan - Poverty assessment 2014 (NSB, 2014a, p.46). If a salaried and stable job is found, those employed in service or industrial sectors would have greater chances of escaping poverty (NSB, 2014a, p.53; NSB, 2014b). However, lack of opportunities in more urbanized areas of Bhutan make it difficult to emerge, ultimately pushing back the young people to their communities. Migration is a theme that is often discussed on Bhutanese media outlets but more often than not as a negative feature of Bhutanese modernisation path.

Figure 8: Percentage of male and female employed by type of enterprise

The 2015 statistics estimate at 558,959 the number of the population in working age of which 352,953 are in the labour force (economically active) and 206,006 are economically inactive. The 2015 statistics by type of enterprise highlight that 58 percent are employed in the agricultural and forestry sectors, followed by 19 percent in the private sector and 17.5 percent in the public sector (armed forces, government companies and agencies).

Source: MoLHR, 2016, p. 24

Nonetheless, agriculture is still the main activity for most of the active population of Bhutan as indicated by recent labour statistics in 2015 (MoLHR, 2016). Initiatives from the MoAF to increase agricultural production and

productivity also include the creation of agriculture enterprises and rural cooperatives, aiming at creating jobs for young people leaving school, reducing imports of agricultural commodities and reversing rural-urban migration. At the moment the 13th National Labour Force Survey estimated a 10.7 percent youth unemployment, an increasing trend from previous years (MoLHR, 2016).

5.3 Patterns of rural economic diversification

In terms of employment, the Bhutan Poverty Assessment stresses the idea that most of the employment opportunities in the rural areas have been pro-poor in the last five years (NSB, 2014a, p. 47). But it also acknowledges that there is no data that can tell if these jobs come from agriculture or non-agriculture sectors. Yet the report highlights three main drivers for poverty reduction: increasing agricultural trade, expanding road networks and the spreading of spill-overs from hydroelectric projects.

What emerges from focus groups that complemented that report is that investments in connectivity (electricity, farm roads and mobile technology) also helped the diversification of livelihoods in non-farm sectors as people could earn income by working as salaried, small contractors, shopkeepers as well as selling directly their farm products (NSB, 2014a). Vegetable and farm products in more remote areas are often sold to government facilities like local hospitals, boarding schools and decentralized government offices providing to certain extent cash to farmers, encouraging some level of local economy (Ibid).

Interestingly the report shows also that place of residence matters for mobility out of poverty. Thimphu, Paro (respectively national capital and tourism hub), Punakha, Wangdue and Trongsa (proximity to hydroelectric power plant location and also tourism hot-spots) have provided increased opportunities for salaried work and small (but market-oriented) farms (which are often incentivised by the Government\(^48\)) creating some level of local economy.

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\(^{48}\) Poultry farming for example is supported by RNR extension offices and national targets of egg production are set by the National Five Year Plan (92M eggs production is the target to be achieved during the 11\(^{th}\) Plan divided by regions and Dzongkhag).
While there is an attempt to roughly estimate the contribution of hydro-power projects to the local economies, and a study has been commissioned to the Royal Monetary Authority (Dorji, 2016), tourism and its pro-poor effects (macro implications, level of investments, job creation, mechanisms for poverty reduction or impacts on rural livelihoods) have been seriously overlooked. This is despite the high potential in terms of investments in the accommodation sector that would generate employment (in construction and maintenance as well as in hotel operations) or opportunities for entrepreneurship along the main tourism routes and hubs, given the broad linkages of its value chain.

Tourism is only acknowledged from a macro perspective as a contributor to export revenues. Yet, there is no clear estimation of the contribution to GDP. Figures on tourism arrivals expanded at an average rate of 15 percent per year in the last five years (The World Bank, 2014). The number of arrivals climbed to 133,000 in 2014, of which 68,000 were from outside the region. Indian tourists accounted for 62,129. This brought USD 73.2 million in earnings. In terms of arrivals this is double the amount of foreign workers for hydro-power projects, and with a much higher potential “acquisitive power”, paying the minimum daily tariff of 250 US dollars a day. This makes tourism an economic driver that cannot be underestimated.

5.4 Pro-poorness of growth and return to assets

The report Bhutan Poverty Assessment (NSB, 2014a) uses four different approaches to describe the pro-poor “bias” of economic growth and it identifies key factors for those biases. Their results have been used to provide the account on livelihoods and poverty described above. However, there is another interesting analysis based on econometric estimations of welfare change at the percentile level to cast light “on the contribution from the accumulation and

49 From a micro-perspective, spillovers from hydro-power are expected to come under the form of direct employment for unskilled people and indirect and induced effects of the investments in local economy. These mega-projects offer opportunities of salaried jobs and non-farm activities. As mentioned above, to some extent focus groups have confirmed that this is already a reality (NSB, 2014a). The report highlights that the total consumption of the three Dzongkhags where the construction is taking place was about BTN 3 billion in 2012. The presence of foreign workers is estimated to augment spending by one-third. In fact, in 2012 there were 50,000 foreign workers. Their contribution evaluated at the poverty line is one billion Ngultrum per year (Ibid, p.53).

50 http://www.theiguides.org/public-docs/guides/bhutan
returns on assets” (Ibid, p.45). This technique highlighted that the rapid economic growth in Bhutan is driven more by per capita consumption expenditure than redistribution (Ibid, p.45-46). This means that if growth has been pro-poor overall, its distributional change was not pro-poor enough, failing to impact on inequality (Ibid, p.75).

The methodology employed belongs to the “family” of methodologies briefly described at a macro level in the literature review and they serve to estimate how growth is pro-poor. The theoretical background comes from the idea that the “living standard of an individual is a pay-off from participating in the life of society”. This payoff is a function of endowments, behaviours and the circumstances “that determine the returns on these endowments from any social interaction” (NSB, 2014a, p.55).

The study concludes that the pro-poorness of the distribution change (change in consumption) that occurred in the period 2007-2012 is due mainly to structural effects (increased productivity, that is to say changes in returns on asset endowments), while “the increase in inequality observed over the same period is driven by the endowment effect”. Since the structural effect represents the change in rewards for participation in socio-economic arrangements (in this case they are not explicit but refer vaguely to market participation), these results suggest that “socioeconomic arrangements in Bhutan may have gradually become more progressive” (Ibid, p.57). In other words, more Bhutanese are participating actively in the socio-economic life and they are consuming more, but those endowed with specific assets are able to increase their asset endowments and gain more and this effect ultimately contribute to inequality.

This analysis is very interesting if it is considered within the debate on livelihoods transformations, and asset endowments/accumulation from pro-poor market interventions in value chains. In fact, macro studies like the one reported can be linked to micro-studies at community levels, specifically designed to see if specific socio-economic interactions (i.e. participation in specific value chains) have impacts on livelihoods and assets and how governance mechanisms and social networks affect the participation and the distribution of benefits. This is addressed in Chapter 7.
5.5 Social capital in the Bhutanese context

If the living standard of an individual is a pay-off from participating in the socio-economic life, an interesting perspective comes from a monograph on social capital in Bhutan that provides an indication of the importance of social norms within the Bhutanese society. In the monograph it is claimed that the Bhutanese society enjoys a deep sense of community that influences both horizontal (bonding ties between those that have the same socio-economic status – “ta lto tshang” and “‘cham mthun”) and vertical social networks (bridging ties with more powerful groups of individuals – “ggom dpon gyog”). In addition, people who migrate (especially to more urbanised areas) tend to maintain ties with extended families and community members in the ancestral community of origin (Dorji, 2013, p.11). The author highlight how particularly vertical linkages (bridging ties) can have a positive effect by providing support for social and economic “mobility”. However, these networks generate many social obligations that are not always positive. On the vertical level they may generate favouritism towards kinship. On the horizontal level they can impose pressure on network members to return favours. Not responding to these social obligation may also cause loss of important networks (Dorji, 2013, p. 12).

The author pointed out how these cohesive networks emerged from the geography that imposed limited mobility and isolation on Bhutanese communities. These characteristics provided the Bhutanese society with traditional institutions like extended families or self-sustaining communities as well as social structures for the exchange of goods and services between members of different communities. The authors argue that social networks built on trust (“blo ted”), reciprocity and commitment (“dham tshing”) are widespread in Bhutan. He provides the example of the “northue” tradition (inter-village cattle herding) that contains both bonding and bridging social capital (Ibid, p.21). He argues:

“Such confined social interactions… [are] characterised by a high level of trust and cooperative actions undertaken to mitigate and overcome common issues like calamities, food shortage, scarcity of
labour, local conflict management, resource sharing and so on” (Dorji, 2013, p.20).

At the micro-level, the institutions of extended families and the cooperation in community life (the connection between relatives, friends and neighbours) are so important that they are safeguarded by the Constitutional Chart (article 9 point 19) and they are integral part of the nine domains of the GNH framework under “community vitality” (Ibid).

At the meso- and macro-levels, the author linked the theoretical discussion on social capital to two elements of the modernisation process of the country, particularly: 1-the creation of civil society organisations and; 2-the process of decentralisation. The first point sees the growth of cooperative groups and institutions that now can be formalised through the Civil Society Act, including spontaneous community groups and several other types of associations and groups encouraged by the Government, donors or national NGOs. The author argues that these new formal groups are nothing more than extensions of traditional practices. The informal norms and practices through which community members support each other still underpin these innovations (ibid). Furthermore, decentralisation links to the process of active participation in the development effort which is supposed to enable local governance.

At the meso-level organizations are being created to support decentralization to enhance participation and control from the bottom-up. Yet, administrative centralization is still very strong being the country’s budget dependent on foreign aid which is canalised through the central government (from the top-down) and around five year programming plans.

By following The World Bank framework on social capital the study estimates a positive effect on household welfare of social capital. He considers two dimensions: structural and cognitive social capital. The most significant variables to welfare in the structural dimension are memberships in groups. From the cognitive perspective the support from neighbours, the availability of sources from which to borrow money and the social interaction contribute positively to household welfare. Trust, which is among the cognitive

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51 Wangchuck, S. 2013, personal communications (retired civil servant), 26-09-2013.
52 Their research is based on The World Bank income and expenditure survey conducted in Bhutan. Welfare is therefore measured by real per capita household expenditure.
variables do not contribute to household welfare (ibid, p.100). Trust, in the survey is measured through and indicator\textsuperscript{53} that considers “the total score on the level of trust and feeling of closeness or togetherness in the neighbourhood and the level of trust within the neighbourhood” (Ibid, p.38).

The return on structural social capital (membership to a community organisation) is higher for the richest quintile. For the poorest 10 percent, structural social capital does not occupy a place in the asset portfolio significant to welfare. The authors link these results to the fact that the poorest are not able to “realise the potential of group membership” from formal groups (see p.110 onwards for details). The survey captures mostly the formal groups and so the effects of the informal groups can be underestimated, yet, for the poorest quintiles the returns on welfare are higher from community-initiated groups.

Regarding the cognitive social capital (perception of trust), its return is higher in the case of the richest quintile, but the factors “close friendship” and “borrowing from others” are only significant for the poorest quintiles. More importantly, the combined social capital effect (structural + cognitive) is more unequally distributed between quintiles (benefiting more the richest) than other assets such as human capital. This shows some parallels with the study reviewed in the literature about Nepal of Gautam and Andersen (2016) and it poses a question about the ability of the poorest in accessing vertical linkages beyond their horizontal closest networks to realise social mobility.

5.6 Conclusion of the chapter

From the reports analysed, there is a quite strong consensus that Bhutan is a sort of “champion” of development in South Asia. Its economy has recently been forecast to be among the fastest growing in the world by IMF and its real GDP will grow at 8.4 percent in 2016 (IMF, 2016). In a few years (from 2007 to 2012) the country managed to reduce poverty by half (extreme poverty fell from 6 percent to 3 percent and poverty from 23.2 percent to 12 percent). It is forecasted that Bhutan will probably graduate from the list of Least Developed Countries in the next few years (Marshall, 2013). But while the Government is

\textsuperscript{53} First principal component.
committed to providing basic and fundamental services that worked as key
drivers for this fast poverty reduction, other challenges emerge.

The two democratic governments that alternated since 2008 have
demonstrated a strong commitment to support existing public services and
create new one (such as new social protection schemes). At the same time they
are aware that demographic and macro-economic pressures have increased. It
is interesting to see how consumption poverty decreased by half in five years
and how in parallel Bhutan in 2011 went through its most serious macro-
economic crisis (current account crisis). This was due to a dramatic increase in
imports and in personal debts followed by an increase of private loans that
precipitated a shortage of foreign currency (rupees in particular).

Yet, from GNH to MDI and the World Bank there is consensus that Bhutan
needs to leave more space to the private initiative in the economic sphere to
increase revenues for the Government through taxation and provide
opportunities especially for youths beyond the public sector. In general, even if
the economy of Bhutan is growing at aggregate level, markets are still small and
this does not allow for example financial autonomy of districts. Following the
current economic policies, ownership of industries and enterprises are still
mostly Bhutanese and are mostly small scale. Some partnerships exist with
foreign companies in the form of management contracts or FDIs especially from
the region (mainly India and Singapore). Most of them can be found in the
tourism sector.

To cite one of the reports:

“From the economic point of view the narrow economic base, high
rural poverty and inequality, the generation of productive and decent
employment opportunities outside the government sector is needed
to arrest youth unemployment. Policies that would rapidly expand
private sector activity to boost job opportunities and broaden the
country’s economic base have to be crafted and implemented” (ADB
and NSB, 2013, p. v).

The question is how to do this in a sustainable way while containing
external and internal pressures on the country’s values. The reports analysed
above put a strong emphasis on trade and on rural and regional development. These are seen as drivers for pro-poor and inclusive market development and they stressed the importance of improving access to credit in rural areas, assisting farmers in bringing their produce to vegetable markets in the towns, training farmers as entrepreneurs to transform their rural products, creating off-farm jobs or non-farm entrepreneurial activities. These are all elements that would leverage the “inclusive” potential of markets and trade.

My study is placed in this context. It looks at tourism as an industry and it fills a gap in the analysis of growth strategies for Bhutan so as to understand and explore what are the “generative mechanisms” behind inclusiveness in the tourism value chain and how they work for rural communities. It also analyses rural transformations by examining the interaction between agricultural and more “advanced” market-based rural livelihoods that are encouraged by donors and the Government.
Chapter 6 – An institutional analysis of tourism governance

This chapter will provide an analysis of the interaction between formal and informal institutions and how they influence economic inclusion and trajectories of upgrading/downgrading in the Bhutanese tourism industry, ultimately impacting on the growth path of the tourism sector. Most of the literature on tourism development in Bhutan concentrates on the formal institutions, analysing outcomes associated with the Gross National Happiness and/or processes of reform ascribed to surpass policy constraints to develop a modern economy.

The unique “high value, low impact” approach to tourism, operationalised through the “tariff system”, is considered by the Royal Government the most effective way to meet GNH requirements in tourism and it is seen to provide substantial contribution to poverty reduction (as stated by the 10th Five Year Plan) or inclusive growth (as stated by the 11th Plan). But these policy and/or strategy statements lack proper assessment. It is important to analyse what are the regulations and policy in place but to also cast light on aspects that go beyond regulations and more into the practices that are not necessarily self-evident.

The Bhutanese tourism context has not been analysed hitherto. Section 6.1 undertakes a review of the research available on Bhutan, highlighting how the “unique” tourism principle (and regulations associated), influence the economic system. The analysis, based on secondary data from the literature and from policy document but illuminated by primary observations, is the first work to explore and understand the Bhutanese tourism governance in terms of relevance of institutional aspects and their relationship to growth and diversification.

This also allows a contextualisation of interview data that cast light on the mechanisms for inclusion and upgrading (section 6.2). The emerging mechanisms will be further “tested” with survey and network data from two communities in an emerging tourism “hub” in central Bhutan (Chapter 7). Therefore, this chapter will answer the following research questions: What
institutional elements characterise the governance of the Bhutanese tourism value chain? How do these elements influence inclusion in the tourism value chain and therefore economic upgrading opportunities?

6.1 Research, policy and regulation associated with tourism

“The polity and the economy are inextricably interlinked in any understanding of the performance of an economy.... Not only do polities specify and enforce property rights that shape the basic incentive structure of an economy, in the modern world the share of GNP going through government and the ubiquitous and ever-changing regulations imposed by it are the most important keys to economic performance." (North, 1990, p. 112).

Tourism in Bhutan’s development trajectory: an overview

A number of studies have been published to describe how tourism is affecting and/or contributing to Bhutan’s development effort. The first study dates back to the 80s written by Valene L. Smith (1981). The author compares tourism in Nepal and Bhutan, describing the almost simultaneous opening to tourism as one of the processes of modernization undertaken by the two Himalayan countries. Yet, she underlines the different outcomes from a tourism development perspective. Comparing the modernization patterns of these two countries is beyond the scope of this research. Yet, Nepal is now commonly used as counterfactual for outcomes of tourism development and the effects of uncontrolled liberalisation by Bhutanese tourism stakeholders, as well as by the Nepali industry.

Bhutan development path has been analysed extensively by Karma Phuntsho (2013). It is characterised by a strong leadership that sees the Bhutanese Royal Family as central actor. The author distinguishes two phases of the modern history of Bhutan, which marked the rapid progression from a theocratic and feudal society (that lasted more than 500 years) to an absolute (from 1907 to 1953) and more recently constitutional (from 18th July 2008) monarchy. In fact, the period from 1907 to 1952 is marked by forceful assertion of power to gain full control over the country and to centralize power, which was
necessary to bring systemic changes and long-term peace and security. This was achieved by the end of the 2nd King reign and Phuntsho refers to this period as “active and assertive”. The process changed to a more “placatory and participatory” in 1952 with the coronation of the 3rd King (H.M. King Jigme Dorji Wangchuck) who introduced various reforms such as land and taxation reforms and the establishing of a National Assembly in 1953, marking the change from a feudal and centralized society (Ibid, p.566) to a more decentralised one.

Bhutan’s socioeconomic and cultural changes, initiated by the 3rd King and deeply endorsed and continued by the 4th King, are described by Phuntsho as the result of two process: 1. “active modernization” through development programmes; and 2. “passive globalisation” associated with the introduction of faster communications (p.583). The development of Bhutan is marked by five year programming, the first plan was launched in 1961 and the 11th started officially in July 2013 after the second parliamentary election. Its implementation started in September when the Indian government released the budget54.

The five year programming approach was borrowed from India, historically Bhutan’s main development partner. Bhutan’s largest donor is also India55, accounting for approximately 66 percent of all Official Development Assistance, ODA (Marshall, 2013, p. 17). Therefore, the country’s budget is dependent on foreign aid, which is channelled through the central government (from the top-down) accordingly to districts’ (Dzongkhag) needs. It has to be noted that the districts have assemblies composed by the elected member of each municipality (Gewog), but the executive role is given to the Dzongdag (the Governor), who is the royal appointee and represents the extension of the central government. In fact, apart from the Gewogs leaders (that in theory should not belong to political parties), the districts’ administrations are formed by bureaucrats, an extension of the central government.

54 “During the visit of the Prime Minister of Bhutan, Lyonchhen Tshering Tobgay to India from August 30 to September 4, 2013, Government of India’s Assistance Package for Bhutan’s 11th Five Year Plan (July 2013 to June 2018), was decided. At Bhutan’s request, India agreed to contribute Rs 4500 Crores. For the current Five Year Plan of Bhutan, out of the total committed external assistance of Nu/Rs 6600 cr.; India’s contribution of Rs.4500cr., represents about 68% of the total external assistance and 49% of the capital expenditure of RGOB’s 9200cr.” (Embassy of India in Bhutan, 2017).

55 Bhutan dependency from India is controversial. It was often considered a protectorate of India as India had deeply influenced the foreign policy of Bhutan following the 1949 treaty until 2007 that was revised (Phuntsho, 2013, p.563).
In this context, Smith (1981) points out how the advent of tourism in Bhutan is marked by a specific event related to the coronation of H.M. Jigme Singye Wangchuck, the 4th King in June 1974. Her conclusions are very relevant to this research. As an anthropologist, she was concerned with how tourism has the tendency to commoditise and package culture, and she compared the “ripple effect” of the first tourists visiting Nepal, contrasting it with Bhutan. In the Bhutanese context, she said “it is ultimately the government that decides who will visit the country, for how long and for what purpose” (p.5). The article showed how the number of tourists was set at two-thousand, who should have entered the country in groups of fifteen, for a minimum stay of seven days, spending one-hundred and eighty US dollars per day in an all-inclusive package. The author also pointed out how aside from fuel, most of the income was retained within the local economy since no foreign carriers, foreign hotel chains or foreign tour operators were involved (Ibid).

Smith in her narrative praised the State as strategic agent, able to control the in-flow of tourists, maximising foreign exchange earnings for the national budget and the monetary reserves, control imports and investments, and limited the degree of exposure, so not to compromise either the culture or the natural environment. Somehow, this emphasis on “national interests” for tourism development in Bhutan is currently under strong pressure, as it will be explained below.

The tourism industry in Bhutan remained operated by the Royal Government until 1983. From 1983 to 1991, it operated as a quasi-autonomous and self-financed body known as the Bhutan Tourism Corporation - BTC (Dorji, 2001). In 1991, the industry was privatized, and the government established a regulatory body known as the Tourism Authority of Bhutan (TAB) to ensure the compliance with tourism regulations. The Tourism Authority of Bhutan later became the Department of Tourism, under the Ministry of Trade and Industry and more recently the Tourism Council of Bhutan (Ibid). The “low-volume; high-value” (now changed to “high-value; low-impact”) policy intention also emerged as main guiding principle for the industry and expression of the Gross National Happiness (GNH) development paradigm in tourism.

The creation of the TCB demonstrated an attempt to further broaden participation in the tourism governance, “at least in theory” (Schroeder, 2015, p.
TCB is a governance model based on the recognition of the multi-sectoral nature of tourism that requires broad participation and coordinated efforts. As such the TCB’s board include various ministries and it is chaired by the Prime Minister, which should signal the importance of tourism as a special project in the hands of one of the highest authorities.

Figure 9: TCB Board and basic organisational structure.

The organizational evolution briefly described above, saw in parallel an increased number of tourism stakeholders with growing numbers of licensed tour operators, hotels of different category and guides. The entry of the private sector into the tourism industry led to the development of civil society organizations (CSOs). Schroeder (2015) observes that the widening on the number of actors and their active participation is consistent with the good governance pillar of GNH (p.16621) and it is understood as a positive outcome (the approach facilitated sector growth). Yet, even if the number of players has increased, the pricing structure that was set for a state monopoly tour-operating business (during the reign of the 4th King), has undergone only few changes and has been renamed into what is now known as the “tariff” system.
Figure 10: Evolution of the tourism industry in Bhutan

Tourism Arrivals in Bhutan

Source: own elaboration on data provided by the TCB and contained on Bhutan Tourism Monitor 2013. The blue portion of the histograms indicates international tourists, whilst the green indicate numbers of regional tourist as well as business and visit friends and relatives tourists that have been recently added to the tourism statistics. The number of arrivals climbed to 133,000 in 2014, a 15 percent increase on the previous year, of which 68,000 were from outside the region. Indian tourists accounted for 62,129. This brought USD 73.2 million in earnings.

Revenues

Source: Own elaboration with nominal data obtained from the Royal Monetary Authority Reports. Data on official visitors and regional visitors from Bangladesh, India and Maldives who do not require visas to enter Bhutan are excluded. It also excludes out of pocket expenses by the tourists. Data are expressed in million Ngultrums. The RMA only accounts for the royalty and the tax obtained from the sale of international tour packages, not for tourism expenditures and therefore it excludes the value in USD of the daily package tour.
Number of licences issued every year for tour operating

Source: Own elaboration on data provided by the Tourism Council of Bhutan. The total number of registered tour operators at the end of 2013 was 1263. Further data from TCB shows that most of the tour operators are inactive or hold very marginal market share. The data available for 2011 and 2012 show the first 100 tour operators ranked by international tourists handled, hold respectively the 85 and 84 percent of the market share.

Number of licences for tour guides

Source: own elaboration on data provided by the TCB. The number could be overestimated. The current information system is not able to distinguish guides with a valid licence from those that are still recorded in the system but not holding a valid licence. 2236 is therefore the total number of people that have had a tourism guiding licence at least once.
Evolution of the Hotel Industry in Bhutan

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<td>4</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>Trashigang</td>
<td>0</td>
<td>0</td>
<td>1</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Monggar</td>
<td>0</td>
<td>0</td>
<td>1</td>
<td>2</td>
<td>0</td>
</tr>
<tr>
<td>Haa</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>2</td>
</tr>
<tr>
<td>Samdrup Jongkhar</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>9</td>
<td>8</td>
<td>45</td>
<td>42</td>
<td>19</td>
</tr>
</tbody>
</table>

Source: Own elaboration on data provided by the Ministry of Economic Affairs and the TCB. Data provided by the Department of Trade (trend) do not coincide with figures contained in the Bhutan Tourism Monitor 2013. On 15 October 2013, a list of 173 operating hotels was provided (none based in the area of Phunethsoling, indicating that perhaps the licence location is attributed following the place of legal residence of the company or person requesting it), while the TCB provided a total of 123 assessed hotels.

Civil society organisation related to core tourism stakeholders:

- The Handicrafts Association of Bhutan (HAB) – created in 2005
- The Hotels and Restaurants Association of Bhutan (HRAB) – created in 2008
- The Guide Association of Bhutan (GAB) – created in 2009
- The Association of Bhutanese Tour Operators (ABTO) – created in 2000
As reported by Phuntsho (2013) the Government through its five year plan set the target for the number of high–end tourists each year. Yet, the system of visa and semi-controlled itineraries has not changed. International tourists have to follow specific itineraries that are communicated by the tour operator to the TCB in advance, who processes the visa upon receiving the payments of the full cost of the tour-package in an official bank account in US dollars. The tour operator through the immigration authority processes the road permits and the visa is issued by the Council once the payment of the package is done. The amounts are released by the Tourism Council to the tour operator in local currency at the end of the stay to pay providers and make profits.

It is evident that the process of modernisation (which focuses on democratization and decentralization) has translated in an increase of the number of players and actors operating in the tourism industry. From a state-monopoly the internal market structure for tour operation now resembles a fully competitive market structure with very low barriers to entry and more than one-thousand tour operators registered at the Trade Division of the Ministry of Economy. In terms of pricing it is the responsibility of the tour operator to set their package products and prices, charging to the final client a minimum per day of two-hundred and fifty USD. Package prices can be set equal or above the minimum tariff depending on the services that are provided and included in the package. The evolution of this system and the exceptions to the tariff are listed in the Table 11.

Table 11: The history of the tourism tariff system

<table>
<thead>
<tr>
<th>Date</th>
<th>Type of change</th>
<th>Culture (price/ person in USD)</th>
<th>Trekking (price/person in USD)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>High season</td>
<td>Low season</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(Mar; Apr; May; Sep; Oct; Nov).</td>
<td>(Jun; Jul; Aug; Dec; Jan).</td>
</tr>
<tr>
<td></td>
<td></td>
<td>High season</td>
<td>Low season</td>
</tr>
<tr>
<td>1974</td>
<td>Opening of the country to foreigners</td>
<td>130</td>
<td>130</td>
</tr>
</tbody>
</table>

56 High-end tourists are the dollar-paying tourists. They differ from regional tourists that can enter the country without visa or the intermediation of national tour operators. Until recently the Tourism Council of Bhutan recorded on the national statistics only those tourists that were required to pay in dollars and use the tariff system. This automatically excluded from the statistics all those that could enter the country without the visa; Indians in particular but also migrants and other regional tourists.
<table>
<thead>
<tr>
<th>Year</th>
<th>Description</th>
<th>Low Season</th>
<th>High Season</th>
<th>Discount</th>
<th>Surcharges</th>
</tr>
</thead>
<tbody>
<tr>
<td>1986</td>
<td>Tariff differentiation based on seasonality</td>
<td>130</td>
<td>90</td>
<td>85–130</td>
<td>85–130</td>
</tr>
<tr>
<td>1989</td>
<td>Tariff raised to 200USD flat rate</td>
<td>200</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>July 1994</td>
<td>Tariff differentiation by region and activity</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>i. Thimpu, Paro, Phuntsholing</td>
<td>220</td>
<td>130–175</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>ii. Wangde Phodrang, Punakha, Tongsa, Bumthang and Samdrup Jongkhar</td>
<td>150</td>
<td>100–130</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>iii. Phobjikha, Mongar, Tashigang, Tashi Yangtse and Lhuntshi</td>
<td>130</td>
<td>90–120</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>iv. Trekking</td>
<td>120</td>
<td>80–100</td>
<td></td>
<td></td>
</tr>
<tr>
<td>July 1995</td>
<td>Amendments to discounts and surcharges</td>
<td>200</td>
<td>200</td>
<td>120</td>
<td>120</td>
</tr>
<tr>
<td>Jan 1997</td>
<td>Flat rate tariff</td>
<td>200</td>
<td>200</td>
<td>200</td>
<td>200</td>
</tr>
<tr>
<td>Jan 1999</td>
<td>Amendments to discounts and surcharges: reintroduction of low-season pricing</td>
<td>200</td>
<td>165</td>
<td>200</td>
<td>165</td>
</tr>
<tr>
<td>Jan 2001</td>
<td>Amendments to surcharges and introduction of the Tourism Development Fund</td>
<td>200</td>
<td>165</td>
<td>200</td>
<td>165</td>
</tr>
<tr>
<td>2008</td>
<td>Tariff raised</td>
<td>250</td>
<td>250</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Jan 2009</td>
<td>Tariff temporarily reduced</td>
<td>200</td>
<td>165</td>
<td>200</td>
<td>165</td>
</tr>
<tr>
<td>July 2009</td>
<td>Discounts for tourists staying more than eight nights</td>
<td>180</td>
<td>150</td>
<td>180</td>
<td>150</td>
</tr>
<tr>
<td>Till the end 2011</td>
<td>low season royalty (now it called SDF - Sustainable Development Fee) was 55USD and high season 65USD</td>
<td>200</td>
<td>165</td>
<td>200</td>
<td>165</td>
</tr>
<tr>
<td>From Jan 2012</td>
<td>Bhutan-Thailand friendship offer – Tariff temporarily eliminated</td>
<td>250</td>
<td>200</td>
<td>250</td>
<td>200</td>
</tr>
<tr>
<td>2014</td>
<td>June, July and August - Only royalty of USD 65</td>
<td>250</td>
<td>200</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Year</td>
<td>Country-People Friendship Offer</td>
<td>Tariff Temporarily Eliminated For</td>
<td>June, July and August - Only Royalty of USD</td>
<td>June, July and August - Only Royalty of USD</td>
<td></td>
</tr>
<tr>
<td>--------</td>
<td>---------------------------------</td>
<td>----------------------------------</td>
<td>---------------------------------------------</td>
<td>---------------------------------------------</td>
<td></td>
</tr>
<tr>
<td>2015</td>
<td>Bhutan-Japan</td>
<td>250</td>
<td>a Person Per Night; and up to 50 Percent</td>
<td>a Person Per Night; and up to 50 Percent</td>
<td></td>
</tr>
<tr>
<td></td>
<td>friendship offer</td>
<td></td>
<td>Discounts in Hotels; Flexibility of Choice</td>
<td>Discounts in Hotels; Flexibility of Choice</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>in Services.</td>
<td>in Services.</td>
<td></td>
</tr>
<tr>
<td>2017</td>
<td>Bhutan-Korea</td>
<td>250</td>
<td>a Person Per Night; and up to 50 Percent</td>
<td>a Person Per Night; and up to 50 Percent</td>
<td></td>
</tr>
<tr>
<td></td>
<td>friendship offer</td>
<td></td>
<td>Discounts in Hotels; Flexibility of Choice</td>
<td>Discounts in Hotels; Flexibility of Choice</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>in Services.</td>
<td>in Services.</td>
<td></td>
</tr>
</tbody>
</table>

Source: Own elaboration. Updated from Nyaupane & Timothy (2010) on available data from TCB. The differentiation of the tariff by geographical areas aiming at redistributing tourism arrivals in the country and incentivise tour operators to develop new tours, is the only of the few exceptions. Most recently, under few “friendship” initiatives the Government lowered the price per day to the level of the royalty.

Brunet et al., (2001) focused their study on the narratives of cultural identity to analyse the alignment and the commitments of tourism stakeholders to follow the “middle path” modernization (otherwise understood as controlled liberalisation) that in tourism translates into the unique Bhutanese tourism principle\(^{57}\). They conclude that stakeholders’ commitment to the “middle path” influences tourism development, limiting negative externalities by controlling the type and the number of tourists through the tariff system. This seems to have sustained a romantic view of Bhutan and the perception among stakeholders of having successfully integrated and operationalised sustainability in tourism. It

\(^{57}\) “Low-volume high-value” and now “high-value low-impact” are policy intentions. However, all authors including Brunet et al. 2001 but also very recent academic articles refer to it erroneously as policy.
also generated the perception that the “middle path” to economic development had prevented rapid social change, resulting in effective development outcomes such as a drop in infant mortality rates, increased life expectancy from improved health care, increased literacy levels, improved agricultural practice and so on (Ibid).

But the integration of the ideological and political discourses that enabled the Bhutanese society to be aware and to embed “a serious discourse on costs and benefits of development” (Brunet et al. 2001, p.261), might not be sufficient anymore given the increasing number of stakeholders. In the case of tourism, the authors showed the increased importance given to the environment and consequently to ecotourism in Government documents and by stakeholders to generate employment and entrepreneurial opportunities for young people in rural areas and prevent migration and unemployment. The paper of Brunet et al. (2001) provides an important insight into the contribution of ideological and political discourses to create a shared vision about development in general and tourism development in particular. Nonetheless, the authors also pointed out the need for practical steps to turn policies into action.

Rinzin et al. (2007) consider the policy change from low-volume high-value to high-value low-impact a legitimation of tourism as “backbone of private sector growth” (p.1) for an economy in transition which is changing to a growing services sector. But in fact, tourism is characterised by almost the same rules that were in place in 1980s: the demand is constrained and “skimmed” through the tariff (or pricing) system and visitation is limited to certain parts of the country (due to lack of investments in key infrastructure). This “ensures” minimum negative impacts. The sector growth, particularly in terms of growing numbers of private sector actors, is stimulated by the above-normal rents created by the “tariff” system that provides an incentive for economic actors to enter the market. Yet, policy and legislative frameworks have hardly changed despite many proposals for reforms (these will be detailed in Policies and Legislative Framework and Policy Process sections). While tourism is still today acknowledged as the main driver for economic and inclusive development in key policy and strategy documents, such as the 11th Fiver Year Plan, the current industry set-up add a lot of pressure as it will be outlined below.
The “tariff” system: structure and developmental impacts

Regarding the “tariff” system, the empirical study of Rinzin et al. (2007) reveal how the “tariff” works for stakeholders and the impacts for the economy and for poverty outcomes. In fact, the study assessed the socio-economic impacts by analysing the economic value captured in the tourism supply-chain using a “follow the dollar” approach. It distinguish the direct contribution of the tourism sector to the national economy (lower part of Figure 11), and the contribution of the tariff system (through the royalty and taxes) to the general budget and consequently the economic contribution to key services important for poverty reduction (upper part of Figure 11).

It has to be noted that the economic contribution of the lower part of the flow chart in Figure 11 are gross figures that do not take into account costs of operations or imports. The article identified interesting features of the tourism sector but a critical review of the findings is particularly needed. In fact, it gives insights of patterns of expenditure of hoteliers, showing two trends: 1. staff salaries in hotels are among the lowest ranked category of expenditure, while items including food (meat and vegetable) are among the highest expenditures. The lowest ranking of expenditure for manpower could raise the question of how this high productivity is artificially created by the tariff and of how the benefits of this “pocket” of high productivity are shared particularly looking at the participation of the work-force and its contribution to this high productivity. The analysis also shows that “most of the edible items such as meat and meat products, groceries, vegetables, beverages, etc. are imported from India” (ibid, p.118).

In addition, Phuntsho (2013) more recently reported that over 60 percent of Bhutan’s essential goods, including rice, are now coming from India. The “rupee crisis” caused by uncontrolled imports hit Bhutan in 2012 and forced the Government to introduce further capital controls that impacted trade and access to finance. Tourism might have contributed marginally to the crisis but statistics are not available to claim its relevance. Many items including construction materials, fittings and often man-power are imported from India for various sectors including tourism and its related activities.
Figure 11: Flowchart of revenues from tourism in the Bhutanese society

Source: Adapted and updated from Rinzin et al. (2007, p.119). Little has changed since their 2005 analysis. The daily tariff has been changing depending on Government priorities as indicated in Table 11 above. The tourism development fund (TDF) has been phased-out. The visa/airport tax is 40USD (in 2015). Air tickets costs have been lowering almost to a half due to the entry of Bhutan Airlines a private competitor. In both cases different prices apply to tourists and to nationals, showing how tourism is used to subsidise costs for Bhutanese nationals. The figures provided in the lower part of the flow chart are gross figures. The figures in the table are own calculations based on the breakdown of two typical tour packages (exchange rates and costs are updated to 30-Jul-2013). The aim is to compare current figures with those provided by Rinzin et al. (2007), which considering the overall daily package increased has not considerably changed.

Regarding rural communities, Rinzin et al. (2007) estimated that in rural areas the average household annual income from tourism-related activities amounted to the equivalent of USD 876 in 2004. This is a considerable amount
for a household’s income in the Bhutanese rural context. They stated that this is the result of the trickle-down effects by selling local produce of various types and the provision of services\(^{58}\). However, they do not specify the areas in which their household survey (N=97) took place.

Overall, the patterns identified by Rinzin et al. (2007) are not questioned. Their results show that tourism has the potential to stimulate private sector growth by producing linkages in related service sectors and to transform the rural economy (p.1). Yet, they provide no evidence of how the sector is growing or of this “transition” among the households interviewed or recommendations to eventually strengthen this potential. The conclusions provide a list of positive aspects associated with the process of “controlled liberalization”\(^{59}\), praising the tariff system (ibid). There is no mention of the need for upgrading legislation, or for a proper destination management and planning, or a more systematic development of local clusters to improve linkages with the local economy (enabling processes of upgrading using tourism as leverage for example) or a proper local governance for tourism destinations, despite they identify challenges\(^{60}\) that are valid still today (regional imbalances, seasonality, development of new routes and the necessity to increasing accessibility).

Brunet et al. (2001) was critical in highlighting limitations in the regulation as well as in implementation and planning of sustainable tourism destinations in Bhutan and the “threat” coming from the possible uncontrolled in-flow of regional tourists that could jeopardize the efforts of the policy intention (maximisation of economic benefit – mainly used for macroeconomic stabilisation purposes - protection of culture and environment through demand “skimming”). They also considered the challenges derived mainly by the need to rely upon western-based technical knowledge.

There is not much doubt that channelling tourism’s revenues in the way it has been done so far have turned tourism in a useful macroeconomic tool for the accumulation of valuable currency. How tourism benefits spread into the

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\(^{58}\) The amount is calculated by adding the average annual income from the hiring of horses and yaks equivalent to USD 527 per family and USD 298 from porter charges (Rinzin et al. 2007, p.118).

\(^{59}\) As defined by the Authors “Liberalized because it aims to contribute to the socio-economic development of a free private sector; and controlled because it is intended to prevent negative impacts on the unique nature and culture of the country” (p.123).

\(^{60}\) The discussion with government officials reported at p.122 shows how things have changed little and the problems that were identified back in 2005 are still discussed at government level.
economy to help sustaining poverty reduction and how tourism can be used for a more inclusive economic growth, is something that needs to be explored more closely. The current system acts *de facto* as capital controls, with dollars earned through the sale of package-tours exchanged in Ngultrums, a currency that can only be used within the country. Redistribution, poverty reduction or inclusive development seems to be assured through the contribution of tourism earnings to the financing and delivery of public services.

Yet, most of the literature (particularly Nyaupane & Timothy, 2010 on power and regionalism and Gurung and Seeland, 2011 and 2008 on livelihoods) highlighted some negative impacts that the tariff produce for broader economic participation given that the tariff favour market dominance of tour operators in the tourists’ trade. Certainly, Rinzin et al. (2007) is more positive on the role of the tariff in redistributing the benefits and encourage economic participation. Rinzin et al. (2007) and Gurung and Seeland (2011) show a considerable impact of the “trickle-down effect” of tourism in rural Bhutan despite the tariff, but there were no attempts to look at how these mechanisms of participation in tourism operate and a clear picture on how the policy instruments complement or clash with each other to make tourism more inclusive is also missing. These contrasting views are not straightforward and they need to be analysed against Government priorities and capabilities, given its omnipresence.

**The “tariff” system as a productive policy**

The tariff system in tourism has been strategic in a number of ways. The royalty system (a percentage of the tariff) has ensured a contribution to the capability of the Government to deliver key services. The State has used the royalty as a redistributive mechanism to make tourism an important contributor to Bhutan’s development trajectory and to macroeconomic stability. Yet, the tariff system can also be considered the instrument through which the Government stimulated private sector growth, enabling a “discovery process” of the underlying costs and opportunities to venture in a non-traditional activity like tourism. The know-how related to tourism was unfamiliar until the 1980s. As

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61 The process of experimenting new products or processes, “discovering” that a certain good, already well established in world markets, can be produced at home successfully (Rodrik, 2004).
such the Government through its state-owned monopoly enterprise was the first economic actor to venture into tourism.

There are features of the current tariff and industry set-up that reflects Rodrik’ framework on industrial policies. Rodrik, (2004) considers two key elements that influence the incentives for productive diversification: *information externalities* and *coordination externalities*. The State entity acting as the entrepreneur bridged the information externalities and allowed imitative entry through managerial and labour turnovers⁶² (they will be documented in section 6.2 with trajectories of inclusion and upgrading from guides, hotels and tour-operators). This tariff is in fact still now a key mechanism that enables the industry to growth.

The overall concept expressed by Rodrik is that once the industry is established by the State (in the case of Bhutan, this was done with the Bhutan Tourism Corporation) the number of players will take-off if the early investments pay-off. The information externalities associated with the underlying cost structures and knowledge of starting an entrepreneurial activity in tourism were lifted by the state monopoly with little risk for the Bhutanese entrepreneurs.

In this context, the tariff system still acts as trade protection (or export subsidy) and keep the revenues artificially high facilitating the process of discovery (through trial and error by entrepreneurs of various types). In fact, Bhutan tourism exhibit high productivity compared to other sectors of the economy. The tariff allows rents for entrepreneurs providing above-normal profits to those who try and are successful in venturing into tourism.

Conditionality and monitoring of rents allocation is a key element in using these strategies and this links to the third strategic objective, which is the potential for the “tariff” to promote high-value tourism and upgrading. The current tariff system has only a few rules. Tourism actors are required to maintain high-end targets. In theory, the rents obtained by entrepreneurs are given “in exchange” of targeting trade of high-end tourists’ and this is also conditional to the provision of quality services. For example, following government regulations, tourists need to be hosted in hotels with 3 stars and above matching international standards. Tour operators should be able to target

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⁶² Ex government officials were among the first entrepreneurs in tourism. Some of the guides working for the State own tour operator also were among the first entrepreneurs in tourism.
a demand that is willing to pay the tour package minimum price of USD 250 a
day (USD200 in low season). In addition tour operators need to use highly
qualified guides and provide quality services. In theory, this should engage the
industry in a virtuous cycle of upgrading, ranging from investments to labour
markets.

The other element that Rodrik considers is the coordination externality.
“The coordination failure model places a premium on the ability to coordinate
the investment and production decisions of different entrepreneurs” (Rodrik
2004, p.13). To be profitable and to avoid economic leakages tourism requires
simultaneous upstream and downstream linkages and sometimes large-scale
investments. In fact, tourism uses generic (i.e. hospitals, roads, airports) and
specific (i.e. hotels, restaurants, parks) infrastructures and it is served by
different industries, which makes the ability to coordinate investment and
production decisions of different entrepreneurs, a key aspect.

In general, Rodrik considers coordination and deliberation councils an
effective institutional setting to develop such coordination capacity (Rodrik,
2004, p.27). The success of industrial or productive policies often depends on
the presence of high-level political support. The Tourism Council of Bhutan’s
organisational structure is therefore very promising as being chaired by the
Prime Minister should signal a credible commitment to the industry. However,
stakeholders’ comments show that this is not guarantee of a smooth
collaboration with the private sector or an effective response to problems.

Operator#5 reflecting on the evolution of the TCB “those days it was easy
to do and to get licenses and policies were already made; we were also making
the policies. Government used to consult us and we gave feedback. It was not
very difficult those days...” and referring to TCB now “the structure is good, TCB
chairman is Prime Minister and then there is Department of Forest member on
the Board there is the Ministry of Home Affairs in charge of local governments
and districts are also on the Board. Basically if you see the TCB Board
composition you will understand from there that they made it to benefit the local
governments, the local people, community tourism and all that, so there are
people from forest, home, agriculture, ABTO, Guide Association, Druk Air, Hotel
Association... All on the board of TCB... so it’s supposed to work very well”.
However, he also points out how good coordination depends on the Prime Minister who ultimately chairs the organization. He noted that with the first Prime Minister was difficult to hold regular meetings. He added “The new Prime Minister seems to be more available to the public. The other was senior and not very available”. About the TCB he argues that it needs to be managed by a director general or an expert manager, he added “… name is very important here [in Bhutan], we are a small society and people look at that so we need to make the TCB stronger and hopefully this Government will do this now. It is just the second month, there is so much to do but we have to tell the Government to look at tourism and if it’s of interest to them and if they are serious then they have to [resolve] fast some of these policy issues”.

The parliamentary Committee on Economic Affairs (EAC) recently invited stakeholders’ associations and the TCB to give presentations during different sessions. The media reported that these meetings were conducted to encourage brainstorming on key issues regarding the tourism policy (norms for policy approval, legitimacy of the policy, royalty and policy reform, bottlenecks, pricing modality, the illegal undercutting of the tariff, promotional initiative, construction of basic amenities and their management and promotion of tourism in less served destinations). These directives were given by the Parliament that during the 22nd plenary meeting required the EAC to conduct various stakeholder meetings and present a report in front of the Parliament in November 2015 (Dema, 2015a).

MPs are pressured from parts of the society to eliminate the tariff and thereby reduce the perceived market dominance of tour operators. Stakeholders’ associations and the Bhutanese Chamber of Commerce in particular sustained this position with a proposal to eliminate the tariff (so to eliminate this perceived dominance) arguing in favour of maintaining just the royalty for the Government (Lamsang, 2015).

All this raises the question on whether the actual system of rent allocation is perceived as transparent. Rodrik argues that the system of rent allocation associated with growth strategies need to be perceived “to expand opportunities for all, rather than as giveaways to already privileged sections of the economy” (Rodrik, 2004, p. 20). As it will be shown in 6.2 rents allocation and their monitoring, need to be applied in a more transparent and systematic way. The
Government has made it very easy to get licences and to operate under the “protection” of the tariff. Nonetheless, the problem of lack of enforcement particularly against malpractices (such as illegal undercutting of the tariff, which is the illegal practice of providing package tours below the minimum daily tariff to international tour operators) and other related to the delivery of services from the private sector, as well as lack of coordination among stakeholders, contributes to negative perceptions of corruption and favouritism.

The following sections will show how and why consultations and coordination with the Tourism Council as well as policy processes have proved to be quite confrontational in recent times. They also represent the never ending dilemma for Bhutan to whether and how modernise the tourism sector.

**Policy and legislative frameworks**

The guiding principle “high-value, low-impact” is the visible aspect associated with the functioning of the tourism sector. In practice, however, the primary (and solely) governing tool for tourism remain the daily tariff system and the regulations associated with it that has not substantially changed since it was first described by Smith back in the 1980s. All academic studies about Bhutan consider that the “high-value; low-impact” policy intention has been embraced by tourism stakeholders in different but consistent ways (e.g. Brunet et al., 2001 and Schroeder, 2014).

Inclusive growth is a terminology that appears in key official documents. The 11th Five Year plan’s title is *Self-reliance and Inclusive Green Socio-economic Development,*

> “Self-Reliance is defined as being able to meet all of our national development needs as articulated through our Five Year Plans by 2020. Inclusive Social Development requires reducing poverty and inequality by enhancing the standard of living and the quality of life of the most vulnerable sections of our society. Green Development means ensuring carbon neutral development at all times” (GNHC, 2013, p. 13).
In the latest two five year plans tourism and eco-tourism have been included as key elements to reduce poverty. Particularly the current plan (July 2013-June 2018) the Government identified tourism as one of the priority sectors under Rapid Investments in Selected Enterprises (RISE) programme. Under this programme, “selected initiatives that contribute to achieving higher yields per tourist as well as double the arrivals but spread throughout the country and throughout the calendar year will be defined and implementation of these initiatives closely monitored” (GNHC, 2013, p.178)

This shows the willingness of the Government to keep targeting the high-end market but at the same time looking for investments that would benefits other parts of the Country and not just the current tourism hubs. “Diversification of the economy to reduce economic vulnerability and absorb a growing and increasingly educated labour force” are also compelling priorities (GNHC, 2013, p.4).

Furthermore, the recent crisis of rupees caused by uncontrolled imports and borrowings briefly outlined above and in chapter 5, brought back the central role of agriculture for self-sufficiency, resilience and vulnerability (ADB, 2015). Young educated people can play a significant role in modernising the agricultural sector. Tourism can also provide viable entrepreneurial ideas especially for educated young people in rural areas. Specifically in the tourism sector the key strategies of the 11th five year plan are regional spread, seasonality reduction and community participation (GNHC, 2013, p.18).

Therefore, the policy framework reveals tourism’s cross-cutting characteristics and as such the need of a coordinated implementation of policies designed for other sectors. They all - at least on paper – influence each other functioning and the functioning of tourism. In Appendix – E are indicated some selected policies aiming at directing, developing and supporting tourism in Bhutan. The Economic Development Policy is the core element and includes references to other policy including the tourism policy which have been in the draft stage for more than 10 years. The main themes emerging include macroeconomic stability but also the strengthening of the private sector. Private sector development, rapid and sustained economic growth are central objectives of the Economic Development Policy.
The key messages that can be extrapolated from the policies commented in Appendix – E in relation to tourism can be divided into two strands: 1. Tourism should be fostered by attracting substantial FDI with the objective to augment productive capabilities. The policy also foreseen performance requirements on investors to upgrade domestic skills, create value-addition and favour technology and knowledge transfers; 2. Policies also favour small scale domestic investments at the “bottom” of the tourism value chain, particularly for their potential pro-poor and inclusive effects and to favour a culture of entrepreneurship and formality in business venture. However, it is not clear what the development of tourism to meet “minimum standards” means for community ventures for example. If also the small scale domestic investments need to comply with the international standards, entrepreneurs in rural areas will have to invest considerable amount of financial resources to meet those requirements.

Yet, recent data from the Department of Cottage and Small Industry shows that between 2013 and 2014 there was a “boom” of new registrations of cottage and small industries (from 12,000 in 2013 to 15,000 in 2014). More than 2,600 licenses were issued in 2014 with a great majority of the licenses issued for the service category in tourism and hotel industries (BBS, 2015). The “communitarian” approach is also encouraged in the EDP. Few initiatives have been piloted mostly pushed by international donors. As such an informal talk with a Government official highlighted how communitarian approaches to tourism was driven by donors, particularly SNV (which phased-out the programme on tourism and poverty reduction globally) and more recently by JICA.

The element missing in the policy framework is the tourism policy. It is foreseen by the EDP but not yet approved. With it, the tourism bill is also missing (there is no legislation in Bhutan for tourism despite being an important industry) and as such the Tourism Council is not yet fully legitimised as a statutory body. Despite various forms of technical assistance that provided a master plan in 2005, an industry and eco-tourism strategies in 2011 and 2012 respectively, there is a strong level of institutional uncertainty and void.

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The main operating legislative framework goes back to 1996 (trekking in Bhutan, rules and regulations) and 1999 (rules and regulations for tour operations) that have been very recently integrated into a single legislative piece (see the following section). The clash with these rules has made it difficult to involve rural communities more broadly and directly. The regulations attached to the tariff system in fact, foreseen that the tourism experience should be “high-end”, complying with international standards. Targeting high-end tourism market make it difficult to include any form of rural tourism based on farmhouses, home-stay and it also make difficult for local communitarian experiences to link with rich segments of the tourism demand and for small local service providers to emerge on a side to the core industry. To these, the legislation associated with the environmental stewardship of Bhutan represents an additional constraint to economic diversification particularly in rural areas.

Nonetheless, initiatives are often pushed by entrepreneurs or by different government agencies, taking advantage of contrasting legislation. Frustration was expressed recently by the director of the tourism council (TCB) on an interview in the national press, she said “for instance, [the Department of] Parks [was] developing homestays, while some agencies have introduced *bed and breakfast* for tourists. This is a challenge for us, as it contradicts the policy of Bhutan as a high-end destination. Such duplication of efforts could lead to issues in future” (Dema, 2015b, p. 1).

**The policy process**

A key aspect in the governance analysis is the policy process and the power constellation that influences that process. Participation in decision-making is also an important aspect for social and economic inclusion. The studies of Schroeder (2014 and 2015) examine how multiple state and non-state governance actors with potentially divergent interests influence the policy process and consequently outcomes in tourism.

Interestingly, Schroeder (2014) states that the evolution of the tourism industry and the change in governance structures with the increased number of players, have witnessed clashes that “have demonstrated some fracturing within the Bhutanese state and an ability of tourism governance actors from the private sector and civil society to influence the nature of policy implementation”
(Ibid, 2014, p.160). Furthermore, for Schroeder (2015) the TCB represents an institutional innovation that should help to democratis the decision-making process in the industry.

He identifies two levels of interaction for policy process: 1. Sub-National Governments and 2. Non-State Actors and Tourism Policy. The direct participation of the Dzongkhag in the identification of development priorities does not eliminate the strong control of the central Government. Through the five year programming every Dzongkhag has to set targets in every sector in accordance with national development objectives. In tourism particularly, Dzongakhags can decide to develop certain infrastructure but they will have to coordinate with the TCB in all aspect related to it, including design, approval, financing and implementation.

The analysis of Schroeder (both 2014 and 2015) evidenced how the lack of coordination between the different levels of the Government in the tourism development effort and the competing priorities between the private sector and the Government, have so far met the policy intention notwithstanding, arguing that:

"The implementation of Bhutanese tourism policy is characterized by diverse and unexpected applications of power by multiple policy stakeholders. These complex power dynamics are not shaped in a meaningful way by the GNH governance instruments. Nor are they rooted in a common understanding of GNH itself. While this situation should subvert sustainable tourism policy, a commitment among state and non-state governance actors to a common set of Buddhist-infused cultural values shapes and constrains policy actions in a manner that promotes sustainable tourism outcomes" (Schroeder, 2015, p. 16616).

He suggests therefore that cultural values and some level of awareness about the negative impacts of tourism are key components that have sustained the success of the policy in maintaining an equilibrium between the environmental, cultural and the economic spheres (not far from the finding of Brunet et al. in 2001).
Nonetheless, it seems that the institutional void associated with tourism is the consequence of the lack of direction for the industry and the increased conflicting interests between central, local administrations and the private sector. The current policy and regulation have been under revision for years. Only recently there has been an attempt to revised rules and regulation by incorporating the separated pieces of legislation (associated with tour operators and trekking cited above) to provide a coherent framework, with TCB being able to centralise and control licencing and enforce regulations by issuing penalties or suspending and cancel licenses (Dema, 2015c).

Tourism decision-making processes however, are more and more confrontational between a growing (and more critical) private sector and decentralised organisations that compete for a limited market, and a bureaucratic apparatus that is supposed to work closely with the industry but seems to lack efficiency and efficacy in doing so (further evidence will be provided in section 6.2 and 6.2.4). The Government has not been investing substantially in destination development and management and this emerges from the analysis of the interaction between local and central governments in the analysis provided by Schroeder (2015).

The institutional set-up of the TCB provide the potential for an active involvement of this organisation as a development agent in tourism (not just as a marketing organisation), and it should play a much central role accompanying changes through consultation, and by sustaining capability development of the industry at its various levels. Yet, the institutional void has made TCB reactive to the private sector as will be showed in section 6.2.

Furthermore, the lack of coordination seems endemic despite the forum that the TCB potentially offers. In the last 6 years the two democratic governments has made various attempts to experiment with the elimination of the tariff as a step to modernise the industry. The resistance of non-state actors have been high. Their representatives have recently accused the government of lack of coordination and consultation. Increasing promotional initiatives (where the tariff is eliminated or substantially reduced such as in the case of the Bhutan-Japan friendship offer in 2015 or the Bhutan-Korea friendship offer in 2017) are perceived by the private sector as “Trojan horses” to start a complete liberalisation (e.g. Dorji, 2015)
While some private actors welcome the initiatives (and also advocate for a full liberalisation) to reduce seasonality and increase occupancy for hotels, these experiments are widely perceived as counterproductive. Some argued that by deciding this unilaterally, the Government alimented conflicts over pricing and programming with international business partners, who are now increasingly pushing for lower prices, while implementation of key projects remain side-lined (see for example Dema, 2016 and Dema, 2017).

Articles in the national press on the evolution of the current policy in tourism, show that the situation has been confrontational between the private sector, accusing the current Prime Minister and the Government of lacking attention to compelling problems, with a lack of periodic consultations as well as lack of action on issues in which agreements were already achieved, while the Prime Minister defends the initiatives taken, the frequency and adequacy of the meetings (Dema, 2016).

Despite the attempt from the EAC (mentioned above) for a comprehensive review that should have focused on the understanding of the root causes of the problems faced by different stakeholders in the tourism value chain, all the recent debates reported in the national press seem to be focused exclusively on the visible aspects: the tariff and the royalty systems, the pressure from the Indian market, the presumed dominance of national tour operators, the problem of undercutting by private agents and the urgency for hoteliers to recover their high fixed costs and investments.

A growing private sector is seen by Schroeder (2014) as a policy success that contributes to enhance economic opportunities. Schroeder (2014) also considers “high-value low-impact” and the stringent rules and regulations associated as the main instrument for GNH, demonstrating “the ability of the Government to rebalance the economic with the cultural and environmental pillars of GNH” (p.155). Other authors, such as Phuntsho (2013) or Nyaupane and Timothy (2010), are more critical about this proliferation of acts, policies, rules and regulations. Phuntsho considers regulations as being the outcome of processes of democratization and devolution of power through democratization, but he questioned the capacity of the public organizations to enforce an intricate framework of rules (see Phuntsho, 2013, p.594).
It is therefore important to understand how the “tariff” and its related rules and regulations, affect the Bhutanese tourism industry and the coordination among tourism actors particularly *vis a vis* key policy priorities such as economic inclusion. The analysis in 6.2 will explore “the intrinsic characteristics of the economic processes” (as defined in Ramos and Ranieri, 2013) to understand the mechanisms associated with economic inclusion and upgrading in the tourism industry.

### 6.2 Coordination among actors: economic participation and upgrading

“*[F]ormal rules... make up a small... part of the sum of constraints that shape choices;... the governing structure is overwhelmingly defined by codes of conduct, norms of behavior and conventions.*” (North, 1990, p. 36).

The previous session showed how policies are integrated in a policy framework driven by GNH. The economic development policy is the pivotal instrument that influences other policies and programmes with the objectives of creating sustainable and inclusive economic growth. It was also shown that the tourism policy has been in a drafting stage for a long time. So it has been the case for the conversion of TCB in a statutory body. At the moment the only visible part of the tourism policy remains the tariff system and the legislation associated with it, “inherited” from the first entrepreneurial “experiments” in tourism with a state enterprise.

As explained in the methodology, the units of analysis in this session are the commercial operations that would reveal the characteristics of exchange. The focus of the enquiry is the “quality” of the relationships that would allow an understanding of the “mechanisms” for inclusion, upgrading and ultimately broader processes of growth and diversification of the economic base. The attempt is to understand not only if, but how relationships and networks matter.
1. Trust as Governance

This is the overarching and most central theme. Trust underpins two relational categories: “Kinship” (family and close friendship) and “calculative” relationships (through reputation and referral, repeated interaction and use of hostage). They form networks of hybrid structures such as recurrent long-term relationships between autonomous economic actors; relational contracting and informal vertical and horizontal integration with different levels of autonomy in the case of kinship. Trust as governance mechanism is driven by high levels of transaction costs, product specificity (tourism tailor made tour package) and overpopulated markets. “Market imperfections” and the quality of formal institutions impact on the perceived risks associated with commercial operations (theme 2). The informal “internalisation” of activities through networks (or the formal integration) occurs to reduce coordination problems between activities that require different capabilities. Fears of opportunism and problem with employment leading to transaction costs are additional factors that justify the use trust as governing mechanisms. Excessive entry seems to be regulated by networks and trust seems to balance a market that is easy to enter, partially preventing a race to the bottom at least for those that are already consolidated operators. At the same time membership to a network might provide a mean to signal to potential customers that a firm is not a ‘fly-by-night’ operation. Networks can maintain certain standards and establish long-term relationships with suppliers and customers (including international partners) favouring upgrading. Opportunistic behaviours are becoming common as a mean of hanging-on in the immediate future, with adverse long-run consequences for the industry.

The following themes are linked to theme 1

2. Power Asymmetries with global markets and the problem of leakages

Undercutting on the tariff appears to be a common practice and it is illegal under current regulations. It seems to be driven by power asymmetries with international markets. This is impacting professionalism and it is jeopardising the objectives of the policy intention (maximise tourism earnings and stimulate upgrading). Nonetheless, if trust is built with international partners, international markets are more likely to favour upgrading and investments.
3. Role of formal institutions
Difficulty to up-date regulations, monitoring and enforce favours uncertainty. TCB has not been formalised as statutory body. Government agencies are open to problem solving but perceived to be too discretionary. Reactive measures are perceived as lacking of impartiality. Policy and legislative mismatch favour networks. The current system favour overpopulated markets.

4. Involvement of rural communities
Kinship link rural entrepreneurs and rural communities with the tourists’ trade - bridging social capital works through kinship. Yet opportunism is present to lower cost structures in tour packages. Chapter 7 will dig deeper on these mechanisms in rural areas. While referral and repeated interaction is also important in rural areas, kinship channels important resources that are vital to start-up and sustain business ideas.

Source: own elaboration based on primary data. The flowchart indicates the context-mechanism-outcome (CMO) configuration that is used as the main structure for realist analysis. The actors and the policies are considered to be embedded in a social reality that influences how actors implement and respond to policies (Marchal et al., 2012).

6.2.1 Theme 1: Trust as governance

Trust among Bhutanese core tourism actors
In explaining its commercial relationships in the country and referring to partnerships between hoteliers and tour operators for setting-up itineraries and tourism products operator #5 stated “just now we all stand alone. It is difficult to trust… [for example] I am a village hotelier and you are a tour operator, the moment you approach me to do something with me, a partnership… I immediately start thinking ‘oh is more educated and experienced than me he will take advantage of me hence I am better remaining by myself’, so things like this are there so [partnerships are] not happening”. However, operator #5 highlighted how their reputation facilitated the creation of various forms of partnerships. Talking about one of the partnerships in place with hoteliers in the countryside, he stated: “…the villagers… they gave us one acre of land, and those days they ask us to buy out and it was just XXXX local Ngultrums. So we said ‘no, don’t sell it to us, remain our partner, keep your land we will build, own, operate’ and during the time we operated we gave him XXpercent of the profit and after six years we transferred it to them because they were able to buy us out”. This particular company seemed to have followed this practice in different locations of the country, and the interviewee stated that this represented a form of corporate social responsibility. By referring to their experience in managing this type of partnership in other parts of Bhutan Operator #5 added “it is very important to go there, experience it, operate and
give it to our partners and then they are forever grateful with you. The moment we want something out of them they always help because we built that in the village”.

Yet, further interviews with two of the beneficiaries mentioned by operator #5 revealed family ties. In this framework (and based on how these two actors reported their own operations and experiences), they manage their business as a sort of informal vertical and horizontal integrated company (hotels + tour operator and other complementary businesses) in which the ownership remains completely independent but some operations (e.g. marketing) and the systematic inclusion in complex tour packages are centralised by the more experienced and consolidated operator (in this case operator #5), who also manage a centralised bookings for them. Furthermore, different members of the family manage the different business units.

In this specific case chain (from agricultural livelihoods to tourism) and functional upgrading in the tourism value chain could be observed. In fact, through kinship ties a household in this particular network managed to turn their activities into tourism and become a successful company. This was reported by hotelier #6, who now owns various forms of accommodations in urban and rural areas and also more recently launched a tour operator.

New projects involving rural communities in East Bhutan from the same operator #5 revealed a similar pattern based on linkages with ancestral communities. Furthermore, this particular operator also stressed its willingness to keep targeting the up-market “…we consider ourselves a little different, because eventually if the market opens up we want to be labelled as a tour company that deals with only high-end tourists. Our company is not looking for numbers; we are looking for quality and number of nights”.

The story above is probably an extreme case in terms of scale of operations (the company is in fact, among the most consolidated in Bhutan and it integrates different business units) but similar underlining dynamics are either reported by or have similar patterns among those interviewed. Furthermore, by being a big player and by harnessing market power the company should have been able to do more arm’s length operations. However, targeting high-end markets, which is what the Bhutanese tariff system encourages to do, requires a high capacity to deliver quality services which are also naturally
“simultaneous-to-production” hence requiring high capacity of coordination and delivery.

Therefore, the characteristics of tourism products in Bhutan can be associated with product specificity, at the basis of transaction costs. Tadelis and Williamson (2012) consider high product specificity when “the asset employed for production cannot be redeployed to alternative uses or users without loss of productive value” (p.10). This seems to be very relevant for the tourism industries. In the Bhutanese context where tailor-made travel services and word-of-mouth marketing are vital, impacts on reputation matter a great deal considering that an “asset can be also the brand name capital not only physical assets” (ibid, p.22).

Furthermore, transactions are embedded in a social context where the level of trust between economic actors is a determinant of the perceived risk of opportunism. This influences decisions on the governance structure (Chiles and McMackin, 1996). They argue that “hybrid structures entail recurrent, long-term relations between autonomous economic actors where non trivial specific assets are involved” (p.89). However, in the presence of trust, hybrid structures can sustain “transaction-specific assets” that in the absence of trust would normally be driven by hierarchical structures (ibid). As explained by Ring and Van de Ven (1992 p.491 cited by Chiles and McMackin, 1996, p.89), the recurrent and relational contracting is a structure where “trust is the principal mode of social control”. Furthermore, Granovetter (1985) views economic actor as embedded in personal relations and networks that generate trust and constrain opportunism. He argues that hybrid governance structure could even be superior to hierarchical structure in generating trust and discouraging opportunism. On the same lines Earl and Potts (2011, p. 11) noted how the “hybrid forms” in Williamson theory remained confined around contract such as joint venture or franchising (e.g. Tadelis and Williamson, 2012, p. 36), but does not expand into the territory of “relational contracting”, “implicit contracts” or “vertical quasi-integration”.

64 In general, this is the nature of the tourism product because consumption cannot be separated from production.
65 This view is very different from the concept of “credible commitment” underpinning hybrid governance that see the use of “hostage” as deterrent to defection in Tadelis & Williamson (2012). In this case credible commitment is signalled by the quality of the relationship.
The Bhutanese tourism context favours almost exclusively “tailor-made” travels. This makes coordination between actors that make-up the tourism experience an essential component to avoid cancellations, overbookings, to control adaptation to market requirements and clients’ requests, and the proper and up-to-standard delivery of services that otherwise could back-fire on reputation, generating penalty fees with international partners and loss of vital tourists’ trade.

Overall, the objective of economic actors is the tourist satisfaction and to limit transaction costs in the absent of fully developed formal institutions and professionalism in the value chain. In this way actors try to overcome difficulties by relying on quick adaptation and minimising negative outcomes. Hybrid (particular relational contracting or quasi-vertical integration) or hierarchical governance structures (if the company is big enough to acquire backward and upward or even horizontal business units) become the rule and not the exception in the Bhutanese context given the fear of opportunism and transaction costs.

Hotel #7 an independent hotel talking about business models stated “we are completely independent, sometimes it makes things a little bit more difficult because other hotels in Bhutan in our categories that have two or more lodges have started to own tour operating business and we kind of understand now why… there is over a thousand [tour operators] and of course it becomes horrifically competitive”.

Hotel #4 effectively indicates the implications for both the demand and the supply side of the package tours in Bhutan and the little choice that is left to tourists. He stated “you will be taken from point A to B and your whole day is coordinated; [there] is not much left for exploration”. Package tours in Bhutan leave little room for the consumer to make choices and for other suppliers outside established networks to eventually benefit from tourists’ spending. Clearly, a closed and cohesive system like this is less likely to produce transaction costs as tourism actors tend to do business with those who they trust the most which also help to contain opportunism and possibly retain value-addition. As stated by Operator #9 “tour operators had been originally tourist guides and many of them had been suspected of stealing groups from their previous employers or previous companies”.

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Operator #8 talking about the selection of national providers stated “Bhutan is a small community… when you get down to your contacts you find out that - oh he is my relative from this side or that side - so you always get this plus points….”. The “plus points” is trust, and particularly the predilection to “assume the best” when it comes to ties characterised by kinship.

In the composition of package tours, reputation turns to be also very important and operates in parallel with kinship mechanisms. Operator #8, expanding on its answer stated “… and of course feedback from the guides are always welcome, they always get back to us saying this restaurant is good, they do this, they do that… they come back and tell us ok let’s not use that restaurant anymore, very dirty [or the] manager is not very helpful and we had a bad experience so then we stop using those services. But we depend a lot on the guides as well as our contacts”.

Therefore, in less embedded networks reputation is an important control instrument and an enabler for business relationships. Formal contracts are used but are framed on a word-of-mouth mechanism in which reputation and networks can play the role of entry barriers in an industry that normally is considered to have very low barriers to entry.

Responding to the question on the criteria to select service providers, operator #5 stated that selection “depend[s] on the commitment they can make, depending on who they are first, how reliable they are and what kind of commitment they have with us and it depends when new draw commitments with them, how long they can help us, if it’s for shorter period or if it’s for longer period, if it’s for medium period. Those are very important and the prices are also determined” and making an example about guides “[I employ] 18 of them, all over the year we have some freelance who freelance exclusively with us and they are also on a selective basis because it depends in their interest… first we look at whether we can trust them whether they can adapt to the innovation we do want to see, those are important factors”. He added “referral is very important in Bhutan” and again “fortunately Bhutan being such small society everyone knows everybody through somebody or the other… contracts and relationship development are very important, we do that with the horse contractors, the yak contractors, transport contractors, we have to develop contracts, because we have a saying in Bhutanese that what is unpleasant
should be said in the beginning, the pleasant thing should be left at the end so no matter who we develop relationship with we go hard with them we go direct with them and develop the contracts”.

Operator #8 mentioned two aspects related to trust and repeated interaction. To the question about the way in which they negotiate the prices with their providers responded “if you give them good enough business to sustain themselves throughout the year then they generally come back to you - ok you are doing this with us we will offer you this much percent discount. So it is very important - I learned this very late but now I know - you need to nurture and work with set of companies that you are able to get that preference. Otherwise it’s crazy during peak season like they won’t even pick up the phone”. The same mechanism has been reported by other operators for freelance guides, hotels and restaurants as well as other business such as handicraft (e.g. Operator #5 or #3 reported the same about contracts, repeated interactions and long-term relationships).

**Payments and professionalism: a pervasive problem**

Payments are a common problem among all actors in the national tourism value chain. From the interviews and observations payment problems seems to be endemic. All actors interviewed underpin their search for providers, employers or employees that are able to deliver (professionalism) or that are less likely to default (with payments for example). In the search for these qualities, kinship, reputation and referral operate as a guarantee that those problems will not materialise. In fact, formal mechanisms such as contracts are not enough as they are difficult to enforce. The TCB (and in general formal institutions) has a limited range of operations to resolve problems among actors (even though this seems to be evolving towards improving enforcement).

The payment problem among actors is inherently linked to the practice of “undercutting”, (international tourists channelled through international tour operators pay the established fees and are often unaware of this practice; however, undercutting can potentially be practiced also with direct clients). These practices will be explained in further details in 6.2.2. Prices of services providers are defined around this minimum tariff and therefore undercutting impacts not only on the quality of the services offered, but also on the capacity
of the economic actors to honour their payments. However, the direct victim of asymmetric information related to the functioning of the daily tariff system it is often the final client.

Hotel #5 highlighted the problem of the payments as did many others hoteliers and guides. However, he further emphasised how the problem is typically Bhutanese. In fact, Indian and international tour operators pay their fees in advance (either the tour package or the hotel reservation – the latter in the specific case of Indian tour operators). For hoteliers overcoming the payment problem is relatively simple. Hotel #2 talks about trust between consolidated operators. While they make discounts to the more consolidated and reliable relationships (up to 20 percent on the price of the room) based on their reputation and repeated interaction, they require new entrants to make advanced payment for the whole value of the booking. Even if this hotel is part of a big Bhutanese company – implying that they can also be selective in their choice of clients and providers – other interviews reveal that is a widespread practice also among recently open hotels. Expatriate hotel managers highlighted the same problem with payments that can be delay for more than 90 days and trust, reputation and networks of reliable suppliers are essential measures to face this problem (Hotel #3).

An example from a recently opened hotel shows particularly how use of hostage is at work in non-embedded relationships. Hotel #4 gives discount to attract business by keeping the rates 15 percent below the market rate for its category. However, the way in which they manage their commercial relationships is through reputation and when reputation is not present use of hostage is required: “right now we don’t really have a major partner because we are like a small hotel with 35 rooms and for that we work with almost all tour operators and we keep our rooms open so we don’t have like blocked rooms. We work with all kinds of tour operators who are new but we do have policy, if you are a new tour operator we take like 100 percent advance or 50 percent advance if you haven’t been with us before. So we don’t have partners in deals. Like I said the number of rooms is very limited and we can’t afford [to block the rooms]; we work [with] very competitive rates... [However] to enter the market it’s all about the network and all here. When we started we didn’t really have a selection, we tried to take as many as we can and then when we grew as a
hotel we found out that who are bad defaulters, who are bad creditors, so according to that we filtered it out”. Talking about how they cope with the payment problems, they commented “we have to sometimes withdraw from my own bank accounts extra and maybe cover it up later on when we get the payments so I think that’s how we cover it up”. This of course can have implications also on internal management practices such as staff relationship and payments of salaries and suppliers.

Hoteliers are those more affected by payments has they have to recover fixed-costs of investments in infrastructure, but also guides are affected and they adopt strategies that are also underpinned by referral and reputation. A junior female Guide #2 “[tour operator] will contact me but even if they contact me also I choose the best travel agency, because to be frank there are lots of travel agents also. Some are very good, some are not" the criteria that integrate the choice are payment and commitment to deliver quality services. If tour operators are not committed will leave the management of the group to the guide alone “some travel agents are like… if we can’t solve a problem, they do, they do everything ... but [with] some travel agents it’s not worth to work because they receive the money and they don’t do anything”. Regarding payments guide #3 “we make sure we don’t work with the companies they don’t pay like they say ‘we’ll give you thousand per day’ but they go on postponing… even after one year you don’t get your payment. There are some companies they don’t pay in time…. Because like you know once we experience and then we spread the word, ‘don’t work with this company. They keep on pending’. Either we go and ask for the money first and then we work, otherwise they don’t pay us.”

A practice that emerges in the hotel sector from the statement above and also evidenced by other interviewees is that tour operators try to secure rooms for a certain amount through allotment contracts normally to lower costs. This is a very common practice in the hotel and airline sectors worldwide. However, in Bhutan this works in two ways. Indian on-line travel companies require Bhutanese hoteliers to provide a certain number of rooms so they can be available on their online reservation systems and can be managed in real-time. This system works well with Indian tourists that can travel freely and that can travel in low season when the occupancy rates are low. However, with
international tourists (the more profitable segment of the tourists’ trade) that are only channelled through Bhutanese tour operators, the main motivation from national tour operators to push for allotment contracts is to overcome overbookings and cancellations during high season.

Tour operators also have their view in these matters. Operator #7 who is specialised in small groups when asked about problems with national partners “...sometimes hotels mess-up our booking, and like when clients check-in there is no room… and if there is enough hotels in the area you can say - okay please we will upgrade you to the next hotel in a deluxe room - but if there is no next hotel, [if] this is the only hotel in the particular place so then we have tough time”. However, hoteliers are reluctant to block rooms during the high season. Hoteliers in high season have a strong leverage. Without cancellation policy or regulation associated, they can cancel bookings for smaller groups to favour bigger ones even if rooms have been booked in advance, showing opportunism. This also shows how they retain certain bargaining power despite an apparent less favourable position compared to tour operators.

Operator #9 stated “as a tour operator I think it is uttermost importance for you to have your own accommodation because your visitors come in the peak season and at that time if you don’t want to get yourself in trouble you got to have your own, so that is one of the reason why I am thinking of setting up my own. Economically not very viable but it is easy to do business if I have my own accommodation”. This demonstrates the reasoning behind forms of vertical integration or quasi-hierarchical or relational contracting.

Transaction costs are also associated with labour market. Actors reported problems related to high turn-over, lack of specialised skills that entrepreneurs need to fill with in-house trainings. This also drives entrepreneurs to favour relatives as a strategy to ensure less turn-over, leveraging on norms of reciprocity and ensuring that the investment in trainings and in knowledge stay within the company. This dynamics will be further explained in the section related to copy-cat competition. However, this also influences inclusion/exclusion criteria from quality jobs creating a sort of ranking. For example, guides occupy a better position that hotel employees, as hotel employments are often perceived as low category jobs with potentially lower exposure depending on the functions.
Guides may be contracted or be free-lance but despite controversies on payments and working condition they all have some level of exposure that could favour upgrading. Furthermore, the GAB association is an important forum for them to speak-up about problems in the sector. Some evidence shows that contracted guides or free-lance guides with exclusivity contracts might have better position than free-lance or occasional guides. Guide #1 considers undercutting one of the reasons why guides are not paid well. However this might be a problem for less embedded ties, particularly for people that do not belong to consolidated networks. Anecdotal evidence show that unskilled hotel employees might be subject to harder conditions and treatments hence high turnover is often reported despite the MoLHR interventions with subsidies for first-time employment and training programs, and the role of the TCB in provide basic skills through the hotel school.

**Prices are limited devices to signal quality and to coordinate economic exchange**

Bhutanese tour operators commit themselves to provide quality services to their international counterparts. Following the study of Uzzi (1997), embeddedness helps solving allocation problems by enabling firms to match product designs and production levels more closely to consumer preferences than is possible in a market governed by the price system. He argues that when the price system operates there is a lag between the market’s response and producers’ adjustment. Dissimilarly, when relationships dominate, this lag is bridged more efficiently. This aspect can be particularly sensitive in tourism as the tourism experience is composed by services consumed in real time during production.

In the Bhutanese context it appears quite strongly that prices are limited devices for coordination especially when adjustment must be timely and coordinated. Networks of trusted providers work better than prices that do not signal quality levels. The capacities to work out problems “on-the-hoof” to match the expectation of international tour operators and international tourists, and managing uncertainty in the operations are central aspects to the ability to provide quality services that can require certain level of problem solving.

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66 Characterised by trust, problem solving and fine-grained information transfer (Uzzi, 1997).
For example, regarding restaurants and price negotiations operator #8 stated “… they need to tell us if this is the price they will give us the discount and then they should tell us well ahead what will include these items for you. But at the end when the group comes and you see that it’s different from what you used to get, then it becomes an issue. They need to tell us that this is what we are doing in order to cut down the price [and] that these are the services that we are not providing at the cost that we are providing it for you”.

The statement from a tour operator here has been selected purposely because they are central in the national tourism value chain to coordinate all other service providers. Yet, leveraging exclusively on prices can have adverse consequences even for them as the statement demonstrates. Price is not the most efficient way of coordination. Eventually more professionalism would overcome issues of up-to-standard delivery and drive more effective coordination, but currently trusted relationships seem to be the preference in an industry that is still developing.

Operator #8 talking about entrepreneurship in the tourism value chain “… we sub-contract treks. So we have good contractors who have good contacts with horsemen or camping gears or cooks or assistant. If we are not able to delegate our own team then we are able to sub-contract them to these contractors who take care of them and they have [been] very good. We are willing to pay for good services.” This statement also allows an important link to the concept of network formation that will be explained further below.

**Copy-cat competition and the use of fine-grained information**

Copy-cat behaviour is common among Bhutanese entrepreneurs and tourism is not immune. Hotel #2 talks about “monotonous” products. Many provide packages similar to each other. Operator #7 argues that “thousand tour operators are only selling two products - trekking and culture”. Without entering the details of the structural deficiencies that underpin the product characteristics, the relevant point here is that copy-cat behaviour enabled upgrading in the value chain. As such, at the same time it justifies the use of close networks that would not disclose important information. In fact, another way to measure asset or product specificity is the “degree of specialised but non patentable know-how” involved in production (see Chiles and McMackin,
1996, p. 74). In the Bhutanese context, this can be linked to both copy-cat and
the sharing of fine-grained information among Bhutanese actors.

Guides usually benefit enormously from acquiring experience, exposure,
business contacts, knowledge and skills. This provides the possibility to spot
opportunities and this is also valid for hoteliers that eventually can integrate
different business units. Overall, if tour operators are the actors that seem to be
the most privileged position in terms of value retention in the national tourism
value chain, their position is constantly challenged. Operator #9 stated how
many “tour operators had been originally tourists’ guides and many of them had
been suspected of stealing groups from their previous employers or previous
companies”. Actors acquiring other licences (particularly Tour Operating
licences) tend not to disclose this information for the fear of losing the possibility
to work with others that can support them throughout the year. Hotel #5 based
in one of the entry points to Bhutan works mostly with Indian tour operators and
it was in the process of getting upgraded from 2 to 3 stars so to get access to
international tourists and a richer market. However, the GM highlighted the
difficulty of getting partnerships with tour operators because - he claims - they
work with established networks and entry is not easy. Furthermore, he pointed
out how many hoteliers acquire tour operating licences in order to trade on
international tourists directly. At the same time new hoteliers fear to take-up
licenses so to not loose partners Hotel#1 “If I also have a travel agency most of
[the travel agencies] would not want to book in my hotel… [people would think] -
this is my guests and of course will give priority to my guests - [not] to their
guests”.

It was argued above that the dominance of tour operators is eventually
reduced because hoteliers and guides can overcome market power by easily
acquiring a tour operating licence. Combining licences supports the possibility
to gradually upgrade within the tourism value chain or provide chain upgrading
by shifting to niches for complementary services and products in the longer run.
This is positive overall but at the same time it creates a feeling of distrust as
ideas and ultimately clients can be easily “stolen” by competitors. The mobility
that is offered by the Government – through the opportunities to acquire
different kind of licences without major impediments – provides a link to another
important component identified by Uzzi (1997) that characterises embedded relationships: the use of fine-grained information.

Therefore, if transaction costs minimising provide the incentive for Bhutanese economic actors to use trust for governing their commercial relationships, the way these actors use fine-grained information provide the explanation of why “kinship” within the “trustworthy” relationships are preferred to those relationships underpinned by referral or reputation in the presence of small and over-populated markets.

For example guide #4 argues that “even if you are a very good professional” sometimes favouritism steps in and he argues “[If] I am a travel agent and a very good group is coming in, usually I [would] delegate duties to my cousin with the intention of getting him exposure, with the intention of making him famous, with the intention of making him get a lot of tips… and it is absolutely understandable… [There is] favouritism, I think particularly in travel agencies and sometimes that is a stumbling block”.

Thinking about national tour operators as bridges between international markets and the Bhutanese context would help explain these mechanisms. The “fine-grained information” as defined by Uzzi (1997) includes sensitive information such as strategies, business contacts, profit margins as well as tacit information acquired through learning-by-doing. This may include knowledge about preferences, feedback and problems recognition. All this provides opportunities for improvements, ideas for diversification and product innovation, leading to some level of competitive advantage.

This information and knowledge obtained through the close interaction with international partners might turn into competitive advantage in the presence of as yet not fully developed and diversified tourism products in the country. Bhutanese operators nurture this information and they rely on their networks inside the country to decide whether to pass it through or to turn it into improved or new products. Tight collaborations with agents or tour operators abroad can give a substantial help to generate competitiveness (this will be showed in 6.2.2 below). This information and knowledge sharing can also scale-up to more closed partnerships with international partners through join investments.
Operator #5 talking about the interaction they have with their partners abroad: “What we are today…, [is] because of our partners because they know more than us, they have been in business more than us, and we are new we are landlocked country so we don’t travel much we don’t have much exposure so whatever they tell us we listen to that and in the process we get improved”. Operator #8 referring to partners abroad “we have only few but they are very reliable and trustworthy, we have been working with them for two decades now so we are very comfortable with them” and regarding suggestions for tour packages “[We] customized itinerary so we need to work on that the travel company will tell us that we have a group of photographers so we work on our photography itinerary… So visits like that its always customized, we have a group and they mentioned that specialized group what would interest them more, so we work on that and we create those for them”.

The initial collaboration might not yield immediately the characteristics of trustworthy relationships but the nature of the almost tailor made package tour that is typical of Bhutan favour trustworthy relationships. Bhutanese tour operators know the importance of the word-of-mouth to consolidate partnerships (and good business contacts) or to secure new market shares in international markets. They try to establish “trusting” relationships abroad and they “listen carefully” what their international partners wish to improve in order to keep selling Bhutan. Managing the above interactions automatically requires “trust” to work within the country. This represents more than just economising on transaction costs, and trust acquires the form of a governance mechanism that can help protecting competitive advantages (similar to Dyer and Chu, 2003).

Operator #4 highlights how tourism demand from western countries can be a driver for upgrading. Expectations are higher from these source markets. In some cases the profile of the tourist requires specific services, and tour operators might prefer not to compromise on services quality if they are nurturing long-term relationships. Operator #5 says that international partners regularly help them with small improvements “those kinds of assistance [happen] regularly, not in a big way but in smaller ways. Supposing it’s a guide training we tell them so and so guides are exclusively picked for you, they chip in like for example we have something of the first respondent [aid] course,
responding to emergency calls, once every 2 years. While we give them food lodge accommodation and everything the international airfare, the people out there is send by our agency, they look for the people and that's how we partner”.

Operator #8 referring to the advantages of working with high-end markets “if you are able to maintain good contacts, it could lead to new projects, new businesses that you can bring into the country. And lot of these people already have their resources, they have their contacts they have ideas, they are looking for people who can execute them and Bhutan is very lucky to be so unique that people in general have a positive approach to it so it could lead that way”. Even though not all tour operators benefit the same way, this is a shared vision. Some also argue that Bhutan as a whole can benefit from people willing to work with Bhutan on the high-end market (operator #3).

These kinds of collaborations help maintaining the advantage against other national competitors. The way in which some operators would like to see competition in the country is related to this learning process and the creation of consolidated networks. “It should not be cut throat by giving Indian agents, Nepal agents, by giving them commission and getting business” operator #5 stated. But competition is quite intense and it is not based necessarily on quality. Even if the tariff system still provides some protection against competition strongly based on prices, operator #8 underline that undercutting is there and “it’s something that a business has to do, and if you want to grow you need to do as long as you don’t get into huge [debts]”.

Outside of kinship networks operators tend to spot opportunities from competitors. The role of the guides is central in observing and reporting “what others are doing”. Operator#5 stated “We keep telling our field staff - the moment other people start doing something different from us and if they think it is of value then feedback should come to the office”.

It is reasonable to assume that all these aspects are related to what Guide #1 points out in relation to the labour market in tourism “now it’s happening like a family oriented business for example if I am opening my travel agent I have so many relatives who are studying, who have graduated and who are class XII… and then they say ‘why don’t you do training in tourism? You know… the guide. Why don’t you get the license, I have my company and I am going to employ
you’ and then what’s happening now is most of the travel agents now are looking and giving work to their own relatives. They are selecting their own people… the money it won’t go, they are happy and their relatives will think ‘our relative have employed him he is giving [an opportunity]’. So in that way, it’s becoming a family oriented business. If we see at present the travel agents and all, the big travel agents, if we start asking who these people are, they are relatives”.

Certainly social recognition from communities and family members is one element that drives kinship. This is related to how socio-cultural norms influence economic behaviour (also highlighted in Dorji, 2013). However, in business terms the preference for kinship is also underpinned by the possibility of enhancing operational capabilities, reducing transaction costs as well as to maintain or acquire competitive advantage by controlling the costs of production, product development and to some extent the quality of the experience through quick information processing and problem solving. In fact, relationships (and kinship in particular) are considered to ensure higher fidelity, commitment and control. They can potentially also overcome other negative characteristics of the Bhutanese context: lack of professionalism in manpower and high turnover in the work place, particularly in the private sector. Therefore, the reasoning is still underpinned by certain levels of “rationality”.

It is reasonable to consider that the value that is retained by the kinship network through this sort of informal system of vertically and horizontally quasi-integrated business units or relational contracting is not just the profit but the value of the knowledge and information that is generated in the learning-by-doing and the interaction with international partners that is translated into the national system. This last idea is less explicit from the statements but tour operators were mostly guides before and they know the process that they underwent to “upgrade” and they wish to avoid giving away fine-grained information to potential future competitors, ultimately retaining differentiation and innovation opportunities, and eventually supporting in this process of upgrading those that are close in kin.

An example of embedded ties related to friendship and upgrading comes from Operator #4 who gave an account of how he started as a guide and upgraded as tour operator when the government liberalised the first 33 licences.
Based on his account he could not get the licence from the first initial quota released by the Government and some friends gave him the possibility to operate under their licences. He paid them a commission until new licences were released. Of course the economic incentive is covered by providing economic rewards (commission), but both sides “assumed the best” based on friendship and trusting that important business contacts would not be given away. On the other hand, they let their friend operate with their licences assuming that his behaviour would not back-fired on them (e.g. through liabilities for wrong doings that would incur on licenses revocations).

Operator #9 also started as guide and the family member for whom he was working supported him to become independent during the liberalisation process “at that time I was working with my aunt [as guide] with another tour operator called X. She said that I should quickly avail new license because this kind of liberty can be stopped at any time and again if you have a license it is an asset. So I and her daughter came about operating as Y”.

This also demonstrates how difficult is to separate the analytical categories developed by Uzzi (1997), as trust operates at the two levels in Bhutan: kinship relationships (characterised by close friendships and family ties to manage fine-grained information, problem solving or providing the possibility to upgrade) and calculative (through reputation, referral or repeated interaction).

In both cases of “calculative” and “kinship relations”, learning seems to be explicit instead of extrapolated from others. This is valid for the operations inside the country within these networks and also from tour operators abroad. For example what are now sub-contractors for trekking previously were trekking guides who spotted the opportunity of providing a much needed service for the tourism industry and use their contacts and reputation in the national system.

**Network formation**

The “apparent” price-maker / price-taker relationships in the Bhutanese context with tour operators occupying a central position in the tourism market, acquires less importance once it is analysed taking into account the dynamics above. Power asymmetries proved to be just one part of the picture. Probably not the most relevant if other features of coordination are taken into account. In fact, even if many consider tour operators as “squeezing” the price within the
country and thereby hampering the development of the sector, what emerged is the high degree of uncertainty underpinning commercial relationships. Transaction costs associated with lack of professionalism and the lack of capacity of formal institutions to tackle illegal or unfair practices seem to impact far more seriously than issues of market dominance within the national value chain.

Hoteliers for example should be affected the most by pricing given the high fixed costs associated with their business combined with the high seasonality. However, the practice to provide certain discounts on the official rates is very common among them and it depends on “who you are”. Working with consolidated networks or through repeated interaction is the most practical step to avoid payment problems and acquire market shares. Reputation functions as a control measure and incentive for the provision of quality services and fair transactions and it works two ways between the core tourism actors.

Reputation-driven relationships work ex-post through repeated interaction (as highlighted by Bachmann and Inkpen, 2011, pp. 290–291) but there is also a component that operates ex-ante which is the referral mechanism as identified by Uzzi (1997). Uzzi considers embedded ties as potentially developing out from third-party referral networks and previous personal relations. He considers the “go-betweenness” mechanism through which the expectation of an existing embedded relationship is transferred to a newly formed one, providing the base “for trust and subsequent commitment to be offered” (ibid, p.48). This suggests the potentially for a more dynamic and vibrant industry.

Regarding the referral mechanism Guide #2 argues “…before when I was a new guide my friends has to allocate me. I didn’t have enough [contacts], I didn’t know anybody, but now when I do with one agent as free-lance guide…the agents recommend to everyone, now I don’t have to tell to my friends ‘please give me clients’. Now I get [to work] naturally”. Operator #3 talks about networks of friends when it comes to goldsmiths or thangka paintings “I have friends in the thangka painting business, I have goldsmith friends who I try to encourage… with private guests we always try to bring [them] forward because I know the goldsmith business, the silver- and goldsmith business, is very limited in Bhutan – it harms the eyes because they work with mercury, so I
know it’s a dying art - so there is not many artist like that, if I know people who are interested in art I try to network them... certain people are interested in certain activities, weaving or other... I try to connect them to the right people”.

Nonetheless, it can be hard for young entrepreneurs or self-employed that have no networks. By answering the question about welcoming new entrepreneurs and new ideas Hotel #6 noted how difficult could be for people with no network to develop their ideas as compared to those with “no ideas but good background”. However, operator #8 talking about entrepreneurship and ways to complement the tourism experience stated “…we sub-contract treks. So we have good contractors who have good contacts with horsemen or camping gears or cooks or assistant. If we are not able to delegate our own team then we are able to sub-contract them to these contractors who take care of them”.

For international markets go-betweenness is also important. Operator #4 talking about how he chooses international partners in his source market he stated “I have an old friend out there who is into travel business also, so … I put them as a guarantor…. so in that way [they] also have trust on me, since I have somebody out there as my representative…. And then even in the contract they are my guarantor, so every time I select a new agent and then make an agreement, I call them and they have to sign also as guarantor”. In international markets the use of close friends and relative as intermediaries is also very common as will be explained below.

**6.2.2 Theme 2: Power asymmetries with global and regional markets**

The dynamics above help to partially redefine what is conventionally understood as a considerable power concentration in the hands of national tour operators within the national system. The data show how easy can be to acquire licences but how difficult can be to operate and upgrading outside established networks characterised by trust. In terms of regional and international markets, Nyaupane and Timothy (2010) considers power relations within a regional perspective pointing out advantages (economies of scale, collaboration, trade) and disadvantages (power imbalances, dominance) of international governance structures. The authors review the controversial
relationship with India. They argue that the tourism policy and its differential application to regional tourists is the result of power imbalances within the system of bilateral and multilateral relations that ultimately can jeopardise the policy intention. Nonetheless, a proper analysis is missing on the implications for Bhutanese tourism entrepreneurs.

The Indian (regional) market

The Government and the key actors in the tourism value chain are aware of the opportunities as well as the dangers of the regional market tourism market and the Indian in particular. Pressured by the Guide Association of Bhutan and other Civil Society Organisations (ABTO included), the TBC proposed the upgrading of all hotels to 3 stars at the end of 2013. This proposal aimed at containing the in-flow that would detract from the principle of “high value, low impact”. Since then, various proposals alternated.

Regional tourists can process their road permits directly from the Immigration Department at the entry points in Bhutan (Phuentsholing by road and Paro airport). Regional tourists (mostly Indian) have increase from 50,722 in 2012 to 65,399 in 2014, and reached 146,797 in 2016 (representing an increase of 43 percent from 2015, of which 138,201 were Indian tourists). Private stakeholders have urged for a policy for regional tourists to maximise the benefits from and minimise the impacts of this source market. A concrete step materialised in January 2017 when a new free online entry permit was launched where Indian nationals can obtain the permit in advance through a travel agent or accommodation providers (TBM, 2017). This means that Bhutan is now incentivising the use of local services, while improving immigration procedures, both issues strongly raised by all stakeholders.

If well channelled the Indian market represents an opportunity for hotelier to get access independently to a considerable market that can smooth the fixed costs and the low occupancy rates. Hoteliers in general seem to favour this market as source of immediate cash (Dema, 2015d). Particularly, for the so called “budget hotels” it is the only market. This particular group of hoteliers is not represented by any association and have recently accused policy makers including other CSOs of not been consulted in the ongoing revision of the tourism policy. For example, the upgrading that the Government proposed was
not backed by the same tax exceptions or import duties’ elimination granted to high-end hotels (classified as 3-stars and above) (Dema, 2016b). Furthermore, it is still to be understood whether regional tourists will be routed through local agents with the requirement to be accommodated in 3-stars hotels. This represents a threat to these types of entrepreneurs.

In general hoteliers of various categories are approached directly by regional tour operators looking to stipulate allotment contracts. Potentially a Bhutanese hotelier can take a tour operating licence and work directly with Indian agents for the Indian or the international markets by-passing national tour operators. Hotel #4 stated “…I did have couple of tour operators wanting to tie up say like they want to give deals to their Indian market, XXXX came, and YYYY but it didn’t make sense to me. Because we don’t have many rooms”.

For tour operators and guides, the independent Indian market is also an opportunity and a challenge. In fact, it clashed with the high-end market as reported by operator #5 who worries about mixing visitation with Indian independent travellers and international high-end tourists from elsewhere. He argued “Indian tourists literally come on cost basis. And… then the high-end tourism experience is compromised, it’s not worth it, so that’s why we have to have good guides that can plan the sightseeing”.

In addition, Bhutanese guides can also be easily by-passed by Indian operators and guides. Indian guides are usually more skilled in different languages (other than English) and they can potentially operate in Bhutan (as tour leaders and guides with international or Indian groups), by-passing the national rules and regulations (as Guide #1 stated). Some argue that this is due to the little presence of Bhutan in international markets so that the tourists’ trade is channelled through Indian and Nepali tour operators (Guide #1).

**Indian and Nepali “dealers”**

The problem of uncontrolled undercutting on the international tourists’ trade, represent the biggest threat to the current policy intention of revenues generation, retention of value-addition, skill acquisition and diversification. In fact, there is certain dominance of Indian and Nepali tour operators that enjoy a better position in the trade of international tourists to Bhutanese tour operators, becoming de facto intermediaries. This is due to the way in which tourism
packages for international tourists are structured as Bhutan is often sold in combination with other countries.

Hotel #5 talks about profits of Bhutanese tourism enterprises squeezed by Nepali and Indian agents as few tour operators have the capacity to attract international tourists independently. This is common also among consolidated tour operators. Operator #5 talking about problems with international partners “…even if we have international agents sometimes … the Indians they will try to cut our prices and then we think it is necessary to generate a group so we conceive to some discounts. But we think to the tourist we have not given [the tourist have not benefit from the discount], they have kept it themselves [referring to the tour operator], when you find these things out, gradually, if there is a way out we prefer not to be working with them”.

About the possibility to diversify markets as a possible strategy to overcome the overdependence on regional “dealers” operator#8 stated “we would like to attend more travel fairs and opportunity to meet foreign contacts directly because currently what is happening is majority of us are working with Indian vendors, and what they do is they have direct contacts with the foreign operators and then they sub-contract it to us. So in lots of cases the middleman makes more money than the third party. So we definitely like to go more travel fairs”. Operator #8 added “…they want us to offer them cheapest of cheapest; They should know and understand that when we offer our cheapest and we will have to bring down our service sooner or later”.

This is the reason why many medium and small tour operators fear the elimination of the tariff system. As stated by operator #7 “in Bhutan tour operators firstly they don’t have a good background on how to run a tour operation business; and secondly… some of the tour operators will become agent service for India and Nepal. They will just simply have an office, some big agents in Nepal or India will tell them ‘okay, I will give you a salary you operate’. So they will send lots of clients you know, because when its liberalized then its volume”.

**International markets**

In a context of competitive environment, trust building also plays an important role in the interaction with international markets and reflects the
mechanisms highlighted in 6.2.1, associated with fine-grained information sharing and the creation of networks. Those national tour operators that can establish trust abroad can enjoy better bargains or can operate with the freedom to establish a package-tour tailored on the needs of the foreign operator. In some cases this bridge is created by having a trusted “business developer” in the source market that can offer guarantees to the agents in the source market. This is almost a constant among those interviewed (for example Operators #1 #4 #6 #7 #10). These can be family members established abroad, or they can be expatriated friends well connected in the source market or close friends.

With an established network abroad it is more likely that contract of exclusivity on a long-term basis are signed between Bhutanese and other tour operators. If a Bhutanese tour operator can establish collaborations in a source market, they are more likely to get business ideas that would turn into investments and competitiveness.

However, operator #4 pointed out how the competition has increased in his market of reference, saying that many tour operators are approaching international markets offering more advantageous prices. However, it leverages on long-term relationships and improved services following contractual arrangements. He points out how price competition from new entrants is bringing more atomistic relationships and bargaining that compromise the quality of services as costs of production in Bhutan are high.

**Asymmetries of power and the link with undercutting**

In general the practice of undercutting on the tariff is understood as a way to obtain more margins by national tour operators, but considering the indications of the interviewed it seems to be mostly created by the pressure from international markets. This has direct implications on the payments of services provided inside the country as outlined in 6.2.1. The practice is also linked to acquire market shares and new business from abroad. Yet, undercutting is not sustainable in the long-run as Bhutanese tour operators must pay in the TCB bank account the full amount beforehand for its minimum of USD 250 a day in US dollars.
Considering these characteristics, undercutting seems to be a practice that can be undertaken only by those tour operators that can balance their revenues combining “undercut” and “tariff-rated” packages or that have undertaken processes of formal and informal integration as described above that enable them to lower the costs in others business units. In other circumstance the risk of default is high. Operator #8 stated: “for any new travel agent or a small operator who just set in new, the reputation of an older company who’s doing better and who’s doing more volume they always get preferences. They are able to give you better prices then we [do].”

The TCB can provide recommendations to the Trade Department to revoke licenses if undercutting practices are evidenced. They also used non-conventional methods to enforce payments. Hotelier #5 pointed out how the TCB and HAB reached an agreement to overcome the lack of payments that result from undercutting practices, through the TCB paying directly on behalf and with the money of the defaulter, the provider whose services have not been honoured. This is done by using the credited amounts in the TCB bank account for the tour operator in question.

This and other practices such as not issuing new tourists’ visas to those tour operators liable of not having paid their suppliers are cohering systems to prevent free-riding behaviours and to some extent balance market power among Bhutanese tourism actors. However, these are not consolidated practices and do not necessarily encourage professionalism. They are reactive measures that have not been systematised. A strict control through the Government bank account is difficult to establish and ultimately the Government automatically collects taxes (3percent on the package tour) and the royalty (USD 65 a day) and retain the foreign currency for its reserves. These are all operations that cannot be by-passed. Therefore, action is taken only if extreme behaviours are identified.

Operator #5 talking about undercutting “… There are some tour operators that do that, not everybody does that but those who do that eventually go out of business. We have seen because there are enough examples because no matter 10-20 percent what you provide to the Indian operators or the Nepali operators to the TCB you have to give the full foreign exchange. So gradually, yes you may have numbers but because you have to get back this money.
Gradually you end up having debt with hoteliers, with transport and guides and they are not able to pay here because 65 dollars is the royalty taken by the government, after that if you give 10-20 percent how will you run a tour actually but because of the credit system they can run the tour for maybe one, two years but after sometime the credit catches up with you there are many examples”. He also points out “…things are changing, more and more tour companies are working directly with agents abroad. Before one of the difficulties were when we started we have to deal, we almost had no choice because we didn’t have internet and no emails. We had to deal with either Nepal or India, because they were far more experienced and expert in this”.

However, moving towards more independence in international markets is difficult. Entrepreneurial tour operators with presence abroad needs to operate cautiously, tour operator #7 talking about its presence in international markets “my colleague… he is selling India, Nepal, Bhutan, and Tibet… and agents in Europe tell me - we can’t work with you because you are also selling the same destinations like we do”.

**Coordination with international markets**

The relationships with international markets that have been identified are listed in Figure 13. These three forms wish to provide an indication of the actual market power imbalances exerted by international players. Figure 13 provides three types of coordination. The first is the coordination by-the-law where the Bhutanese operator pays back 10 percent commission on the established minimum package. However, the second figure shows the undercutting practices where around 30 percent of the tariff is “lost” to the international intermediaries from the local economy (in any case the Government revenues are safeguarded). The third figure represents the hypothetical situation, which was reported by few, where the Bhutanese operator acts as a subordinate of international agents, getting a commission for “backing-up” the payments and the visa procedures. It is unclear the relevance of this practice and therefore how is impacting the local economy, but most of the net-value of the tariff would be lost to international dealers without considering the mark-up that is often charged on the tariff and which amount is unknown.
The final mark-up on the minimum tariff, that is to say the price to the final client is unknown. Some respondents have argued that international agents can charge the final client up to double the minimum tariff (operator #10). Guide #1 said that Indian or Nepali tour operators when working as intermediary charge for Bhutan USD 350 per day per person, but tourists come on the minimum daily tariff of USD 250 in addition they push for the lowest price pushing the Bhutanese tour operator to undercut.

Figure 13: Undercutting and economic leakages
In brief, it is unknown not just the extent of undercutting practices but often also the final price that it is applied to the tour packages by international counterparts. A recent article in a national newspaper, show how this topic has become central involving the Royal Audit Authority and the National Council in the revision of the policy to tackle tourism malpractice and undercutting endorsing recommendations to the economic affairs committee in the Parliament (Palden, 2015). Recently TCB is undertaking a special auditing to understand the extent of undercutting and the economic damaged that has created (Palden, 2016).

In all this, the final client is also affected by asymmetric information generated by the lack of clarity regarding the “tariff” and malpractices in the management of tours especially when packages are created by third parties with little knowledge of Bhutan. Guide #3 gives an account of this “… the guests coming from outside, they will carry a program that is made by an Indian or a Nepali company and then we have another program here. [The programme] doesn’t match. You visit Paro Rinpung Dzong, they’ll put a visit to the Museum and then drive to Thimphu and then you have visit this place, this place and this place. Put so much and then we cannot cover up in that time because you see, because these people living in Delhi and then Nepal, they don’t know how far Thimphu from Paro is or like they feel that it’s just 5 minutes’ drive”.

As indicated by Hotel #2 internet can represent a strong instrument to eliminate lack of transparency and asymmetries of information. Talking about the use of on-line feedback on tourism portals, he stated “… I think actually the tourist, once they know that we are doing better they will come through comments and all these things and when they come through the agents they can suggest their agents so they want to stay in [a particular] hotel”. More and more tour operators are able to do direct marketing and sales abroad.

6.2.3 Theme 3: Role of formal institutions

Nyaupane & Timothy (2010) also noted how the effectiveness of controlled tourism depends on the capabilities of the Government to control and monitor the private sector and they also noted how “lack of transparency, integrity and
accountability within the government in developing countries… is also apparent in Bhutan” (p.981). Rules and regulations may be not sufficiently enforced by government officials or their enforcement may appear too discretionary. As a result, market information and formal contracts are not sufficient to govern economic exchanges, which will then rely on networks. So one aspect that inherently links to the way exchange is arranged and governed is the role of formal institutions.

Bhutan is implementing the good governance agenda and is strengthening its formal institutions. Yet, from the interviews’ transcribes above it emerged that business-supporting systems are weak. As a matter of fact they are characterised by under-developed or out-dated legal and regulatory frameworks despite the willingness to reform. Furthermore, a persistent and strong focus on macroeconomic stability, characterised by long and bureaucratic processes for imports, capital controls, and an excessive focus on revenues generation from the Government, seem to impact very much the business environment and particularly on coordination.

Networks become important also in the interaction with the public administration to problem solving and speed-up byzantine processes. Referring to the relationships in general operator #5 “it’s very important you cannot be one person [we encourage] staff to develop the thinking that we live in a relationship era today if we don’t have relation no matter how perfect the system is its all manned by people: you go to department X, you go to department Y sometimes you have special requests the system will not allow it but if you have good relations, it can always be done”

Operator #7 talking about the necessity of importing new equipment “…we need trekking equipment like tent and pressure bags. And for the next 4 years you cannot buy new ones. If you go on one trek sometimes it gets spoilt. So how do I, how am I supposed to provide good service to my clients you know. So the government is not looking into these things … this is encouraging people to find other means to do business”.

For expatriates managers business in Bhutan can be hard without the support of a local network to mediate with institutions. Hotel #7 in rural Bhutan, talking about public sector institutions as facilitators “…not really [you are] pretty much on your own and you have to figure out everything yourself”. This show
also lack of coordination among different government institutions and make business development or upgrading difficult. Operator #10, wanted to start a new trail “… you have to get lots of permission. Go to forestry, and then come to land commission, so many different institutions. You plan today and it will take more than 3-4 years to get into that real point. This affects a lot”.

Operator #7 on the same lines “if we want to start a new product the main constraint is [that] there is no one particular office where it says okay you want to do this, here is the approval now do it. Because you have to go from one pillar to another pillar you know asking for permission and getting their views and things like that. Then it becomes very difficult for somebody who is willing to invest you know. For instance just to set up an infrastructure X it has already cost me X lakhs because first I had to go to one village and talk to the community telling I am going to bring this product, this is going to benefit you, give me your land I will pay you. Communities are not talking to each other; they will say go and talk to the district, go and talk to the Governor, go and talk to the headman. … central government is still strong and plus the local government, the local leader though he is the overall leader of the community at the same time there are other stakeholders. Forestry [Ministry of Agriculture and Forests] people are there you know the health [Ministry of Health] people are there… the local leader he is the leader of the local community only. … if I want to start fly fishing in one of the community, the local leader cannot give me the approval because it falls under the Forestry because I have to go to the forestry and I have to tell him I want to start a fly fishing product here so can you help me. And he will say come next week I will talk to the central government and when I go back and he will say ‘the central government boss has gone on tour [business trip]’. So I think like in that particular area the local government should be given the full responsibility”.

Hotel #1 referring to business incentives (clearings on imports and tax holidays) for the construction of its hotel and the import of items functional to its operations “I don’t know if [different institutions] they work together well. I always hear that they have problems. But for me the incentive process went well. It’s also because I worked with department X before, for X years, so I know people, not that they did favours for me, but I know the system floor and everything so when you ask [this] query to me… you will not get the actual
scenario kind of picture... But from department X there were lots of requirements you have to fulfil: bio-cues, you will have to fill your specifications, you have to justify your quantity, value, how many rooms, and why do you need this many linens; so that actually it was not that easy for me too! And there are lot of people I think if you meet them they will say it was not too easy to get these incentives. Most of them they ignore it also. They rather pay [the full price]... or they rather don’t declare it”.

Rating system – lack of transparency for customers favours undercutting

Hotels follow a rating system but it emerged that the lack of consistency and compliance to these rules can create lack of transparency, impacting on the information available to the final clients and the travel industry, creating problems leading to transaction costs and favouring undercutting practices. Hotel #7, talking about the star rating system “[The TCB] they have just started to implement ...they are encouraging basic hospitality institutions to upgrade themselves to what they called a tourist standard and we know a little bit about this rating, we know that they are really busy with this and that’s one of the reasons that actually we have not been able to receive our ratings yet because the officers are too busy trying to go to the other places so that’s kind of limiting us a little bit because for instance we cannot import any of our wine that we would like to offer our guest. In order to do so, we must have an official rating first without that we can’t... so we are kind of limited in our ways”.

Guide #1 mentioning about quality of services, “…[hotel rating] should be made aware [to] the guide also. So that when the tourists ask us [we] can tell him the stars, whether it’s a 2-star, 3-stars, or 4-stars; so that we can tell... for us [guides] it looks similar everywhere. Even if we see sometimes in 3-stars its better than in 4-stars”.

Anecdotal evidence provides also the view of the TCB officers not able to cope with the rating. Official may be “on tour” for 2 to 3 weeks in different parts of the country in the attempt to classify new infrastructure which are able to operate without official rating until they are classified. Officials are not in sufficient numbers, with improper manuals, and with investors challenging them on their capacity to understand the industry and to do their job.
Hotel #7 talking about the experience in Bhutan and the difficulty to get information on Bhutan “if the guest do not get the right experience then that word travels fast too… because right now, I mean even before we moved here we did a lot of research of Bhutan in the internet, but at the end of the day you find out very little… every webpage you go is the same all over, it's the copy-cat but it's been managed by different people and different agencies but at the end of the day it's the same thing”.

**Overpopulated markets**

The Government has made extremely easy to obtain licences and every actor interviewed mentioned that starting a business is very easy *per se*. No restriction for giving licences except few requirements for tour operators to have an office. For guides, they need to be educated at class XII and a course is compulsory and they must pass an exam done by TCB officials. Hoteliers do not need any particular requirement except to respect the guidelines for standards. This created particularly in the guiding and tour operating sector an overpopulation of suppliers. Some hoteliers argued that tour operators should not get licences automatically.

For guides the same problem arises. New guides are licenced every year but the market is too small to absorb them all. Few guides highlighted during the interview the need to establish a threshold for the number of licences issued every year. It has been shown that prices are going down for guiding and with that quality of services, an issue that is also been reported in the press (Dema, 2015e).

Quality of employment in such scenario is also compromised with many guides employed as freelance while in the past most of the jobs were offered as waged employment. Many new guides in the interviews reported to be working just 3 months a year during peak season and need to combine with other source of incomes. Others more senior guides are also looking for reliable business relationships as highlighted above. Free-lancing is not a problem in itself but it is linked to certain casualization of the guiding jobs and to the payment and undercutting problems. Junior guides have reported difficulties to sustain themselves throughout the year as they need to meet costs of living in
Thimphu. In fact, guides are required to be based in Thimphu, Paro or Phuentsholing as tours start from there, being tourism strongly centralised.

Some guides during the interviews noted how the Government uses guide licencing to push down the statistics on youth unemployment. Registering as guide impacts on the statistics of unemployment so it is plausible that licensing reduces it. Even though it is unlikely that the Government is promoting this mechanism, it is true that the TCB recently privatised the guiding trainings. Participants interviewed (a view shared by all core actors), questioned the quality of guiding experience and the quality of the training provided. Guiding courses were organised internally by the TCB, and the number of licenses to be issued where decided upon a rational method based on the needs assessment for the industry. Training and exams were done in collaboration with donor agencies through technical development assistance. Now, private schools run courses continuously. The TCB is only responsible for issuing licences upon the successful completion of a written and oral examination.

Acquiring the licence is also straightforward for hotels. All the licences are processes by the Trade Division of the Ministry of Trade with the TCB giving recommendations on quality standards for grading. This practice is now being changed and all the processes are going to be overlooked by the TCB. Yet, regarding hotels development a similar situation is also observed. Operator #5 talking about hotels in the west part of Bhutan “around here is enough and if… of course it should be an entrepreneur who should take the risk but it’s also I feel the responsibility of State the governing authority to sometimes look into this and limit and advise, you cannot let people do whatever they like because supposing I am an illiterate contractor that does road building and I have enough money suddenly I see people building hotels, I would also jump to build a hotel without doing any analysis or without partnering with any one, without knowing anything about tourism and make a huge thing and then the hotel is empty and that’s where he defaults his loan and so many problems occur”.

And Hotel #1 talking about the tourism demand stated “…Nobody is going to give you a clear picture on that but… we looked at whether the hoteliers themselves were doing any kind of expansion works. If they were doing expansion work definitely they are doing well. So that was our indication. Some of them were not only renovating… of course renovation is a common
requirement for TCB, but some of them were already doing expansion in other Dzongkhags… so this was an indication that they were doing well. …So that encouraged us but on the overall for Bhutan I think the safest bet is tourism at the moment as a business”.

An interview in Phuentsholing with a Bhutanese expert in hotel construction highlighted concerns about seasonality, occupancy rates versus the high costs of construction in Bhutan (he claimed that the cost of building a room in Bhutan is BTN 2,000,000 without including the cost of the land - the interview was conducted in July 2013). He believes that there would be a downgrade of tourism experience in Bhutan. Indian market will be the dominant with a consequent adjustment towards 3-stars hotels as luxury hotels are straggling with high seasonality. Recent statistics shows that the occupancy rate is about 30 to 35 percent on an average for hotels in the Western region, about 17 percent in Central and 7 percent in the Eastern region (Dema, 2016c). However the consultant interviewed had serious doubts about official statistics.

The small market and the danger of an over-supply may put pressure on prices and the ability for this category of entrepreneurs to repay their loans given the fixed capital investment typical of the hotel industry. The expansion of the hotel sector has been stimulated by a tax holiday and import offered by the Government (for a period of 2010 to 2015) which might be extended further for the period 2016 to 2019 (Dema, 2016c). One additional problem however is still the strong concentration on the West part of Bhutan with most of the hotels based in Thimphu, Paro and Punhakha (see hotel data in Figure 10 in section 6.1). Constant road closures and the inability of the Government to invest in reliable infrastructure in Eastern Bhutan, make it very risky for entrepreneurs to invest in tourism infrastructure and products in other areas.

**Services from key complementary industries**

Three other sectors emerged from the interviews as contributing to transaction costs and coordination failures. One is the **banking system**. The banking system does not favour a smooth management of payments for example. Hotel #7 “…[The problem] is also between banks; …tour operators

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67 The interview was conducted the first week of July 2013. The figure translates to USD 33200 with BTN 1 (with BTN=INR) = USD 0.0166 on 5th July 2013.
make payments to our company but [if we have accounts in different banks] it takes 3-5 business days but that communication is not a smooth one and so we end up calling tour operators [to ask them] where is the payment. [They would say] ‘we [have] already made the payment 5 days ago’, it takes 5 days to clear or to show. [Or the payment] gets lost or double payments [are] made sometimes. So... it creates a lot of accounting confusion for everybody. The other thing from a business perspective is that you cannot get bank statements on regular basis and you actually have to physically send a person to the bank to get your statement and sometimes for two or three hours so from an efficiency stand point to run your business that’s pretty difficult”.

In general the telecommunication sector is well rated among the interviewed but with improvements in rural areas it would favour coordination among economic actors. Hotels based in rural areas with no office in Thimphu rely on mobile networks which have limitations. Internet services are still not completely reliable and are not yet providing a good enough internet service to carry-out simple operations including emails, bookings or website maintenance.

The airline sector it is expected to become quickly more reliable given the entry of a second airline company and helicopter services that complemented the operation of the national state-run airline. However, competition is hard in such a small market and only one airport with international standards. International connectivity services are sufficiently reliable but domestic services still suffer sudden cancellations without warning despite being scheduled flights. This is problematic for tour operators and their operations in the eastern part of Bhutan.

6.2.4 Theme 4: Involvement of rural communities

Gurung and Seeland (2008) challenged the idea of equal distribution of benefits under the current tariff system. Their assessment is that the current tourism policy hinders development in rural areas and favour power concentration in the hands of few stakeholders, particularly the tour operators. They argue that the policy intention favours only the development of products that can match the expectations of high-end markets. Furthermore the focus of Nyaupane & Timothy (2010) shows how tourism (that is normally buyer-driven)
becomes supply-driven where government exerts control to protect local ownership in business, trying to limit negative externalities (social and environmental) and competition over scarce resources by dictating the kind of products that can be developed.

Nonetheless, Gurung and Seeland (2011) and Rinzin et al. (2007) estimated quite high benefits for rural communities under the current policy set-up. Gurung and Seeland (2011) compared 3 different trekking routes (Chomolhari, Nabji-Korphu and Shingkhar) and noted that the redistribution of benefit could be problematic considering high incomes that few households in rural areas can obtain compared to other community members or more remote peers. Particularly Gurung and Seeland (2011 and 2008) advocated for micro-enterprise models as well as communitarian initiative and community funds to share the benefits from tourism. In their study households are involved in different activities, and they are involved in tourism mainly through the hiring of horses and yaks and/or as porters, not involving formal contracting. Those working directly with tourists’ traders have considerably higher incomes (ibid).

The policy framework provided by the Economic Development Policy encourages the participation of rural communities, tourism not excluded. Therefore the involvement of rural communities is tolerated by the authorities that at time are supporting initiatives involving community-based organisations when opportunities of financing through international donors arise. From a market access perspective, rural initiatives aiming at reducing poverty (through community-based or micro-enterprise development approaches), seem to be difficult under these circumstances and without a tight partnership with national tour operators as it will be shown below.

The role of government agencies

It has been shown that coordination problems among Government agencies is common particularly in tourism and this affects also the involvement of rural communities. The TCB, in theory should work as forum for multiple stakeholders, and implement accordingly. As stated by operator #7 who also covered a Government position in the past “I think now it is working well for the last couple of years. Previously it has been very difficult I would say, because everybody was like protecting their own territory - the Tourism [Council] wants
to start some eco-tourism project, [the] Ministry of Forest under Agriculture will not listen. They will have their own project. Of course they can have their own project but when it comes to tourism component they need to talk to the Tourism Council and discuss and take it to the next level... for instance, the Nabji-Korphu community-based trekking it is supposed to be a [pilot] product but it is not working well because of certain things like half initiative was taken by Ministry of Forestry under Agriculture and the Tourism Council, and at the same time the local community... 3 components. I think to my opinion it didn’t work well because the Ministry of Agriculture wanted to take their own lead, Tourism Council of course being a tourism [project] wanted to get involved and the local community had no idea what is tourism.

A concern also emerges quite strongly from the point of view of policy makers related to the difficulty in enabling communities to participate effectively in the tourism industry. These include problems of provision of up-to-standard tourism service delivery, commitment and professionalism, safety concerns to which need to be added concerns to avoid opportunistic behaviour from tour operators regarding undercutting and pricing.

Some argued how important the role of Gup (head of Gewog) is for a community to take opportunities from tourism. He noted that budgetary constraints to do investments and lack of awareness about tourism are problematic, but educated and informed Gups that are able to coordinate with the central government, could be able to bridge these problems.

As effectively noted by Hotel #4 “I think right now communities... are experimenting with a lot of products ... now lots of entrepreneurs are coming-up and there are lots of people with innovative ideas and they are trying to do farm-stays and trying to develop those areas”. In fact, the main drivers to integrate rural communities in the tourism value chain from the private sector perspective are: response to market (search for authenticity), product diversification and the need to overcome transaction costs mostly associated with cancellation or overbookings in accommodation services. These have been identified as main operational drivers for the development of rural accommodation and it shows how the imperfect interception of policies and policy intentions, rules and regulations is filled by private initiatives and by donors’ keenest, in this latter case to support community-based initiative (particularly for environmental
conservation and socio-economic development). While the role of donors is marginal compared to the current investments taking place in rural communities, rural areas are reached by the same mechanism associated with trust and kinship, bridging urban entrepreneurs and rural communities, enabling different forms of rural venture.

**The role of the private sector**

Consistently with the work of Dorji (2013) on social capital, the bridging role of core tourism actors towards their “kinship” communities offer the link to integrate rural areas (and households) into more systematised tourism products and broader entrepreneurial networks. Tourism actors tend to benefit and prioritise their community of origin incentivised by competition in the Bhutanese context, ultimately supporting forms of upgrading and rural diversification. This behaviour is driven by a certain level of strategic thinking that includes product development and response to market.

In fact, despite the constraints associated to various rules and regulations (mostly related to the tariff and the environmental stewardship of the Country), there is a strong flexibility for demand driven products (e.g. #7 and #10). All actors interviewed stated how they are driven by the request for authenticity for their tourism products based on rural areas, the need to develop some sort of competitive advantages or for logistical strategies (including avoiding cancellations in tourism standard accommodation).

However, given the blurry lines and the centralised bureaucracy the processes of investment in rural areas and the involvement of rural communities are not straightforward. In terms of regulation various operators (#3, #8 and #9) talks about confusion related to what is feasible as rural accommodation as compared to the standards required by the law. Operator #7 talks about endless red-tape. Furthermore, it appears to be difficult to coordinate initiatives with community-based organisations at least with those that have been introduced as pilot projects by donors, leading the way to private initiatives instead.

Relationships and community of origin matter in this context and seldom serve to overcome problems of coordination. Operator #5 answering the question about what kind of coordination a tour operator needs to involve rural communities “…it is definitely relationship with the villager’s and ourselves; we
need to develop a relationship. And it automatically develops and the guide sometimes, when they are from that region it automatically develops”. He added “…these things happen regularly because the moment a villagers is given some income or benefit immediately the face of the village also changes, the sanitation the hygiene, the stone walk ways in the village and then to keep their houses clean, because tourists are visiting and then weaving inside coming to the veranda so that when the tourist pass-by and then they see them weaving. So many things automatically happens actually those upgrades are happening”.

Guide #4 highlighted the importance of an educated Gup that is able to coordinate with the central government but he also referred to the importance of having awareness about the positive and negative impacts of tourism, in this respect he highlighted that the role of guides that have become Gups have brought positive influence in the community.

The type of investments could take several forms. Almost all operators interviewed are considering investing or have already invested. Operator#3 regarding product innovation talks about investments “…now everyone sort of getting into the mood, mum is building a new restaurant and she has also started the construction of a lodge in locality X” and asking the question on how to improve market shares “…my aim is not to have a definite market share, it is about been comfortable and able to deal with it…so my mum family’s place is in locality X we have land there we have built a small guest house we could use [for] ourselves but are also open to tourists as well there; and we have land in locality Y and we have land in locality K so slowly I think the investments will be in hotels maybe”. The same operator interacting with a family member (and a senior guide) that was attending the interview said addressing him “…and he helps his brother in the village to do the village house for [company X], to do the farm house, this is why he works in the farm... you know he was of encouragement ‘build your house into a farmhouse and I will get my company to use your house’...”.

Another example comes from hotelier #6 whose family in the span of 17 years was able to develop a network of hotels and farmhouses in different locations and started their own tour operator. They started with a farm-house and were supported by their kinship network and constantly upgraded “there was no other hotel [in the community] and my mother had land and then they
thought it’s the right time to build a hotel and my uncle had been very supportive to my family…. [he] encouraged us to do this, do that and helped, guided. Even now we depend on them, any advice, every little crisis I face here, I call them”.

The other mechanism is by referral and the bridging role of guides or personal networks is again central. Guide #2 talking about her experience in rural Bhutan and referring to farmhouses and tourism product in rural areas, pointed out that “sometimes we recommend to the travel agency and sometimes we do cooperatively, ….like last time in locality X we were supposed to stay in a hotel in Trongsa but we cancelled that and come to locality Y and then we just went for the eco-tourism farmhouse”.

Operator #8 talking about the involvement of local communities “…there is not really a portal where you can find farm local communities or services. Right now what we are doing is we are calling our hotels and asking them - do you have anybody who can give us referrals to who has a farm house and able to give us rooms? - …. Because at the moment you find homestays and farmhouse through guides maybe or hotel managers that we know well that we ask them to help us”.

All this however puts some challenges on who benefit from tourism activities as rightly pointed out by Gurung and Seeland (2011). If tourism development is left completely to the private initiative, local communities have not enough awareness and capacity and skills to deal with a rather complex industry. Directing investments to family members or to ancestral communities might create a sufficient bridge to fill these gaps as these findings show, but the negative side of these mechanisms is more inequality perceived in rural communities especially remote ones.

Furthermore, it seems that a pattern exists where the Government experiments, the private sector follows. In fact, the challenge is that Government interventions often lead the way with infrastructural as well as marketing investments. This motivates private interests and put pressure on traditional land ownership versus villagers (especially the poor ones) that inhabited the community for long-time.

An account from a Government source (source #1) offer insights about the intervention in locality Y “…there is a very beautiful house in locality Y, we found out that it belongs to one of the tour operators. He was from locality Y, he
came to Thimphu maybe 30 years ago or something, they started the business so they have hotel and all, they are doing well so they hear that tourism was coming to their village and they went back to the village and they [constructed] much more beautiful house compared to the other villagers. [This is happening] even in other [rural] areas, because when we started that project and then some villagers they start talking and they have their relatives in town and they are interested somehow and they want to buy land”.

This offers a further corroboration of the strategic thinking associated with business relations related to kinship. Outside kinship intentions might be inherently speculative especially when land is bought for small sums knowing that the area would develop in the future due to Government investments or international projects. The hypothesis related to kinship and support to rural diversification will be explored and corroborated further in chapter 7.

6.3 Conclusion of the chapter

From the interviews and the material reviewed, trust seems to operate strongly in the Bhutanese tourism value chain. It is the most important theme; it is mainly linked to transaction costs in the business environment, and it operates under two mechanisms. It operates as “calculative thinking”, motivated by risk-based judgments associated with the lowering of transactions costs and maximising mutual benefits. However, economic actors turn towards family members, ancestral communities and close friends for their economic transactions whenever this is possible. This category is indicated by “kinship” and highlights the finding that economic and non-economic relationships and rationales overlap.

Granovetter (2005) defines social embeddedness of the economy as “the extent to which economic action is linked to or depends on action or institutions that are non-economic in content, goals or processes” (p. 35). When relationships are characterised by “kinship” commercial relationships seem to be sealed by a predisposition to “assume the best” of the other. Kinship relationships for market exchanges appear to be related to social and cultural norms (see Dorji, 2013). However, actors are broadly motivated by quite strong strategic and rational thinking in choosing these options.
Consistent with Uzzi’s observations (1997), who defines embedded relationships as characterised by trust, fine-grained information transfer and joint problem-solving (Uzzi 1997, p.42), these relationships operate for critical exchanges also in the Bhutanese context. Consistently with Dyer & Chu (2003), the use of trust is linked to transactional difficulties due to environmental uncertainty, asset specificity as well as the high-value associated with information sharing that is a particularly valuable resource in the Bhutanese tourism context and its competitive environment (see Dyer and Chu, 2003, p. 67; Dyer and Chu, 2011).

In fact, the environment in which tourism actors operate is characterised by tourism products that are of a “tailor made” nature, but also subject to high level of copy-cat behaviour in an overpopulated market. Coordination failures between economic actors often require on-the-hoof problem-solving. Coordination failures are also caused by perceived inefficient formal institutions that are deputed to respond to these coordination failures. Therefore, trust also becomes an important “enabler” of competitive advantage in the Bhutanese tourism value chain.

What is particularly relevant for this research is that trust has implications for economic participation (inclusiveness and upgrading) in the tourism value chain. In fact, trust (that underpin both calculative and kinship relationships) can act as an entry barrier for those that do not belong to consolidated “networks”. Those within the networks can enjoy reduced transaction costs not necessarily specific to tourism transactions. In more embedded networks (kinship networks) there are also higher degrees of knowledge and information sharing, and resources leading to different forms of upgrading. In both cases of “calculative” and “kinship” relations, learning seem to be explicit instead of extrapolated from others, but information, knowledge sharing and financial resources seems to be a stronger prerogative of kinship networks.

This also implies that the same mechanisms are at work for the integration of rural communities, influencing participation and access of rural entrepreneurs to the tourism value chain, ultimately impacting on the capacity to diversify rural livelihoods. On the broader entrepreneurship side even if Bhutanese economic actors in the tourism value chain can enjoy the “bridging” role of tour operators that includes the information flow from their international partners (this is
happening through the constant search of new ideas and long-term “partnerships” by national operators in international markets), the close interaction within close groups, may foreclose innovative entrepreneurial ideas and investments.

Overall, governance by trust promotes access to privileged information and resources; it lowers transaction costs and overcomes information and coordination externalities. This supports different forms of upgrading. On the negative side, it creates barriers to broader participation for those that have no access to the consolidated or kinship networks. Small markets and closed networks can frustrate Government entrepreneurial schemes (willing to foster entrepreneurship and employment/self-employment opportunities) directed to young people, unless a more proactive role of engagement of the Government with the private sector is envisaged. The inclusion-exclusion of economic actors and new entrants based on networks in a context with significant youth unemployment and underemployment can have adverse consequences.

The role of the Government can be critical in two ways: by facilitating a proper destination management and by sustaining the development of clusters and linkages. These points are very relevant and are related to modernising the current tourism policy, turning it into a proper productive policy to support investments of various types and solve the coordination problem. Another critical aspect is that by modernising and increasing enforcement and transparency of current regulations and by proactively engaging with the private sector, the Government through the TCB, would be able to facilitate what in the analysis has been indicated as “go-betweenness”, the capacity to increase business networks through referral.

The importance of the referral mechanism is that it can solve the commitment problem. This aspect, combined with the professionalization of the sector (through trainings, certifications and professional placements with the active role of the TCB for example) can potentially overcome the problem associated with the closed networks. In the agricultural sector, RNR can target specific cooperatives to improve standards, yields, diversity of crops and provide professional skills to meet the needs of specific segments of the tourism industry. All these points will be addressed in greater detail in the final conclusions (section IV).
Chapter 7 – Community Level Analysis

Following the discussion in chapters 5 and 6, Bhutan has undertaken a progressive change in various key policies to favour markets, trade, private sector development and diversification of the rural economy. This is combined with a right-based approach to livelihoods that emphasises individual rights (Dorji, 2013, p. 30). So far this research has focused on the identification of mechanisms through which economic actors are able to participate and change into more rewarding positions in the tourism value chain. Regarding rural entrepreneurs, the hypothesis emerging (reported and discussed in section 6.2.4) is that in rural areas, the ability of households to successfully diversify their economic livelihoods into tourism depends among other things on social relationships. Their relevance is linked to high transaction costs related to coordination uncertainties, small markets but also to the presence of strong social norms (see Dorji, 2013 for a broader perspective on social norms in Chapter 5).

This chapter focuses on understanding rural households’ ability to diversify livelihoods and generate income. This is done by focusing on the analysis of social networks that are considered important mechanisms to adopt new practices and sustain new entrepreneurial ideas and income streams. In addition a gender perspective will also be explored. Institutional dynamics related to land tenure may affect the ability to diversify economic livelihoods in the case of female-headed households.

From the literature on rural diversification it has been shown that availability of assets is a key determinant for the capacity to diversify and participate in various markets. At the micro-level, for example, better-off households are typically able to diversify into more favourable labour markets and to take advantage of market forces than the rural poor (e.g. Donovan and Poole, 2014; Ellis, 2000; Scoones, 1998 in the literature review). Provision of public services to strengthen key assets can help. In both cases of Nepal and Bhutan education proves to be a driver for social mobility providing access to activities with higher returns. But opportunities for higher returns in both rural and urban areas are also conditional to the level of a country’s development.
When opportunities are scarce social networks become an important mechanism to access new opportunities (Zhang and Li, 2003, Gautam and Andersen, 2016). In addition, Anderson (2012) effectively showed that variables associated with social capital (bridging and bonding ties) and time use, affect assets returns and the ability to transform assets into economic livelihoods.

Looking at social networks would provide a “microscope” for analysing people’s livelihoods strategies inherently linked to decisions on the assets that they have available. Phobji-Gangtey Valley (also known as Phobjikha) in central Bhutan is a relevant study area. In fact, following Winters et al. (2009) argument in favour of interventions based on a composite investment strategy involving key assets to influence economic choices of local rural populations, Phobjikha offers few advantages:

- a vibrant institutional setting with local organisations that have evolved into more formal and diversified community initiatives under government and donor guidance, signalling a certain level of empowerment and local decision-making;
- the willingness to sustain and guide diversification into non-farm livelihoods from government and non-government organisations mainly driven by conservation priorities, vulnerability reduction and adaptation of livelihoods to climate change;
- the diversification of livelihoods is sustained by the increased accessibility of the valley by road (development of farmers roads and paved roads and consequently access to markets), the provision of environmental friendly infrastructure (underground electrification), primary and secondary schools, a health unit and agricultural services based on agricultural extensions offices;
- a rich natural environment;
- the points of attractiveness and the increased tourism related investments (in addition to the natural environment and the renowned black-necked Crane migration, the Gangtey Goenpa hosts the Nyingmapa Buddhist sect and it is one of the oldest monasteries. Hotel construction has been increasing over the years).

The analysis of social networks is often associated with the literature on social capital. Yet, perspectives and approaches about social capital could be
very diverse. For example, the contribution of Dorji (2013) outlined in section 5.5 emphasised the role of community groups and the importance of the self-instituted groups (and in general local groups) in their capacity to sustain livelihoods and poverty reduction. Dorji (2013) also argues that the role of the Government and NGOs should be to sustain and connect a wider network of inter-community groups, without patronising (Dorji, 2013). He looks positively at social capital in Bhutan and considers a positive relationship to welfare. In particular, he stressed the idea of community-based organizations in Bhutan (spontaneous or incentivised by the Government) should also be seen from the collectivist perspective of GNH philosophy, that provides a framework for their establishment and development (see also Dorji and Choden, 2005). Nonetheless, the results of his analysis highlight how the richest quintiles that are benefiting more from both structural and cognitive social capital.

Generally speaking, from a market perspective the integration in a market economy requires investments in new productive structures to adapt to different market demands. From an alternative perspective, community groups and cooperatives are often regarded as a way of generating social capital, mitigating market failures and transaction costs, tackling adverse power structures, sustaining livelihoods strategies and ultimately poverty reduction and inequalities. While the main research question is to what extent rural households (HHs) are able to diversify into tourism, this question is answered by focusing on a sub-set of questions and on variables linked to network theory which are described in the methodology chapter.68

Given that one of the working hypotheses is that social networks matter for households to diversify successfully into new productive activities (particularly tourism), the research questions to be answered are: How does a household’s position in the multipurpose productive network relates to its demographic, assets and economic livelihoods characteristics? And, how do households’ ego-centred networks affect the ability to diversify economic livelihoods strategies? How different measures of centralities and network structures of each household in the sample relates with different demographics, assets or livelihoods characteristics, can provide an indication of

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68 Please refer to section 4.6.4 for the design, definition of productive network and different measures of centrality
the relevance of the networks in which households are embedded. The analysis of households’ positions in the multipurpose network cast light on the horizontal relationships among community members, while the ego-network analysis has implications for horizontal as well as vertical relationships, since measurements involve actors beyond community members.

This chapter will explore if:

- Different measures of centrality from the analysis of the multipurpose productive network are related with different demographic, assets or livelihoods strategies.
- If the structural characteristic of ego-networks (densities and structural holes) of the multipurpose productive network relates to specific livelihoods income streams.
- Whether kinship-networks are associated with livelihoods networks.

Analysis of intra-household characteristics that may constitute barriers to diversification will include gender and time constraints:

- How do centralities and network structures in the productive multipurpose network differ by gender of the household head?
- Does time constraints relate to a households’ ability to diversify?
- Are female-headed households and time constraints associated with specific livelihoods?
- Do female headed households experience more time constraints compared to male headed households?

7.1 Livelihoods trajectories and institutional setting in the Gangtey – Phobji Valley

7.1.1 Study area description

This section is a historical reconstruction of the livelihood path that has shaped the area under study during the last 35 years, discussing key micro and macro drivers of social, economic and environmental change. Accounts from previous research (e.g. Dorji and Tobgay, 2003; RSPN, 2005a; RSPN, 2005b; Phuntsho, 2010a; Phuntsho, 2010b; ICIMOD and RSPN, 2014) show how the inhabitants of the valley have undergone a process of livelihoods
transformations from subsistence and diversified agriculture, livestock herding and transhumance, to more intensive monoculture with the introduction of potato, favoured by increased farmers’ access to markets. The introduction of potato as a cash crop (between 1980s and 1990s), together with a series of development interventions, provided the economic incentives for most of the households in the valley to stop migrating during the winter months and settle permanently in Phobjikha, intensifying agricultural practices and the use of natural resources (Phuntsho, 2010b, p. 22). These brought higher standards of living for the communities but also more environmental pressure. In this context, tourism appears to be the next “bonanza”, but consequences for the environment and the socio-economic structure of the valley are unclear.

Phobjikha valley (in 2015 renamed officially Phobji-Gangtey valley) is situated in central Bhutan and it is the largest high altitude wetland in the Country surrounded by an important watershed. It is about 161.9km² with a mean elevation of 3,500m. The highest ground is Lapchekha (4,200 m) and the valley floor is about 2,000m (RSPN, 2005a, p. 3). The land area of Phobjikha valley includes parts of two Gewogs of Wangdue Phodrang Dzonkhag (district) – Phobji and Gangtey – and includes 15 Chiwogs (villages) with approximately 474 households and 3,899 individuals. According to 2007 Gewog Basic Health
Unit records, the area hosts 466 non-native inhabitants, adding to a total population of 4,365 (Phuntsho, 2010b).

Although the valley spreads between Gangtey and Phobji, several households are settled in four additional Gewogs (Bjena, Ada, Nyesho and Sephu), bringing the households’ total number to 498. These Gewogs are traditionally connected to Phobjikha as they offer warmer areas where some households still practice transhumance today with their cattle in winter. The wealthier households also own land and cultivate paddy fields in those areas. This provided an additional rationale to include part of these Gewogs in the “Phobjikha Landscape Conservation Area” (PLCA) a broader area identified by key cultural and natural parameters, justifying the need for its integrated management (RSPN 2005a, p.3).

Figure 14: Location of the Phobjikha Landscape Conservation Area

Administratively, the boundary of the PLCA falls within 890 57’ 54” - 900 17’ 30” North and 270 13’ 50” - 270 31’ 27 East. It includes all areas of the Gangtey and Phobji Gewogs, a large part of Athang and a small section of Bjena Gewog (Figure 14). The northern boundary is bounded by Gangtey and Phobji Gewog, east by Phobji and Gangtey Gewogs till they meet the northwestern boundary of Jigme Singye Wangchuck National Park, and thereafter, the boundary follow Ma Chhu (river) along the boundary of Jigme Singye Wangchuck National Park, west ward till the confluence of Ma Chhu and Kangkha Chhu, and then up stream along the boundary of Athang Geog and a section of Bjena Geog which falls within the valley rim of Phobjikha. The PLCA
area is estimated to be 402.9km². Within its boundaries, the Phobjikha valley (rim) was considered the crane area which lies within 90° 5’ 55” – 90° 17’ 30” North and 27° 22’ 16” – 27° 31’ 27” East - with an area of 161.9 km² (RSPN, 2005a, p.8).

The PLCA was proposed to counterbalance the huge development pressure to convert Phobjikha wetland for economic purposes (e.g. drainage for commercial agriculture), which is driven by the change in the population dynamics (increased population density) due to development interventions that over the years encompassed: general infrastructure, schools, a health unit, community centres (ICIMOD and RSPN, 2014); transformations of traditional livelihoods (progressive abandoning of herding and transhumance practices); and the intensification of economic activities (Phuntsho, 2010b, p.66). In general, all the development interventions that took place in the valley since the early 90s were driven by the necessity to sustain and restore the wetland for its ecological importance and to address climate adaptation and poverty reduction. Within this framework many proposals have been advanced that combine conservation and development, including more recent schemes such as payments for ecosystem services.

The study of poverty dynamics and the application of monitoring systems for socio-economic and environmental changes in the valley started with the recognition that an excessive focus on normative conservation would have created conflicts with the communities in the long-term. A retrospective account by Dorji and Tobgay (2003) evidenced how people in the valley perceived conservation as mainly an aesthetic/moral value and that there was an increasing trend within villagers to value the costs of conservation vis a vis what they had to give-up in terms of economic opportunities (Ibid, p.256).

The origin of the Integrated Black-Necked Crane Conservation and Development Programme in 1999 and the PLCA as a matter of fact, are based on the need for more comprehensive plans to sustain livelihoods and conservation involving the communities in the valley. In this context, the Black Crane is taken as an “indicator species” which serves for the conservation of

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69 The Black Crane is taken as an “indicator species” for the conservation of the complex ecosystem in the valley. The Black-necked crane which is an endangered species of crane (IUCN red list) migrates between Tibet and Bhutan during the winter season. There are also cultural meanings attached to this species. Some of the Bhutanese folklore, songs and dances refer to these birds as heavenly birds (RSPN, 2010, p. 28).
the complex ecosystem in the valley. Two main pillars are then considered in the plan: the conservation component (it encompasses conservation education, wetland restoration, research, monitoring and evaluation) and; the developmental component that encompasses community organisations “and capacity building, alternative energy, improvement of socioeconomic conditions and eco-tourism development” (Dorji and Tobgay, 2003, p.256).

The article evidenced constraints to the plan that included policies and coordination (national tourism policy, national wage policy, the vague definition of conservation area and the coordination among institutional actors). At the micro-level bottlenecks included the “heterogeneous interests of multiple actors” and the search for instant benefits at individual level, the lack of awareness and initiative, the low human resource capacity and the low economic standards of the local population “do not allow individuals to think beyond their own [and immediate] benefits” (Dorji and Tobgay, 2003, p.249). Enhanced awareness, participation as well as people’s aspirations were considered essential elements to be taken into account for conservation and development efforts in the valley.

Since that early account, coordination has been improved with the role of the Royal Society for Protection of Nature (RSPN) as a central organisation responsible for undertaking management and conservation activities in the valley in close coordination with the Government. All the economic activities such as construction of commercial and public buildings, construction of roads and commercial extraction of natural resources in the valley are subject to consultation with the RSPN and the other relevant government offices in Phobjikha or in Thimphu. “It is only after certification and physical verification by these stakeholders that the activities are allowed for operation” (Phuntsho, 2010b, p.61).

The Government offers its services through the extension offices in the valley - mainly through the RNR office (for livestock and agriculture) but also through the Jigme Singye Wangchuck National Park (JSWNP) Office, the Health Unit and primary and secondary schools (Phuntsho, 2010b). Yet, the RSPN have been acquiring the role of umbrella organization for implementation of development and conservation programmes in Phobjikha. Following informal talks with the personnel of the NGO in Phobjikha, the role of RSPN is so central that government agencies often consult the RSPN before implementing any
activity. “It is like the valley would have been outsourced to the RSPN”\textsuperscript{70} or “the MoAF [Ministry of Agriculture and Forests] have leased Phobjikha to RSPN for sustainable development and conservation”\textsuperscript{71}. The approach of RSPN is problem solving and it often acts as a mediator between the strict rules applied often to the letter by the government agencies\textsuperscript{72}.

Phuntsho (2010b) argues that the complex system of “responses [to the challenges above] have been a mix of policies, conservation activities, education and awareness and few technical measures” (Ibid, p.71). The author groups the responses under 3 categories:

1. Leveraging community level response – this is by engaging community through their “local institutions, norms and ethics” (Ibid, p.71) and encouraged the formation of new groups in Phobjikha. The local groups are the Phobjikha Environment Management Committee (PEMC) and the Women’s group, Community Forests and the recent creation of a Community Based Sustainable Tourism group to manage tourism.

\textsuperscript{70} Fieldwork notes, personal communication with RSPN officials, 17 February 2014.
\textsuperscript{71} Email exchange with RSPN programme coordinator, 6 April 2016.
\textsuperscript{72} “Sometimes government field officers prefer to say no to villagers in order not to incur in mistakes” fieldwork notes, personal communication with RSPN officials, 17 February 2014.
2. Enhancing the role of RSPN and the involvement of international agencies to support the implementation of key projects for environmental education and infrastructure.

3. Responses by the government are mainly related to the opening of extension offices to supervise activities in the construction sector and support agricultural and livestock good practices. The rationale underpinning these interventions is that better yields from potato and more productive breeds would provide potentially higher incomes and ideally required less animals and less land to sustain livelihoods, ultimately putting less pressure on the ecosystems of the valley.

Nonetheless, some of the problems evidenced in the early accounts (particularly from Dorji and Togby, 2003) are still present today. More recently, proposals have focused strongly on providing alternatives incentives for conservation of ecosystem services as well as opportunities to enhance food security through income generating activities with potentially low impacts on the wetland. Tourism is always cited as a strategy either for PEC systems or food security through income generation.

However, on the policy side, the government is still unclear about the definition of the conservation area (the lack of which emerged in a recent email exchange with RSPN officials\(^{73}\)); the national tourism policy is still unchanged even if the Government (the TCB in particular) demonstrated openness to the concept of community-based organisations to manage tourism. The TCB does tolerate the involvement of rural entrepreneurs through home-stays, camp sites management and local guiding. Yet, under the current policy set-up the direct benefits to the rural communities from tourism are difficult to measure and difficult to see. The legislation does not allow international tourists to stay in home-stays and tourism services are transacted exclusively with professional tour operators. Thimphu-based tour operators by the law have to provide all services required (transport, guide, and affiliated accommodation) and often

\(^{73}\) On a recent email exchange with the RSPN programme coordinator, noted how the management plan expired and the PLCA is not yet approved by the Government. The core wetland area is protected by the RAMSAR (International Wetland Convention) which Bhutan ratified. The Royal Government submitted the PLCA to RAMSAR despite the fact that itself does not legally recognised Gangety-Phobji valley or the PLCA. At the moment they do not have a legal status \textit{per se}, but PLCA will have RAMSAR recognition in the near future (email exchange, 6 April 2016).
bring equipment from the capital. Local supply of accommodation is limited in rural areas, and hotels are generally not owned or managed by locals.

Image 5: Local owned hotel

Source: Courtesy of GAB President. Locally-owned hotel with the finalised expansion on the left-hand-side and potato fields.

The work of RSPN in Phobjikha has been providing support to change these dynamics, encouraging locals to provide those services and products needed to generate some levels of local economy through self-employment or communitarian initiatives. Income generation through livelihoods diversification (particularly into tourism) in parallel with the development of environmentally friendly infrastructure, conservation initiatives and capacity building in a range of matters including organic cropping, has been the objective of most of the activities in the valley.

From a resilience perspective diversification is often encouraged to reduce livelihoods vulnerabilities. From a conservation perspective the question stays in whether such responses will put more pressure on the system in the future (e.g. Phuntsho, 2010b). Yet, local economies change composition with development, bringing less involvement in natural resource-based occupations and extraction, with higher incidence of sectors like tourism or salaried employment74 (see evidence provide by Cinner and Bodin, 2010).

74 By using a network approach to study “livelihoods landscapes” in tropical coastal communities, the authors observed an increased specialisation with development. At the
7.1.2 Poverty and livelihoods composition in the valley

An attempt to understand poverty and inequality dynamics in the valley comes from a qualitative participatory wealth-ranking exercise based on score cards undertaken by Phuntsho (2010a). The assessment used a reduced census list available from two Gewogs comprising of 475 households that excluded Gogona Chiwog. The report is effective in identifying key assets perceived as important by the families and observed that despite some level of inequality (some households who are extremely well-off), people perceive that there are no large gaps among the population and that there are no households who have difficulty in making a living and who are in extreme poverty (Phuntsho, 2010a). They also perceive that their living standards have improved substantially in the last 20 years and they attributed this mainly to development in the agriculture sector, particularly the introduction of potato farming:

“Potato cultivation … is considered as a sort of ‘revolution’, which has not only increased their income and living standard but has become a part and parcel of their livelihood. People associate their well-being and wealth with income generated from the sale of potato, land area under potato cultivation, house with CGI sheet roofing, power tiller and tractor, car etc. Similarly poor people are those who have less land and less income from potato, small house/hut (wooden buckle house) and those who have less money at their disposition” (Phuntsho, 2010a, p. 7).

In general, Phuntsho (2010a, b) reports how the income from potato has revolutionised livelihoods in the valley and increased living standards:

“It is often heard from the local community that in the past there were huge gaps between the rich and the poor but now because of the income from potato there are fewer poor people and the gap has subsequently lessened.” (Phuntsho, 2010b, p. 48).

Community level economies remain diversified but households specialised in specific livelihoods portfolios. They called this phenomena an “apparent professionalization of natural-resource-based occupations along the spectrum of development” (Cinner and Bodin, 2010, p. 11).
Table 12: Participatory wealth ranking in Phobjikha

<table>
<thead>
<tr>
<th>Category</th>
<th>Criteria</th>
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| Very rich | • Have large land holding (above 3 acre)  
|           | • Have tractors and power tillers  
|           | • Have cars/trucks  
|           | • Have other source of income like business and trade  
|           | • Have big house with CGI roofing  
|           | • Remittance from children who are employed  
|           | • Enough money for daily expenditure  
|           | • Who have power chain saw |
| Medium | • People who have decent housing  
|         | • Enough land to cultivate crops (especially potato)  
|         | • Who have power tiller (some HHs didn’t have power tiller but they were still considered under medium class as they were relatively well-off compared to the poor group).  
|         | • People who have adequate number of labour/ who can afford to pay for hired labour. |
| Poor | • Small land holding (because of land fragmentation)  
|      | • Less labour availability in the household  
|      | • No proper (decent) house and lives in small wooden buckle house  
|      | • No enough money for daily expenditure |

Following those criteria in Phobji Gewog (8 Chiwogs - total population 268 HHs - 2,340 persons) the majority of the HH falls under “Medium” category, about 63.4 percent (170 HHs); 7.1 percent (19 HHs) fall under “Very Rich” and 27.2 percent (73 HHs) under “Poor” category. Around 6 HHs (2.2 percent) were unknown by the various groups. In Gangtey Gewog (7 Chiwogs - Gogona Chiwog excluded - total population: 207 HHs and 1,653 persons), 78 percent (161 HHs) falls under “Medium” category, 6 percent (12 HHs) under “Very Rich” category and 15 percent (32 HHs) under “Poor” category. In both Gewogs, the largest proportion falls within the category “Medium”. Phobji has 12 percent more poor people than Gangtey. The percentage of households under the “rich” category is almost the same for the two Gewogs with 6 and 7 percent for Phobji and Gangtey respectively.

Source: Phuntsho, 2010a. Categories and criteria are identified by the participants.

**Agriculture and Potato Cropping**

The communities primarily depend on crop farming and livestock-rearing for their livelihoods (RSPN, 2005a). The main crops include potato, buckwheat, wheat, and root vegetables such as radish and turnip, often grown as feed for livestock (Phuntsho, 2010b).

Nonetheless, potato it is by far the most important cash crop in the valley. Potato seeds were introduced in the 1990s with seeds distributed to all families in the valley under a Government scheme. ICIMOD and RSPN (2014, p. 15) estimated that the PLCA has one of the highest rates of potato productivity in the country (8 tonnes per hectare) and it produces 41 percent of Bhutan’s total potato production. Phuntsho (2010b) also reports the total potato yield for Phobji and Gangtey, increased from 2,615 tons in 2000 to 5,388 tons in 2008.
Table 13: Crop calendar Phobjikha

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<td>4.5. Harvesting</td>
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Source: Courtesy of RSPN.

The Livelihoods Assessment Tool (LAT) administered by the RSPN in 2011, collecting data on livelihoods on a random sample of 218 households in the PLCA, estimates that “the average household produces 6 tonnes of potatoes”. The assessment report estimated that 93.6 percent of the households in Phobjikha in 2012 depended on potato cropping (ICIMOD and RSPN, 2014, p. 19) a trend previously identified by Phuntsho (2010b) who, by using a PRA, documented that 91 percent of farmers’ income is generated from the sale of potato (ibid, p.46).
The figures on the average income derived from potato cropping are comparable: in 2012 an average household derived an annual gross income\textsuperscript{75} of BTN 168,544 from potato farming (ICIMOD and RSPN, 2014, p. 15). Phuntsho (2010b) reported that the average land under cultivation in Phobji and Gangtey is 1.8 acres (composed by dry land), which produces 130 quintals (13 tons) of potato each year worth BTN 182,000 (equivalent to 3,956 of 2009 USD). A figure that the author found exceptionally high compared to national per capita income of USD 1,900 in 2009 (World Bank data cited by Phuntsho, 2010b, p.47).

In terms of marketing, Bhutanese farmers have a predilection for auctioning. Auctioning is done mainly in Phuntsholing a major trading centre located at the border with India in the South-West of the country. Anecdotal evidence during the administration of the survey to the households provided a quite encompassing view on how the arrangements to market potatoes can be incredibly straightforward. Trucks drivers know when the harvesting season is taking place in the valley and they make themselves available for transportation by parking their trucks along the main roads that connect the valley. They simply wait for the households to arrange with them the transportation\textsuperscript{76}.

At the time of the survey few households hold mobile numbers to contact drivers in nearby Wangdue Phodran to arrange their services beforehand. Once the track is loaded a member of the household travels with the truck to Phuentholing and overlooks the auctioning. There are also cases in which neighbours or family members arrange the sale of the potato for those who cannot travel\textsuperscript{77}. The observations are consistent with a sectoral report on the Bhutanese potato value chain at national level. The report noted that depending on the accessibility of the farm, farmers in remote areas can wait up to “2 to 3 days at the road head to find a truck” (Joshi and Gurung, 2009, p. 29).

The study also observed how the Bhutanese potato value chain is particularly short. The report highlights how most functions are performed by the potato growers themselves (Joshi and Gurung, 2009). Phuntsho (2010b) provides an overview of the arrangements for potato production and marketing

\textsuperscript{75} The study assumes a 35percent of costs on the total gross return, providing a net figure of BTN 124847 (ICIMOD and RSPN, 2014).
\textsuperscript{76} Field notes 13-12-2013.
\textsuperscript{77} Field notes 13-12-2013.
in Phobjikha. By breaking-down his observations in the “steps” of a typical value chain analysis, and by combining them with observation from field-notes, it can be described how seeds suppliers are often households themselves that either stocked potatoes from the previous year or borrow seed potatoes from their neighbours. They also have the option to purchase from RNR or Druk Seed Corporation (DSC). RNR is providing various types of support in the form of provision of fertilisers and pesticides as well as information about potato cropping. Chemical fertilizers are mostly bought in Wangdue Phodrang through fertilizer commissioning agents\(^78\), which since 2009 directly deliver those seeds in the valley (Phuntsho, 2010b).

Land preparation, preparation of seeds, plants protection, fertilising, irrigation and harvesting is also mainly done by members of the households. During the survey administration it has been observed that usually all members of the family are involved in potato “production” (as further evidence of the importance of this crop for rural livelihoods in the valley), often in combination with a mixed system of exchange and hired labour, involving neighbours or community members. Labour is exchanged or hired for specific tasks related to land preparation and harvesting. Machinery is also privately owned or rented from neighbours. Potato fields have no irrigation systems and depend on rainfall.

Image 6: Different stages of potato production

Image: Own photographs. 16 May 2013.

\(^78\) The “system of Commission Agents (CA) was introduced in 1989 and is the main channel for the sale and distribution of agricultural inputs. Commission Agents are identified and appointed by the Dzongkhags and are responsible for the distribution of seeds, saplings, fertilisers, agricultural tools and small machineries. The cost of transportation for the supply of most inputs to the farm is subsidized by the government. The CAs receives 10percent of the value of inputs distributed to the farmers as commission from the Government” (Joshi and Gurung, 2009, p.21).
In terms of financing, Phuntsho (2010b) reported how households made use of different types of formal (bank) and informal lending (friends, relatives or local money lenders borrowing). After having improved its services Bhutan Development and Finance Corporation Limited (BDFCL) has become the main source of financing through which farmers cover the costs of production (seeds, fertilisers and transportation).

There are almost no middlemen in this value chain in Bhutan (Joshi and Gurung, 2009). Phuntsho (2010b) reported a cost for transportation of BTN 150 for a quintal of potato. Joshi and Gurung (2009) also reported a price ranging from BTN 20 to 70 for 50kg bags which is consistent with the Phobjikha figure. Traders at the auction yards are mostly Indian merchants who purchase in bulk and sell the produce in the major border town (Phuntholing). Farmers find auction yards in the border towns convenient, as they can combine their travel to sell potatoes with the purchase of household utensils (Phuntsho, 2010b and Joshi and Gurung, 2009). The action yard is supervised by the Food Corporation of Bhutan a government agency established in 1973 (Joshi and Gurung, 2009). Potatoes in Phuentsholing yard arrive from Wangdue Phodrang (including Phobjikha), Bumthang, Paro, Chukha, and Trongsa. The six eastern dzongkhags take their crops to Samdrupjongkhar.

Phuntsho (2010b) argues that potatoes from Phobjikha are preferred by buyers for quality and size. However, prices with the auction system can fluctuate substantially. Joshi and Gurung (2009) observed additional weaknesses of an overall underdeveloped value chain that include: a weak input/service market from public and private sector, lack of group enterprises (farmers are not organised in cooperatives), lack of storage facilities for seeds and produce, over-dependency on Indian market and Indian traders (Ibid).

These general problems add-up to what the ICIMOD and RSPN (2014) report identifies in the case of Phobjikha as over-dependency on a single cash crop. The Livelihoods Assessment Tool estimated 87.6 percent of the households depend exclusively on the potato monoculture.

There are no refrigeration systems that would give for example the possibility to store potato and wait for better prices (field notes 13-12-2013).
**Livestock**

Livestock rearing and herding have been for centuries the main activity of the inhabitants in Phobjikha, so much so that cattle is still kept as indication of wealth (Phuntsho, 2010b). Animals, mainly yaks and cows, provide milk and milk products while sheep were kept for wool, blankets and garments. Populations practised transhumance in winter by moving to lower altitudes. In the past, roughly 50 percent of the population in the valley used to migrate to warmer areas in Ada, Chitokha, Sha Ngawang (Ibid).

Transhumance is still practised today by few households but the infrastructural improvements and particularly the introduction of the potato as cash crop in the 1990s provided sufficient income compared to any other form of cultivation or livelihood activity altogether. While households originally from the valley have started to settle permanently in Phobjikha other households from villages at lower altitudes in Ada and Chitockha started settling in the valley through land *kidu*\(^80\) attracted by the success of potato cropping. New tourism ventures also attracted people from other districts (Phuntsho, 2010b).

At the moment livestock includes cattle, yak, sheep, horses and poultry. Livestock rearing is practiced largely for dairy production and it is based on a combination of stall-feeding and free-range grazing in the forests, natural wetlands and scrub meadows (RSPN, 2005a, p.25). However, as noted by Phuntsho (2010b) income generation is low and livestock are kept mainly as a customary practice, as well as to assure farmyard manure supply (often mixed with chemical fertilizers when those are scarce).

Dairy products are normally for self-consumption. The animals are “widely kept by many farmers” but in small numbers (only a few farmers own sheep and yak in large numbers) to provide butter and cheese that supplement the household’s food sources (Phuntsho, 2010b, p.47). The surplus dairy products are either sold locally or taken to Wangdue Phodrang (Ibid). From the interviews and during the administration of the survey it emerged that a few farmers are now linked to a cooperative in Gogona (2 hours’ drive from Phobjikha) specialized in the produce of various types of cheese that now supply also local hotels.

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\(^{80}\) *Kidu* refers to a traditional land-grant system whereby landless villagers, for their hardship and family grievances, are granted land belonging to the state.
The RNR centre has been encouraging the local communities to rear improved breeds (especially cows). They provide artificial insemination services and pasture development that would potentially have two benefits: fewer animals to manage and higher income through increased productivity on the one hand, fewer animals grazing on the wetland on the other (Phuntsho, 2010b). However, outsiders also bring livestock animals to Phobjikha. The yak herders of Sephu still practise their traditional nomadic migration by bringing their yaks to the hills slopes at Lawala (Phuntsho, 2010b).

**Tourism**

Phobjikha is strategically located between two major tourism hot-spots Punakha and Bumthang in central Bhutan. The valley offers a logistical hub and stop-over on the long drive from West to Central Bhutan. Visit takes place during the period between October and May. In the valley management plan (RSPN, 2005a) it is argued that tourism activities have steadily increased in Phobjikha both in terms of investments and number of tourists visiting the area. Visits from overseas started with natural scientists assessing the migration of BNC in the 80s. The increasing popularity of Phobjikha as an eco-tourism destination (bird watching in particular) acts as an economic driver that has resulted in increased interest from outsiders and increased tourism-related activities and ventures in the valley.

![Figure 15: Phobjikha tourist arrivals](source)

Source: Own elaboration based on data from TCB and RSPN.
According to Phuntsho (2010b), arrivals have grown significantly in the past ten years. Availability of accommodation and related facilities after 2006 led to an increased numbers of tourists. From a few hundred tourists annually visiting the valley in the late 1990s (817 in 1996), tourist arrivals increased to 6,945 in 2012. Before 2001 there were only three guest houses with limited rooms and facilities. Tourists usually camped near the wetlands and farm lands (Phuntsho, 2010b). Today there are 5 major hotels in the valley that started operation between 2004 and 2014.

Image 7: World class hotels in the valley.

In economic terms the ICIMOD and RSPN (2014) report estimated that in 2011 the total revenues of the hotels in the valley was BTN 114millions equivalent to USD 2.42millions (at 2011 prices). This was a rough calculation summing the results of hotel-specific room rates and the respective number of tourists hosted, and assuming one bed-night per tourist. The study assumed a flat rate of 35percent of costs, to obtain the net revenues from tourism estimated at BTN 78million (USD 1.48 millions). This represents 40percent of the total value of the ecosystem services from the wetland. Revenue generated from recreational services (tourism) ranks first in terms of its contribution to total economic value from ecosystem services (ibid, p.18). Potato cultivation represents 30percent of the economic value of ecosystem services in Phobjikha.

The PRA conducted by Phuntsho (2010b) estimates that 91percent of farmers’ income comes from the sale of potato, the remaining from other
sources such as livestock (5 percent), kitchen gardening and shops (3 percent) with remittances and tourism representing altogether only 1 percent (p. 47). The LAT exercise (using a random sample of 218 households in the PLCA) estimated that less than 2 percent of households had members either employed or engaged in managing nature-based tourism business in Phobjikha Valley (ICIMOD and RSPN, 2014, p. 20).

It is evident that the high economic value of tourism (estimated to understand the services provided by the wetland) is not shared among the households which experience a strong economic dependence on potato monoculture. One of the recommendations therefore is to promote nature-based tourism to diversify the local economy and decrease vulnerabilities associated with a single crop production either by direct management through ventures of community members or by increasing the links to the tourism supply-chain as food provider, handicrafts or support services (ICIMOD and RSPN, 2014, p. 40). It is also noted that except for two hotels, others are owned by external ventures and entrepreneurs. Phuntsho (2010b) observed that most of the employees in the hotel sector are from other districts given that hotels require educated and trained employees. He also argues that hotels run by the locals tend to employ relatives, providing few opportunities for others in the valley (Ibid, p. 45). Recently, entrepreneurs have been acquiring land and four more hotels are planned.

### 7.1.3 Community organisations

One of the issues that are highlighted by Phuntsho (2010b) is the pre-existence of community norms and traditional groups in the management of the natural resources in the valley. The management of forest resources and water was particularly linked to livestock farming before the introduction of intensive forms of agriculture. People’s livelihoods depended on forest resources for almost everything. Therefore, forms of community organisations were linked to the management of timber, firewood, leaf litter and grazing for the cattle from the forest (Phuntsho, 2010b, p. 28).

Each community had its own village forest with a specific name and boundary with user groups that could access the forest resources. They used
local forest keepers called “resup” appointed by the community to monitor their resources, including water use. In Phobjikha there were 49 locally instituted village forests with an average user group of 12 households ranging from as small as single household to 36 households (Phuntsho, 2010b, p.59).

The government institutionalized community forests (CF) management and they are similar to the traditional village forests. CFs are formed by locals to support the Forestry Department effort to bring communities to a level in which they can take forest management decisions based on rational decision-making\(^81\). Eight community forest management groups have been instituted in Phobjikha by the Government and supported by RSPN (ICIMOD and RSPN, 2014, p. 36) collectively covering and managing 699.6ha of forest where 237 households are directly responsible and benefiting from their management (Phuntsho 2010b, p.42).

Image 8: Community forests

Source: Own photographs. Community forest signposting in different villages (Gangtey, Aekho, Tabaden).

**Governance in Phobjikha – The Environment Management Committee**

Given the long tradition of community involvement, self-regulation and management as well as the positive attitudes of villager towards community groups, others groups have been instituted for conservation activities. They were initiated by the RSPN, the WWF and government agencies. On the line of these community forests, a local group was created in 1998, the Phobjikha Conservation Area Project (PCAP) Committee, with the objective to overlook at development and conservation initiatives. Its name was changed to Phobjikha Environment Management Committee (PEMC) in 2005. Along with this

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\(^81\) Even now decisions on accessing specific areas of the forest and use of resources are based on traditional beliefs and superstition, often involving local Lamas.
committee other groups were created such as the Women’s Group, supported by International Centre for Integrated Mountain Development (ICIMOD), to involve women in conservation activities, the Waste Management sub-committee and the Community Based Sustainable Tourism group.

Figure 16: Phobjikha Environment Management Committee and subgroups

![Diagram of Phobjikha Environment Management Committee and subgroups]

Then PEMC has the scope to be the decision-making body and ensure the promotion of an integrated conservation and development of Phobjikha area linking the community to the Government and other conservation agencies. It comprises members representing the local people (local leaders), business community and religious institutions within the conservation area and the government agencies such as RNR sectors, health, education and the RSPN (Phuntsho, 2010b, p.59).

**Phobjikha Conservation Fund**

One of the mandates of the Committee is to raise funds to accomplish its own objectives related to environmental conservation and community development projects. Even though the Committee cannot receive or operate its functions by taking loans, it can manage funds from different sources. Funds can be contributions from donors, revenues from community business ventures, interests generated by the microfinance scheme or donations. The minimum for the Fund to be operational is BTN 500,000.
Depending on the levels of capital collected, the Committee can approve micro-loans for amounts not exceeding BTN 5,000 per household at a nominal interest rate approved by the Committee. The Committee therefore, determines interest rates and specific terms for the loan repayment and approves loan to households. Each household within the jurisdiction of the Committee is entitled to an approved loan and may be eligible in the future upon full repayment of the previous. Priority is based among the needs of the households. If the fund reaches BTN 1,000,000 the Committee can also approve grants for amounts not exceeding BTN 50,000 per annum for each Gewog for community project approved by the Committee (RSPN, 2005b, p. 8).

Community based sustainable tourism (CBST) group

The work on tourism was initiated in 2003 by the RSPN with the assistance of the UNESCO (Phuntsho, 2010b). The CBST group was created with the support of the RSPN and after the PEMC opted for the decision to develop a system of home-stays in the valley in consultation with the households. The objective was to provide alternative non-farm income sources to locals mainly through the delivery of trainings in a range of skills related to tourism management (home-stay, guiding and handicraft) as well as the support to upgrade housing and general infrastructure.\(^2\)

The recently created group is meant to be responsible for the management and promotion of the community-based sustainable tourism initiatives in Phobjikha in coordination with other businesses in the area and

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\(^2\) Fields notes 29-10-2013.
stakeholders in Thimphu. The group currently includes members of the home-stay program (21HHs) and local guides (9HHs) and it is meant to be open to other business and initiatives in the valley as well as local representatives. It is established under the Phobjikha Environmental Management Committee (PEMC). In the long-term the community through this group should play an active role in monitoring the sustainability of tourism activities in Phobjikha.

The CBST members, through a general assembly elect the members of the CBST Steering Committee. The decisions and directives of the committee are executed by a management team and involve: - development and maintain standards with the responsibility to monitor home-stay and guide \(^{83}\), review and improve products and services, promote local products and handicrafts, facilitate group services (cultural programs and festivals); - maintain links with tour operators, develop and update websites, produce brochures to market products and services and; - provide a fair distribution of guests, including the timely collection and deposit of membership and community service fees.

**Figure 17: Organizational structure of the CBST Group**

<table>
<thead>
<tr>
<th>CBST Members’ General Assembly elects CBST</th>
<th>CBST Management Team</th>
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<tr>
<td>Secretary</td>
<td>Chair-person</td>
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<td>Treasurer</td>
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**Functions**
- Monitor homestays’ standards.
- Review and improve products.
- Promote local products and handicrafts.
- Facilitate group services (cultural programs and festivals).
- Maintain links with tour operators and facilitate/arrange programs as per reservation.
- Distribute guests among the households.
- Collect and deposit membership and community service fees.
- Develop and update websites, pamphlets, and brochures.
- Organise general/regular stakeholder/members meetings.

Source: RSPN - Presentation to tour operators held on 22 January 2014.

Infrastructure has been developed so far with the collaboration of international and national donors. Over the years the RSPN has helped in

\(^{83}\) Standard Operating Manual for Home-stays in Phobjikha was developed in cooperation with the TCB and the NRED.
setting-up basic tourism facilities such as nature trails, camping sites and visitor centres, and it has recently been involved in developing a series of tourism products (services such as home-stays, bike riding and more complex packages, local handicrafts and cultural festivals). The latest project (financed by JICA and executed in partnership with JEEF) contributed to the improvement of toilets for the households and the acquisition of key items for the management of up-to-standard home-stays services as well as the development of handicraft skills. General infrastructure up-grading included trails on the wetland and the visitation centre improvements. The association of Bhutanese tour operators and the Austrian Cooperation office co-financed the bike trail inaugurated in 2014.

Image 10: Tourism infrastructure

Biking trail inaugurated in 2014 co-financed by ABTO and the Austrian Development Cooperation.  

Previous nature trail, going through the valley.  

Renovation works at the visitation centre.  

New nature trail across the wetland under construction.  

Source: Own photographs.
The range of tourism products offered include home-stays, hot-stone baths, evening cultural programmes, traditional games, campsite management, day walks and trekking, local cultural guiding, bicycle rental, cultural festivals and a gift shop within the Black-necked crane visitor centre. The centre is the hub for the tourism activities in the valley and it maintains its functions of main interpretation centre.

Image 11: Homestay network trainings and infrastructure

Source: Own photographs – May 2013. “Software” and “hardware” for home-stays network development – training courses for cooking and housekeeping, acquisition of new items and improved toilets. Faces were purposively blurred.

**Current issues related to tourism**

There is the perception that tourism is increasing competition over resources such as land, timber, fuel wood and water. Locals ranked tourism among one the significant factors causing of environmental degradation (Phuntsho, 2010b). As noted by Phuntsho (2010b) people are sceptical “about the sustainability of the forest and water resources, as most hotels also depend on local forest and water resources” (p.37). In addition, it greatly benefits few households and often outsiders. Phuntsho also observed how hotels buy vegetables from farmers but this is done in small quantities and that “most of
the food items for the hotels are brought from other places such as Thimphu and Wangdue Phordang” (Ibid, p.51).

The development of a more sustainable and equitable tourism remain the priority of the RSPN. But the impact on the households of the existing eco-tourism activities is still unclear. Full operations of the CBST initiated in 2013. During the 2014 World Tourism Day the Government took Phobjikha as a flagship for community tourism in the country\(^{84}\) and celebrate the initiative at the presence of the Economic Affair’s Minister. The TCB used inputs from RSPN expertise in the area of community tourism development to create national classification and guidelines for the management of home-stays. But home-stay for international tourists is still contrary to the country’s legislation and it is a practice that it has been tolerated by the TCB.

The RSPN developed a business plan for the CBST group in the valley in 2014 with pricing of different and more complex services that can be contracted directly (by regional tourists) or by Bhutanese tour operators (normally including those services on the minimum package or by asking to pay extras to the tourists). Following the business plan, collective benefits from tourism should be ensured through a mechanism of revenue sharing where all members of the CBST group have the obligation to maintain records of products and services sold. From this, receipts are issued against all payments received from visitors. All members need to declare their monthly revenue and ensure 10 percent fee is deposited with the CBST Management at the end of each month. 70 percent of the amount deposited by the individual members shall be retained in the CBST bank account and the remaining 30 percent is deposited to the bank accounts of the PEMC. The treasurers of the respective committees need to ensure the funds are received. The revenue can be utilized for covering management and operating cost of the CBST group.

Workshops and a familiarisation trips were held respectively in Thimphu (on 22 January 2014) and in Phobjikha (on 16 February 2014) to present the products and services to the national tour operators. However, the press reported in October 2014 that homestays from the community of Phobji did not

receive any guest even during peak season. The article reported how people invested between BTN 50,000 to BTN 100,000 to bring the house up-to-standard in addition to the RSPN-JEEF contribution of BTN 15,000 for toilets improvements. The concern from many of the households involved is to be able to repay the investments made and more actively participate in tourism.

To conclude this section, despite the wide recognition in the country that tourism is, with hydropower, one the main commercial sectors that most benefits from the natural environment, communities still face stringent regulations that are attached to the environmental stewardship and conservation priorities of the country. This translates into livelihoods vulnerabilities and food insecurity at the local level with “a pressing need to develop mechanisms to balance conservation and development… [and] to compensate land managers for costs and foregone benefits of national nature conservation priorities.” (FAO, 2010, p. 5).

In Phobjikha local communities face major limitations “in terms of forest use, built area expansion, road building and even electrification has been
delayed until donor funding has covered the higher costs of bird-friendly underground electrification” for the area which still suffers electricity cuts (FAO, 2010, p.8; Gyelmo, 2015). The reports available for the valley, consider the potential links between service providers (farmers) and service beneficiary (tourists) through the direct or indirect involvement in tourism by the community and the indirect contribution through the access to hotel supply chains for local produce and the collection of fees for visitation\textsuperscript{85} to capture and maximise tourism revenues locally.

Recommendations also include the adoption of low input agriculture techniques, production of a wider variety of produce and organizing a local supply chain to local hotels (Ibid, p.8). However, it is widely recognised that farmers often resist change and are careful at adopting new methods of production especially if they depend on single crops if inadequate income alternatives or complementarities are present (e.g. Evans et al., 1991).

Pilot experiences in Bhutan from past community-based ventures in tourism show that community people can benefit but there are a number of constraints. Essential to tour operators are the provision of reliable services, hygiene and quality standards. The recommendations to the pilot project in Nabji-Korfu are not different from other case studies around the world and not only in tourism (Unknown, 2010).

Successful market linkages imply a number of actions to support community members through capacity building in various skills and ensure flow of knowledge and investment at the individual household level as well as infrastructural development at community level. The RSPN put most of these actions in place in a consistent and informed way.

At the same time the idea of increasing horizontal coordination through community-based groups has the potential to increase in the long-run the governance of common resources and productive assets in the valley (which is

\textsuperscript{85} FAO (2010) estimates significant funds can be collected from visitors. As an indication, in the management plan prepared by RSPN, budget requirements for nature conservation activities, for the first 5 years are estimated at BTN 5million/year or USD 32,000 (of a total BTN 10million or USD 215,000). Considering that the valley gets about 6000 visitors a year, for at least one night, this would require a contribution of only USD 5 per tourist (BTN 233). Informal discussions with tour operators working in the area and a willingness to pay survey to tourists reveal that tourists would be willing to pay such an amount, provided that its goals and investment priorities would be made clear. For the tour operators, the interest in facilitating this process lies in ensuring the maintenance of the landscape values in the area (Ibid, p.49).
now characterized by a mix of private land ownership, common land and rich intangible assets), ultimately increasing the capacity to sustain the conservation efforts.

The creation of new ties and the strengthening of old ones within communities and between households, through new business models such as the CBST group, should reduce problems associated with coordination, production and delivery of different tourism services while benefiting more directly the communities in Phobji and Gangtey. The creation of the CBST group should benefit communities by increasing the level of social capital and by creating communities of practice (i.e. frequent interaction within the members of the group) as well as bridges between the CBST group, the hotels in the valley and the tour operators in Thimphu. The analysis below will explore these issues.

7.2 Survey data analysis and discussion

7.2.1 Sample characteristics

The methodology chapter provided detailed information about the study design and “how” and “why” the sample (N=39) was selected based on specific characteristics. This section offers descriptive information about the sample, highlighting its commonalities and differences from characteristics of representative national surveys or other statistics summarised in the previous studies.

Land ownership and Livestock

Table 14 shows that land ownership for this sample (mean 2.45 acres, SD=1.4) does not deviate significantly from the rural mean at the national level which is 2.72 acres (ADB and NSB, 2013). The area of land under potato cultivation is 1.87 acres (SD=1.2) and does not deviate from the mean of 1.8 acre, indicated in previous studies in the valley (e.g. Phuntsho, 2010b or RSPN 2005). In terms of number of livestock owned per household (including cattle and sheep, but not poultry), the mean in the sample (mean 8.36) is higher than the generic “3-4” indicated by Phuntsho (2010b) but there is also great variation
in this variable as shown by the percentile distributions, with over 25 percent of households owning no livestock. These findings are in line with previous studies that suggest only a few households still own large numbers of livestock. Contrary to the national statistics (ADB and NSB, 2013), in this sample the negative relationship between livestock owned and income levels was not observed.

Table 14: Descriptive statistics for key asset variables (year one)

<table>
<thead>
<tr>
<th></th>
<th>LND OWNED</th>
<th>LND OPERATED</th>
<th>LND POTATO</th>
<th>NLVSTOK</th>
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<tr>
<td>N Valid</td>
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<td>39</td>
<td>39</td>
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<tr>
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<tr>
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<td>2.4533</td>
<td>1.946</td>
<td>1.869</td>
<td>8.36</td>
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<tr>
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<td>3.000</td>
<td>2.500</td>
<td>12.00</td>
</tr>
</tbody>
</table>

Source: Own calculations.

Table 15: Descriptive statistics for key asset variables (year two)

<table>
<thead>
<tr>
<th></th>
<th>LND OWNED</th>
<th>LND OPERATED</th>
<th>LND POTATO</th>
<th>NLVSTOK</th>
</tr>
</thead>
<tbody>
<tr>
<td>N Valid</td>
<td>39</td>
<td>39</td>
<td>39</td>
<td>39</td>
</tr>
<tr>
<td>Missing</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Mean</td>
<td>2.3154</td>
<td>1.7503</td>
<td>1.7503</td>
<td>8.00</td>
</tr>
<tr>
<td>Std. Deviation</td>
<td>1.53130</td>
<td>1.09018</td>
<td>1.09018</td>
<td>7.423</td>
</tr>
<tr>
<td>Minimum</td>
<td>.00</td>
<td>.0</td>
<td>.0</td>
<td>0</td>
</tr>
<tr>
<td>Maximum</td>
<td>6.00</td>
<td>4.00</td>
<td>4.00</td>
<td>30</td>
</tr>
<tr>
<td>Percentiles</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>25</td>
<td>1.3000</td>
<td>.8000</td>
<td>.8000</td>
<td>.00</td>
</tr>
<tr>
<td>50</td>
<td>2.0000</td>
<td>2.0000</td>
<td>2.0000</td>
<td>8.00</td>
</tr>
<tr>
<td>75</td>
<td>3.0000</td>
<td>2.5000</td>
<td>2.5000</td>
<td>11.00</td>
</tr>
</tbody>
</table>

Source: Own calculations.

**Income and livelihoods activities**

In year one (data collected between December 2013 - January 2014), the total income from the sample is BTN 38,409,600. 87 percent of the households in the sample are involved in potato cropping, however due to the sample selection criteria (all households involved in tourism), income from potato
cropping corresponds to only 14 percent (BTN 5,417,000) of the total income; income from tourism services of various types corresponds in this case to 82 percent (BTN 31,649,000) of the total income; while income from livestock (selling of cattle, milk and milk products) corresponds to 0.6 percent. If respondents that work professionally and have diversified successfully into tourism (by managing accommodation services) are excluded from the sample, the income from potato cropping accounts for 75 percent of the total income of the households; income from livestock for 4 percent and income from tourism would account for 9 percent of the total. Tourism is still higher than the 1 percent mentioned in Phuntsho’s rural appraisal (2010b) as the sample includes those households that have been targeted by the RSPN intervention for tourism development in 2013. Table 16 below offers a description of different income sources, their means and standard deviations with income from tourism services (CASHECON6) having the greater standard deviation among the different livelihoods strategies (SD=4,799,047.38 BTN) with over 25 percent of households receiving no income from it.

Table 16: Summary statistics for key income variables (year one)

<table>
<thead>
<tr>
<th></th>
<th>TOT_INCOME</th>
<th>CSHPOTATO</th>
<th>CASHECON2</th>
<th>CASHECON6</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>N</strong></td>
<td>Valid 39</td>
<td>39</td>
<td>39</td>
<td>39</td>
</tr>
<tr>
<td><strong>Missing</strong></td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td><strong>Mean</strong></td>
<td>984861.54</td>
<td>138897.44</td>
<td>5912.82</td>
<td>811512.82</td>
</tr>
<tr>
<td><strong>Median</strong></td>
<td>210000.00</td>
<td>150000.00</td>
<td>3000.00</td>
<td>10000.00</td>
</tr>
<tr>
<td><strong>Std. Deviation</strong></td>
<td>4803398.21</td>
<td>92930.59</td>
<td>9406.134</td>
<td>4799047.388</td>
</tr>
<tr>
<td><strong>Minimum</strong></td>
<td>42000</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td><strong>Maximum</strong></td>
<td>30200000</td>
<td>300000</td>
<td>50000</td>
<td>30000000</td>
</tr>
<tr>
<td><strong>Percentiles</strong></td>
<td>25 160000.00</td>
<td>50000.00</td>
<td>.00</td>
<td>.00</td>
</tr>
<tr>
<td></td>
<td>50 210000.00</td>
<td>150000.00</td>
<td>3000.00</td>
<td>10000.00</td>
</tr>
<tr>
<td></td>
<td>75 262000.00</td>
<td>200000.00</td>
<td>10000.00</td>
<td>40000.00</td>
</tr>
</tbody>
</table>

Source: Own calculations.

In year two (data collected between December 2014 - January 2015), the total income for the sample is (BTN 35,335,800). 89 percent of the household are involved in potato cropping, income from potato cropping is higher in proportion - 30 percent of the total income, literally doubling from the previous year (BTN 10,943,000). The observed increase in income from potato cropping
in year two is consistent with a price increase documented by the Food Corporation of Bhutan at national level\textsuperscript{86}. Income from tourism services corresponds to the 65\% of the total income; income from livestock is 0.5\%. Again if those that work professionally in tourism are excluded from the sample, the incidence of income from potato cropping is 81\% of the total; income from livestock 1.4\% and the incidence of income from the provision of tourism services is 6\%. It seems that the households that have been targeted by RSPN intervention have been benefiting less from tourism in 2014. In both years without the “tourism outliers” the contribution of tourism as an alternative economic livelihood to households seems marginal.

Table 17: Summary statistics for key income variables (year two)

<table>
<thead>
<tr>
<th></th>
<th>TOT_INCOME</th>
<th>CSHPOTATO</th>
<th>CASHECON2</th>
<th>CASHECON6</th>
</tr>
</thead>
<tbody>
<tr>
<td>N</td>
<td>Valid 39</td>
<td>39</td>
<td>39</td>
<td>39</td>
</tr>
<tr>
<td></td>
<td>Missing 0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Mean</td>
<td>906046.15</td>
<td>280589.74</td>
<td>5307.69</td>
<td>576020.51</td>
</tr>
<tr>
<td>Median</td>
<td>349000.00</td>
<td>300000.00</td>
<td>.00</td>
<td>10000.00</td>
</tr>
<tr>
<td>Std. Deviation</td>
<td>3248681.97</td>
<td>176153.00</td>
<td>9081.94</td>
<td>3196360.66</td>
</tr>
<tr>
<td>Minimum</td>
<td>20000</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Maximum</td>
<td>26035000</td>
<td>600000</td>
<td>35000</td>
<td>20000000</td>
</tr>
<tr>
<td>Percentiles 25</td>
<td>252000.00</td>
<td>150000.00</td>
<td>.00</td>
<td>.00</td>
</tr>
<tr>
<td>Percentiles 50</td>
<td>349000.00</td>
<td>300000.00</td>
<td>.00</td>
<td>10000.00</td>
</tr>
<tr>
<td>Percentiles 75</td>
<td>580000.00</td>
<td>400000.00</td>
<td>9000.00</td>
<td>53000.00</td>
</tr>
</tbody>
</table>

Source: Own calculations.

In general, it can be said that households in the sample have some general characteristics that are similar to observations from previous studies and national averages. However, the sample contains five “outliers” that make income derived from tourism more pronounced. These are community members that were able to diversify successfully and substantially into tourism\textsuperscript{87}. If these

\textsuperscript{86} The Food Corporation of Bhutan Ltd (FCBL) reported that at national level the total earnings from potato increase by 60\% compared to 2013, even though the total quantity of potato auctioned did not increase much between 2013 and 2014. The average potato price per kilogram in 2014 was Nu 38.51 (Rai, 2015).

\textsuperscript{87} 11008 - member of the community and professionally running a guest-house at international standard but also cultivating potato and member of the community forest; 11010 - not originally from the community is employed as manager in a guest-house in partnership with a tour operator based in Thimphu but originally from Gangtey; 11023 - member of the community has
outliers are eliminated, the sample has characteristics close to national averages. Yet, the advantage of studying the outliers is to see where the difference from the average cases stands.

**Demographic characteristics**

The rural national average of household members in Bhutan has been estimated to be 4.8 in 2012. The average household size in this sample (including those leaving temporarily outside the household) is 6 (SD=1.8) with the mean age of the household head estimated at 42 years old and a national rural average of 49.1 years of age for households heads in Bhutan.

Table 18: Summary statistics for key demographic variables (year one)

<table>
<thead>
<tr>
<th></th>
<th>HHEAD_AGE</th>
<th>HH_MEMBERS</th>
<th>EDU_M</th>
<th>EDU_F</th>
<th>TOTALNact</th>
<th>MGRTNRATIO</th>
</tr>
</thead>
<tbody>
<tr>
<td>N Valid</td>
<td>39</td>
<td>39</td>
<td>39</td>
<td>39</td>
<td>39</td>
<td>39</td>
</tr>
<tr>
<td>Missing</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Mean</td>
<td>42.03</td>
<td>6.03</td>
<td>2.21</td>
<td>1.41</td>
<td>4.64</td>
<td>.0998</td>
</tr>
<tr>
<td>Median</td>
<td>42.00</td>
<td>6.00</td>
<td>.00</td>
<td>.00</td>
<td>5.00</td>
<td>.0000</td>
</tr>
<tr>
<td>Std. Deviation</td>
<td>11.536</td>
<td>1.857</td>
<td>3.708</td>
<td>2.816</td>
<td>1.784</td>
<td>.17808</td>
</tr>
<tr>
<td>Minimum</td>
<td>21</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>1</td>
<td>.00</td>
</tr>
<tr>
<td>Maximum</td>
<td>81</td>
<td>10</td>
<td>15</td>
<td>12</td>
<td>9</td>
<td>.63</td>
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<tr>
<td>Percentiles</td>
<td>25</td>
<td>33.00</td>
<td>.00</td>
<td>.00</td>
<td>4.00</td>
<td>.0000</td>
</tr>
<tr>
<td></td>
<td>50</td>
<td>42.00</td>
<td>6.00</td>
<td>.00</td>
<td>5.00</td>
<td>.0000</td>
</tr>
<tr>
<td></td>
<td>75</td>
<td>49.00</td>
<td>7.00</td>
<td>3.00</td>
<td>2.00</td>
<td>6.00</td>
</tr>
</tbody>
</table>

Source: Own calculations.

More than half of the household heads and spouses in the sample had no formal education, which is consistent with the National Living Standards survey (ADB and NSB, 2013) that estimated than 7 out of 10 household heads had no formal education. The average numbers of livelihood activities in the sample is 4.6 (SD=1.8) and migration is low with less than 50 percent of the household having at least one member that migrated for education or other purposes.
Table 19: Household head gender by community

<table>
<thead>
<tr>
<th>HD_GENDER</th>
<th>MALE</th>
<th>FEMALE</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>GANGTEY</td>
<td>10</td>
<td>16</td>
<td>26</td>
</tr>
<tr>
<td>PHOBJI</td>
<td>5</td>
<td>8</td>
<td>13</td>
</tr>
<tr>
<td>Total</td>
<td>15</td>
<td>24</td>
<td>39</td>
</tr>
</tbody>
</table>

Source: Own calculations.

7.2.2 Livelihoods and network analyses

This section visualises and measures the position of household in the multipurpose network (centrality measures are provided in section 7.2.2.1) and the structure of their ego-network (densities and structural holes measures are provided in 7.2.2.2) related to the economic-livelihoods ties, and correlates them with household assets and livelihoods data (respectively in sections 7.2.2.3 and 7.2.2.4). Broadly speaking, network theory argues that the way an actor is embedded in a network of social relationships - and the structural characteristics of that network - affect the ability to act upon the resources that the actor has available.

Given that one of the working hypotheses is that social networks matter in order for a household to diversify successfully into new productive activities (particularly tourism), the research questions to be answered are: How does a household’s position in the multipurpose productive network relates to its demographic, assets and economic livelihoods characteristics? And, how do households’ ego-centred networks affect the ability to diversify economic livelihoods strategies? How different measures of centrality and ego-network structures relate to different demographics, assets or livelihoods can provide an indication of their relevance for the ability to act upon assets and sustain livelihoods. The analysis of households’ positions in the multipurpose network cast light on the horizontal relationships among community members, while the ego-network analysis has implications for horizontal as well as vertical relationships.

This section will also test the hypothesis emerging from the findings in chapter 6, that social relationships based on kinship are an important
mechanism for actors to be included successfully into the tourism value chain. Results will be triangulated with qualitative data to cast light on how some of the “outliers” in this sample were able to diversify with the aim to further understand the arrangements for coordination and support associated with different economic-livelihoods. In this way there is a mix of exploratory and confirmatory objectives. Other “sub-research” questions include the exploration of institutional arrangements associated with gender and how this variable relates to other network and intra-household variables such as time constraints.

As detailed in section 4.6.4 information about social relationships (ties) was collected in two steps:

1. Asking about the members of the bounded network (sample of 39 HHs). The result is a whole-network formed by community members’ interaction. This analysis includes all the relationships (directed ties) among the households in the sample. The network represented is multipurpose meaning that it collects information about the work-related demand for assistance in production and marketing for various livelihoods strategies. For simplicity the aggregated ties will be called economic-livelihoods ties.

2. Asking about any other actors in the community and beyond. The result are ego-networks that would include the role of the Renewable Natural Resources (RNR) extension office for livestock and agriculture; the national environmental NGO (RSPN); luxury hotels and established farmhouses in the valley; as well as tour operators in the capital city that work as gatekeepers to the market for tourists.

**Visualisation**

As a first step, the graphic representation of the network should reflect the ethnographic sense of what is going on (Borgatti et al., 2013, p. 70). The visualisation of multipurpose ego-networks (Figure 18) shows the centrality of certain members, of organisations from the public and private sectors as well as a local environmental NGO. This is consistent with field observations and the information reviewed on the previous section.

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88 This property is known as “multiplexity” when multiple ties exists among the same set of actors (Borgatti and Li, 2009, p. 4).
Figure 18: Multipurpose ego-networks of economic livelihoods

Source: Own elaboration. Network based on the 39 households reporting on their relationships adding also the role of the public sector organisations (orange nodes) and the private sector (yellow nodes).

The network with organisations of the private and public sectors clearly shows patterns consistent with field observations and from previous studies (e.g. Phuntsho, 2010b). These studies describe the relevance to agriculture of RNR offices in providing fertilisers, seeds, advice in agriculture and livestock management. The central role of RSPN is also evident in the network.

Figure 19: The role of public organisations in agricultural livelihoods

Livestock
Considering that the RNR and the RSPN have no direct commercial role, the network linked to them suggests that it can be considered as a knowledge generating network. The position and the outward orientation of ties of the RNR in the graph show its role in advice-giving on production techniques more than coordination of groups or individuals for commercial purposes. From the visual exploration public and professional private sector actors seem connected in a “point-to-point” fashion to some of the households.

Figure 20: The role of the tourism private sector
In the case of the private sector of tourism (yellow nodes), relationships do not extend beyond the interaction among a few actors. In tourism the role of tour operators (coded as TOs in yellow), the RSPN and the chair-person of the CBST group are prominent and include a mix of knowledge and commercial relationships. In general, it seems that economic livelihoods activities of households are influenced substantially by public organisations and the professional private sector. It is also apparent that a certain level of interaction among small groups of households is consistent with their geographical location (proximity).

Following the visualisation, metrics related to households’ positions in the network are calculated based the whole network design formed by the group of 39 households. Metrics associated with the ego-network (that include other actors beyond the community) are also calculated and used in section 7.2.2.3. These measurements whose meaning is explained in the methodology and in Appendix – D, provide information on the ability of households to take advantage of their positions, such as those being the interface between different actors or by acting as brokers, mediators or coordinators, or being embedded in a particular network structure (e.g. Giuliani and Pietrobelli, 2011). The measurements are correlated with livelihoods and asset variables (section 7.2.2.2 and 7.2.2.4). The next section will provide a description of the characteristics of the whole network configuration.

7.2.2.1 Whole-network analysis

The graph of the whole-network (39 HHs) clearly shows how the CBST group coordinator (actor 11032) serves as a bridge between two main communities: -Gangtey (11 is the identifier in the first two digits of the household code) on the left side of the graph and; -Phobji, on the right (identified with 12). The graph shows also 4 unconnected households.

Given the apparent central role of a few actors in the network, a core/periphery algorithm was used to identify a set of actors who have a high density of ties among themselves, the core. In theory, the actors in the core are able to coordinate their actions and this gives them “a structural advantage in exchange relations with actors in the periphery” (Hanneman and Riddle, 2005,
The core is composed by actors 11001, 11004, 11005, 11006, 11011, 11032, 11034, 11039 and 12031.

Figure 21: One-mode network based on 39 households.

By using Freeman’s approach to degree centrality, network centralization can be estimated based on both out-degree and in-degree. Freeman graph centralization measures express the variance in the network as a percentage of that of a perfect star network (perfect inequality) of the same size. In the current case, the out-degree graph centralization is 41.5 percent (in general, a high percentage of network centrality indicates a tendency to have hierarchy) and the in-degree graph centralization of 9 percent of the theoretical maximums of a star (100 percent).

The average actor degree (the sum of both out-degree and in-degree) is 1.641, not high considering the number of actors in the network and their geographical position (proximity). Variance is higher in out-degree - indicating some actors’ influence (7.358) - than in-degree (1.358). The range (minimum and maximum) and variability of different measures of degree centrality can be important, because they describe whether actors are “homogeneous or heterogeneous in structural positions” (Hanneman and Riddle 2005, p.149). In terms of out-degree the range is higher (from 0 to 17) than in-degree (from 0 to 5).
So there is a substantial amount of concentration in this network in terms of out-degree. This can imply positional advantages unequally distributed in the network. However, out-degree is higher in the case of the actor coordinating the CBST group. The first three positions on the output table from UCINET routine are occupied by the CBST chairperson (actor 11032) and actors 11039 and 11004.

The betweenness centrality is an additional measure of centrality that considers an actor as being in a favoured position when “the actor falls on the geodesic paths between other pairs of actors in the network”. Alternatively, if two actors are connected by more than one geodesic path, and the actor is not on all of them, the actor loses some power (Hanneman and Riddle, 2005, p.163). The overall network betweenness centrality is 5.76 percent and there is higher variation in actors’ betweenness metrics (from 0 to 88).

The centrality measures related to actors’ betweenness show positions of few actors which are again consistent with field observations. In fact, in the case of actor 11032, its position is consistent with the business model of the Community Based Tourism organization (CBST). This actor coordinates the members of the CBST group that are not otherwise connected. The actor connects households in the lower valley (Phobji) and in the upper valley (Gangtey). In this case, its role as coordinator of the group of households is reflected in its betweenness scores. In general, it seems that the left-side of the graph (actors from the Gangtey Gewog) betweenness is higher overall.
The community actors that seem to harness more “power” are: household 11004 - its position might reflect the fact that both, household head and spouse hold a role in the community: the spouse is a village chief (Tshogpa), while the household head is home-stay supervisor (an additional role foreseen in the CBST group business model). Household 12022 - the household head is accountant for the same group. Household 11006 – the spouse is chair-person of the community forest. Other households’ members do not cover specific roles.

### 7.2.2.2 Centralities, livelihoods, assets and demographic variables

The analysis of betweenness, out-degree and in-degree centralisations on the whole-network configuration (one-mode analysis) is motivated by the visual exploration of the graphs. Nonetheless, as pointed out in the methodology chapter, outcomes for individuals are “in part a function of the resources that their social ties enable them to access” (e.g. Lin, 2001 cited by Borgatti et al, 2013, p.8). These include the patterns of interaction within the community that can explain concentration of power, flow of information and resources. The analyses below combine networks metrics from the multipurpose network of the 39 households with demographic, asset and livelihoods data. The
measurements related to network structures are extracted from the ego-network routines in UCINET and correlations are instead presented further below (in 7.2.2.4).

Are different measures of centrality associated with different assets and livelihoods? The result of the analysis is discussed contextually. The correlation matrix (Figure 24) shows how out-degree is positively associated with cash from crop agriculture (Spearman’s rho=0.45; p=.004) and land operated (rho=0.39; p=.014). In-degree shows positive correlations with cash from crop agriculture (rho=0.357; p=.026), while with land operated is significant at 10percent confidence interval (rho=.29; p=.079). The other variables are not strictly significant. Betweenness scores are weakly associated with the same variables yielding weak significance levels (at 10percent). Cash from crop agriculture, for example, is significant (0.29; p=.075) at 10percent confidence interval.

The above might imply that for traditional livelihoods strategies generating cash (potato is a cash crop) the network is more complex at the local (horizontal) level. Even though households conduct commercial transactions independently (e.g. field observations triangulated with the observation of the SNV report at national level by Joshi and Gurung, 2009), support networks exist with the exchange of labour in key moments of potato production. This might explain why in-degree, out-degree (but not much betweenness) are associated with income from potato, total land owned, land operated and land under potato cultivation (in the case of out-degree).

The network related to livestock is not complex due to the fact that it is more a subsistence livelihood strategy dealt within the households, compared to crop agriculture (mainly potato). The number of livestock is associated with out-degree only at 10percent (rho=.31; p=.06).

Land under potato cultivation shows a negative and significant relationship with income from artisanal activities (rho= -.49; p=.00) and income from tourism activities (rho= -.39; p=.012). Number of tourists as well as cash from tourism are negatively and significantly correlated with land operated (rho= -.33; p=.03) and (rho= -.40; p=.01) respectively, and number of livestock (rho= -.55; p=.00). Income from tourism is also negatively correlated with agricultural crop and non-

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89 This was also indicated and recorded during the administration of the survey. Neighbours, friends or relatives play an important role in many phases of potato cropping.
crop incomes (respectively rho = -0.45; p = 0.00; and rho = -0.51; p = 0.00). This might imply that those that were able to diversify into tourism are now allocating different assets or have abandoned more traditional assets and livelihoods (e.g. livestock), providing a strong indication of livelihoods specialisation.

Figure 24: Correlation matrix of key variables

Source: Own calculations. Spearman correlation coefficients, magnitude and direction of the correlation, illustrated only for coefficients that are statistically significant at a p-value < .1; colour code for correlation coefficients: from –1 (red) to 1 (blue). Built using R package ‘corrplot’ (Wei and Simko, 2016). The list of variables and descriptive statistics are provided in Appendix – F.

Furthermore, it seems that tourism-related activities rely on completely different networks. Tourism-related flow variables (income from tourism services or number of tourists) are not associated with any of the networks metrics above (i.e. they are not significant and they hold a negative sign). The same
consideration can be extended to other non-agricultural activities, not associated with any of the centrality measures.

**Demographics - Role in the community**

In the previous section it was shown visually how having a role in the community seems to be related to various centrality measures. Statistically, out-degree has a significant relationship with having a role at 10 percent (rho=.29; p=.067), and so does in-degree (rho=.29; p=.068). Betweenness a measurement that indicates power is significant (rho=.34; p=.032). Those households whose members hold a role in the community are positively associated with land ownership (rho=.45; p=.004). Land operated or land under potato cultivation show also a positive correlation but at 10 percent confidence interval. The result of an independent samples t-test revealed that means in land holding are systematically different – t(37)= -2.994; p=.005 – between those with a role in the community (M=9.43, SD=1.18) as compared to those who have no roles (M=2.09, SD=1.5). Land operated also shows a systematic difference t(37)=-1.8905; p=.033.

An independent samples t-test shows that those holding a role (M=196000, SD=83957.66) also have significantly higher incomes from crop agriculture – t(37)=-2.4626; p=.02 – than those not holding a role (M=117758.6, SD=87480.47). Incomes from crop agriculture (rho=.37; p=.018) and potato (rho=.36; p=.024) are in fact associated with having a community role. But more interestingly those having a role have a positive association with self-reported perception of wealth (rho=.46; p=.002).

These results (particularly the significantly higher mean incomes from crop agriculture, total land ownership and land operated associated with the role in the community) might imply that roles in the communities are associated with the ownership of agricultural assets (livestock excluded) and participation in more traditional livelihood strategies. Furthermore, those holding a role in the community might facilitate market-based exchanges in traditional livelihoods such as potato (given their higher incomes) and the relevance of betweenness centrality. Holding roles in the community is not associated with non-farm livelihoods as it is also negatively correlated with the number of non-agricultural activities (rho= -.39; p=.01). Education has no relationship with holding a role.
**Demographic - gender of household head**

Gender of household head (female coded as 1 and male as 0) moderately positively correlates with betweenness centrality ($\rho=.33; p=.035$) as well as with in-degree centrality ($\rho=.47; p=.002$). This might be related to the sample selection criteria as the NGO intervention also adopted a targeted gender perspective so that female-headed household make-up 61 percent of the sample. But it could also mean that female-headed households might have specialised in more traditional livelihoods, which have more complex support networks.

In fact, in terms of livelihoods and assets, gender of household head is positively and significantly associated with cash from crop agriculture ($\rho=.37; p=.018$), number of livestock ($\rho=.35; p=.026$) and land operated ($\rho=.37; p=.018$) but there are no significant relationships with total land owned or with cash from tourism activities (which hold a negative sign). This might suggest that for this small sample the characteristics related to feminisation of agriculture might hold and that agriculture is also increasingly characterised by land fragmentation (as documented for the national level in section 5.2).

Gender is also negatively related to self-reported perception of wealth ($\rho=-.37; p=.019$). Female-headed households seem to perceive poverty more strongly and in addition there is a significant and positive association between gender and time constraints ($\rho=.45; p=.004$). Correlations are not significant with any of the variables from non-agricultural livelihoods (income from handicraft, tourism services or professional activities which hold a negative sign).

While there is no systematic difference between the number of activities carried out by female- or male-headed households, female-headed households experience higher time constraints levels (two-sample Wilcoxon rank-sum Mann-Whitney test $z=-2.750; p=.006$). Also, from the networks in Figure 25 it seems that male-headed households benefit more from tourism. Female-headed households have significantly higher incomes from crop agriculture (Wilcoxon rank-sum Mann-Whitney $z=-2.323; p=.0202$) than male-headed households. There is no systematic difference in incomes levels from tourism between male- and female-headed households and this might be the result of the targeted intervention in tourism by the NGO.
A note on time constraints

There are few relationships that provide an important intuition about land constraints and lack of opportunities beyond agriculture. Time constraint\textsuperscript{90} is associated with agricultural activities and assets (number of activities – rho=.65; \(p=.000\); land operated – rho=.61; \(p=.000\); and livestock – rho=.77; \(p=.000\); as well as livelihoods variables of income derived from crop – rho=.57; \(p=.000\); and non-crop agriculture - rho=.44; \(p=.005\)). Number of people living in the households is also associated with the same variables and it is associated with time constraints (rho=.36; \(p=.02\)) as well as number of activities (but not significant in non-agricultural activities). They are all strongly correlated and this suggests that people deriving their livelihoods from crop and non-crop agriculture are involved in a number of activities but they also face more time constraints.

The positive correlation between the number in the household, time constraints and number of activities (as well as in crop and non-crop agriculture) show that people are involved in numerous activities with low productivity (time constraints and number of activities are strongly correlated rho=.65; \(p=.000\)). It is not possible to identify whether this is due to the fact that a number of people living in the households are people unable to work or that there are few opportunities available off-farm. Most probably the explanation is a combination

\textsuperscript{90} Ratio variable between the number of hours that do not generate income, to the number of hours that contribute to generate income.
of both factors. The variable gender of household head is correlated with migration ratio but migration is mostly linked to education in this sample.

In general, larger labour endowments and excess labour are expected to led to an expanded range of activities alternative to agriculture (as hypothesised and tested by Winters et al., 2009, p. 1438 and 1450), but these results are suggesting that the additional activities are not necessarily productive and that people cannot easily expand beyond potato cropping or other agricultural activities. This poses the problem of high labour to land ratios that can go far beyond the demand of labour for potato cultivation, affecting the profitability of potato monoculture. Therefore, it is unclear whether labour to land ratios could create a comparative advantage for certain types of occupations to emerge (Pender, 2004) in the presence of a low level of local economic activity.

In fact, it could be expected that a higher labour endowment would push towards non-farm activities (wage employment or self-employment, particularly if the marginal returns to labour-time in farming decreases below the returns from non-farm labour for example). However, in the case of Phobjikha the number of people in the household is not significantly associated with number of activities in non-agricultural sectors (including waged labour) which is not significant but has a negative sign. Conversely, the number of people in the household is negatively associated with the incomes from tourism at 10 percent confidence interval (rho=-.27; p=.08) and other non-farm activities. Time constraints and number of activities have also a strong negative correlation with tourism and artisanal incomes, suggesting both that those that were able to diversify into tourism are involved in higher productivity activities but more importantly, also suggesting a lack of opportunities beyond agriculture, at least in the valley.

### 7.2.2.3 Ego-Networks analysis

The correlations explained above provide important hints on specialisation around livelihoods activities. The scope of this section and section 7.2.2.4 is to explore relationships at a vertical level, by considering the roles of private and public sector actors in household ego-networks. Figure 25 and Figure 26 show that a portion of the graph is visually denser (the right-end). The question that
arises therefore is how do households’ ego-centred network structures affect their ability to diversify economic livelihoods strategies?

Figure 26: Distribution of key assets and variables across nodes.

**Land operated**

Land operated concentrates in the right-end side of the graph where the presence of female headed households is more relevant. Node size proportional to land operated. Triangles indicate female households heads.

**Total land owned**

Total land owned more equally distributed across the graph but the left-end side show cases of small or null land holding.

**Livestock**

Livestock concentrate in the lower valley whose members are clustered on top-right side of the graph. Female headed households are associate with livestock keeping.

**Financial capital**

Few actors have high levels of financial capital availability.

**Time constraints**

The incidence of time constraints (ratio variable between number of hours that do not generate income to number of hours that generate income) seems to be higher in the female headed households in the lower valley.

**Number of livelihoods activities**

Number of livelihoods activities carried out by the HHs does not show a pattern related to gender but it does show a pattern for those HHs based in the lower valley and some on the upper valley.

Source: Own elaboration using UCINET and primary data from the survey.
Density can be measured on a single actor through clustering coefficients. This metric is calculated by UCINET turning all ties as undirected (e.g. Borgatti et al. 2013, p.156). The routine examines the local network of an actor (all actors connected to ego) and calculates the density in the neighbours (density of ties among nodes connected to a given ego). Other concepts related to the identification of how individuals are embedded in social structures are extracted with ego-network routines in UCINET. They measure density based on directed ties as well as structural holes.

UCINET provides various measurements for structural holes. The measure that is most representative of this concept is probably “efficiency”, that is, the proportion of an ego’s ties to its neighbourhood that are not redundant. The definition of redundancy - that is “if A is tied to both B and C, and B is tied to C, A's tie to B is redundant, because A can influence B by way of C" - underpins the concept of structural holes (see Hanneman and Riddle, 2005, p. 138).

It can be tested whether there is a systematic difference in density, by using as a grouping variable the membership to the CBST group as compared to those who do not belong to the community group. By using the clustering measures (with undirected ties) the two-sample Wilcoxon rank-sum (Mann-Whitney) test shows a systematic difference between groups at 10percent confidence interval (z=-1.686; p=.092) with those belonging to the group having higher clustering. However, clustering measures are based on undirected ties. Density measures with directed ties (based on out-degree, given its relevance) capture the importance of different actors within the network, based not just on the presence of ties but also on their direction.

By testing differences between groups with “out-neighbourhood density” (density calculated with directed ties referred below as “out-density”) it can be observed that the two-sample Wilcoxon rank-sum (Mann-Whitney) test shows a significant difference (z=-2.239; p=.0251) of out-neighbourhood density between groups, with those belonging to the CBST having higher “out-density”. In line with the analysis of densities, the t-test on the “efficiency” metrics between the CBST group members and the rest of the sample, shows a systematic difference in means – t(37)=2.2442; p=.031 – with those not
belonging to the CBST group having a higher mean efficiency \((M=0.8025252, SD=0.1691229)\) than those belonging to the group \((M=0.6806755, SD=0.6240702)\).

Figure 27: Multipurpose ego-networks and CBST membership

![Image showing multipurpose ego-networks and CBST membership](source: Own elaboration. Blue actors are coded 0 (not belonging to the CBST group) while red actors are coded 1 (members of the CBST group). CBST members are part of the denser network. This is reflected by the statistical test based on efficiency and densities metrics.

As conclusion of this section, the difference in densities and therefore in network structures related to the households, have been explored. The differences of the “efficiency” and “out-neighbourhood density” measures, using as a grouping variable the CBST membership, provide evidence with relevant implications based on network theories. In fact, it can be argued that the adoption of new practices or venturing into new entrepreneurial ideas (such as tourism) might be facilitated by less dense networks, as the central argument around networks rich in structural holes is that they provide access to diverse and novel information (Burt, 1992).

The next section (7.2.2.4) will correlate measures of density and structural holes with livelihoods, assets and demographic variables to further test these aspects. Section 7.2.2.5 will analyse each livelihood network and will explore the relationship between them to see whether newly created networks supported by the NGO project correlated with pre-existing networks and whether kindship networks are relevant for the adoption and diffusion of different livelihoods.
7.2.2.4 **Densities, livelihoods, assets and demographic variables**

Ego-network routines in UCINET highlight the role of ego in its social neighbourhood. Metrics of density and structural holes are considered here and the hypothesis related to household social neighbourhoods can be tested. *How does network structures relate with demographic, assets and livelihoods? And, does network structure matter for livelihoods diversification?* Figure 26 above visually shows patterns of diversification/specialisation. Apparently those households in less dense networks were able to pick up new ideas, successfully adopting tourism. The theory behind structural holes encourages this exploration and most of the correlations provided so far found significant associations with traditional livelihoods activities (with the various definitions of centralities), but no significance was found with non-farm livelihoods.

Correlations between efficiency and livelihoods activities show a positive association with income originating from tourism activities ($\rho = .40; p = .01$) and total number of tourists ($\rho = .49; p = .001$) as well as for transport activities ($\rho = .34; p = .03$). Interestingly, more traditional livelihoods and assets such as number of livestock ($\rho = -.33; p = .03$), cash from crop agriculture ($\rho = -.29; p = .07$) have negative correlations with efficiency. Efficiency also negatively correlates with the number of activities in agriculture (crop agriculture $\rho = -.29; p = .08$ and non-crop agriculture $\rho = -.32; p = .05$) and with time constraints ($\rho = -.32; p = .04$). Therefore, cohesive networks have more relevance for traditional livelihoods, supporting the idea that modern market-based livelihoods such as tourism, may reduce the stock of traditional social capital at community level as evidenced by Dorji (2013). The other resulting correlations with “efficiency” are reported here: income from potato ($\rho = -.32; p = .04$); income from non-crop agriculture including livestock ($\rho = -.45; p = .004$), number of livestock ($\rho = -.33; p = .04$). Land operated and owned are not significant but holds a negative sign.

Contrary, out-neighbourhood density (a variation of the clustering measure) shows a significant and positive correlation with land operated ($\rho = .28, p = .08$) and land under potato cultivation ($\rho = .33; p = .04$). Gender is also positively correlated with “out-density” ($\rho = .33, p = .04$). Yet, “out-density” is
negatively correlated with the number of non-agricultural activities carried out by the households in the sample (\(\rho = -0.27; p=0.09\)).

These relationships show that tourism related activities might rely on different forms of social capital, making use of different networks. In fact, agricultural-based livelihoods use pre-existing institutions such as exchange of labour that might not be needed for non-farm activities (this will be further explored in 7.2.2.5). The fact that members of the CBST group are significantly more present in the potato network than those not belonging to the group at 10 percent confidence interval (Fisher’s two side small sample exact test has \(p=0.083\)) shows that the relationships indicated above might not just be due to a sample selection bias, as the potato network pre-existed the newly formed tourism network.

**Does network structure matter for livelihoods diversification?**

It was highlighted above that the CBST group members are those that have lower efficiency and higher densities. It can be tested whether being part of the CBST group put households in a “structural advantage or disadvantage” for diversifying into non-farm activities.

As a starting point, the result of a Wilcoxon-Mann-Whitney test suggests that there is no statistically significant difference between the underlying distribution of the total income (from all sources) between those belonging to the CBST group and those who do not (\(z = -0.687; p=0.4920\)).

However, a systematic difference – \(t(37)=3.4299, p=0.0015\) – is found for (the logarithm of) the sum of all non-farm incomes (tourism, handicraft, transport and professional incomes), with those belonging to the CBST group having a systematic lower mean income (\(M=6.657; SD=4.829\)) with respect to those not belonging to it (\(M=11.884; SD=2.214\)).

Mean incomes from agricultural activities (income from crop and non-crop agriculture) are also systematically different – \(t(37)= -3.3022, p=0.0021\) – with the mean income of the CBST’s members systematically higher (\(M=171628.6\ SD=88284.54\)) than those not belonging to the group (\(M=72727.27; SD=71880.58\)).

In terms of specialisation, there is a systematic difference – \(t(37)= -2.8334, p=0.007\) – with those belonging to the CBST group been involved in more
livelihoods activities (M=5.1071, SD=4.488) than non-members (M=3.4545, SD=1.752), which are also less time constrained (Wilcoxon-Mann-Whitney test z=2.347, p=.019).

This provides further evidence that those actors embedded in less dense networks are also those that have effectively diversified into tourism. Less traditional livelihoods activities might rely on different forms of social capital. In fact, as noted above, activities related to potato cropping use exchange of labour between close friends and relatives, in the absence of formal cooperatives or farmers’ associations in the valley. Therefore, support networks exist in more “traditional” livelihoods that influence density.

7.2.2.5 Analysis of the economic livelihood networks

The questionnaire collects multiple relationships on the same set of actors and therefore the network can have overlapping ties in the presence of multiple livelihood strategies. The data collection strategy sought information concerning relationships among the 39 community members in the sample and also their relationships with the private and public sector organisations. In this latter case the resulting network is composed of 140 ties and 46 nodes.

Figure 28: Multipurpose ego-networks

Seven types of ties are identified: livestock, potato, tourism, handicraft, tourists, vegetables and wood. Potato and tourism are the most relevant networks (with the greatest number of overlapping ties) and together with
livestock are related to “assistance relationships”. The other networks are instead related to commercial transactions of tourists, wood, vegetables and handicrafts. Handicraft, vegetables and wood are marginal networks and are composed respectively by one, two and one ties. These transactions mainly involve hoteliers purchasing local products from community members.

The multipurpose livelihoods’ network for the 39 households (without private and public sectors in Figure 29) is instead composed by a total of 64 ties. Handicraft, vegetables and wood are not present, whilst livestock is marginal with only 3 ties and 6 nodes involved; the potato network is composed of 19 ties and 22 nodes; the tourism network is composed by 48 ties and 34 nodes; and the tourists’ trade network by 11 ties and 13 nodes.

Figure 29: Multipurpose network of 39 households

If information about multiple relations among the same sets of actors is available, it is possible to see whether the probability of a tie of one type is related to the probability of another (Hanneman and Riddle, 2005, p. 294). It may be that consolidated relationships in the potato network may create a sense of trust, making relations more likely in newly developed networks. As a matter of fact actors can use relationships in one livelihood to support also other livelihoods strategies or transactions. Or it can also be the case that actors decide to specialise in specific activities and leave others.

In general, it can be hypothesize that the matrices of relationships of support related to different cash generating activities would be positively correlated. We can expect that the correlation is higher among networks related
to agricultural livelihoods strategies and lower (or non-existent) between newly-generated livelihood strategies (e.g. tourism) and subsistence activities like livestock farming (correlations with negative sign were observed in the previous section among different livelihoods incomes and assets).

The dyadic correlation\(^91\) between potato cropping and tourism is significant \((r=.32; \ p=.0000)\). This implies the new tourism network and a pre-existing network (support network related to potato cropping) among community members are related.

**Table 20: Dyadic Correlation. Tourism and potato networks**

<table>
<thead>
<tr>
<th>Obs Value</th>
<th>Signifcance</th>
<th>Average</th>
<th>Std Dev</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Prop &gt;= O</th>
<th>Prop &lt;= O</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pearson Corr</td>
<td>0.3180</td>
<td>0.0000</td>
<td>-0.0001</td>
<td>0.0277</td>
<td>-0.0208</td>
<td>0.1824</td>
<td>0.0000</td>
</tr>
</tbody>
</table>

Source: Own elaboration.

Dyadic correlation with 50000 permutations, between Potato and Tourism networks without public and private organisations.

Potato and livestock are weakly correlated networks; given that potato is a cash crop (and the primary economic livelihood activity for many), while livestock is mostly for subsistence and is dealt almost exclusively within the household. The potato network is more complex than livestock as it requires exchange of labour during specific stages of the crop cycle.

**Table 21: Dyadic Correlation. Potato and livestock networks**

<table>
<thead>
<tr>
<th>Obs Value</th>
<th>Signifcance</th>
<th>Average</th>
<th>Std Dev</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Prop &gt;= O</th>
<th>Prop &lt;= O</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pearson Corr</td>
<td>0.1283</td>
<td>0.0377</td>
<td>-0.0000</td>
<td>0.0259</td>
<td>-0.0051</td>
<td>0.3952</td>
<td>0.0377</td>
</tr>
</tbody>
</table>

Source: Own elaboration.

Dyadic correlation with 50000 permutations, between Potato and Livestock networks without public and private organisations.

---

91 Borgatti et al. (2013) suggest Pearson correlation for dyadic correlations and suggest a minimum of 50000 permutations to calculate the p-value on the random assignments, that is to say the probability that permutations are yielding a correlation as large as the one observed (Ibid, p.127). Permutation is a technique similar to bootstrapping. The observations in networks are not independent and distributions are not normal but unknown. In these conditions the use of standard inferential tests is problematic. Permutation allows an estimation of the p-value comparing the observed correlation, and the one based on random assignments of the scores. In other words it provides the probability (p-value) that the proportion of random assignments yield a correlation as large as the one actually observed. It compares the observed correlation against the distribution of correlations obtained if two variables were independent (Borgatti et al. 2013, p.127).
Interestingly, the dyadic correlation between tourists and potato networks is not significant, meaning that the potato support network is different from the one that transacts tourists.

Table 22: Dyadic Correlation. Potato and tourists networks

<table>
<thead>
<tr>
<th>Obs Value</th>
<th>Significance</th>
<th>Average</th>
<th>Std Dev</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Prop &gt;= O</th>
<th>Prop &lt;= O</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pearson Corr</td>
<td>-0.0099</td>
<td>0.08752</td>
<td>-0.0002</td>
<td>0.0270</td>
<td>-0.0099</td>
<td>0.2697</td>
<td>1.0000</td>
</tr>
</tbody>
</table>

Source: Own elaboration.
Dyadic correlation with 50000 permutations, between Potato and Tourists networks without public and private organisations.

In addition, the tourism and tourists networks dyadic correlation is weaker than tourism and potato cropping, indicating that economic livelihoods support networks are related but not quite with the network that transacts actual tourists.

Table 23: Dyadic Correlation. Tourism and tourists networks

<table>
<thead>
<tr>
<th>Obs Value</th>
<th>Significance</th>
<th>Average</th>
<th>Std Dev</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Prop &gt;= O</th>
<th>Prop &lt;= O</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pearson Corr</td>
<td>0.2506</td>
<td>0.0017</td>
<td>-0.0000</td>
<td>0.0329</td>
<td>-0.0158</td>
<td>0.3394</td>
<td>0.0017</td>
</tr>
</tbody>
</table>

Source: Own elaboration.
Dyadic correlation with 50000 permutations, between Tourism and Tourists networks without public and private organisations.

Given his coordination role, if actor 11032 (the CBST chairperson) is eliminated from the network, the correlation between potato and tourism support networks increases.

Table 24: Dyadic Correlation. Tourism and potato networks reduced

<table>
<thead>
<tr>
<th>Obs Value</th>
<th>Significance</th>
<th>Average</th>
<th>Std Dev</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Prop &gt;= O</th>
<th>Prop &lt;= O</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pearson Corr</td>
<td>0.3887</td>
<td>0.0000</td>
<td>-0.0001</td>
<td>0.0286</td>
<td>-0.0181</td>
<td>0.2260</td>
<td>0.0000</td>
</tr>
</tbody>
</table>

Source: Own elaboration.
Dyadic correlation with 50000 permutations, between Tourism and Potato networks without public and private organisations and actor 11032.

Under the same conditions the relationship between the tourism network and the tourists’ network is not significant any longer.
Table 25: Dyadic Correlation. Tourism and tourists networks reduced

<table>
<thead>
<tr>
<th>Pearson Corr</th>
<th>Significance</th>
<th>Average</th>
<th>Std Dev</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Prop &gt;= 0</th>
<th>Prop &lt;= 0</th>
</tr>
</thead>
<tbody>
<tr>
<td>-0.0041</td>
<td>0.9755</td>
<td>0.0002</td>
<td>0.0273</td>
<td>-0.0041</td>
<td>0.1721</td>
<td>1.0000</td>
<td>0.9755</td>
</tr>
</tbody>
</table>

Source: Own elaboration.
Dyadic correlation with 50000 permutations, between Tourism and Tourists networks without public and private organisations and actor 11032.

This analysis confirms that there is an association between the pre-existing support network for potato cropping and the newly created tourism support network. The Pearson’s coefficient is significant and moderately strong and it increases when the chairperson of the CBST group is eliminated.

If degree centrality (sum of in-degree and out-degree calculated on the reduced networks) is taken as an indicator of the level of participation in the potato and tourism local networks, and membership to the CBST group is used as grouping variable, a statistically significant difference between the underlying distribution of degree in the potato (z=-1.979, p=0.0478) and in the tourism networks (z=-3.447, p=.0006) can be found between the two groups. The CBST’s members are significantly more present in both support networks.

This shows that the project supported by the RSPN in tourism might benefit from pre-existing networks with positive implications. The intervention of the RSPN has built on existing bonding social capital from traditional livelihood activities. However, the correlation between the tourism network and the one associated with the trade of tourists is not strong as commercial relationships are still limited among community members and centralised through the chairperson of the CBST group. Therefore, and given the correlations highlighted in 7.2.2.4, it might also be the case that the “typology” of social capital that can be found at the horizontal level might not be the most adequate to support diversification, given that those that have already diversified in tourism have leveraged a different form of social capital.

7.2.2.6 The role of kinship for the adoption and diffusion of economic livelihoods

Phuntsho (2010b) highlighted the central role of agricultural extension offices in providing potato seeds, fertilisers and in supporting the adoption of
new techniques and crops. He also argued that these efforts have been sustained by local social networks and he pointed at kinship (family, neighbour and close friends) as an important factor for the diffusion of seeds, the use of fertilisers and techniques associated with potato cropping (p.47). So kinship appears to be an important enabler for adoption and diffusion at the horizontal level. Relational questions collected data on kinship (being a relative or a close friend) associated with the ties. By isolating the network based on kinship and by correlating it with the potato network, the resulting coefficients are strong and significant. Therefore, the anecdotal evidence provided by Phuntsho (2010b) is reflected in the following dyadic correlations.

Table 26: Dyadic Correlation. Kinship and potato networks

<table>
<thead>
<tr>
<th>Obs Value</th>
<th>Significa</th>
<th>Average</th>
<th>Std Dev</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Prop &gt;= O</th>
<th>Prop &lt;= O</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pearson</td>
<td>Corr</td>
<td>0.5569</td>
<td>0.0000</td>
<td>0.0000</td>
<td>0.0276</td>
<td>-0.0158</td>
<td>0.2045</td>
</tr>
</tbody>
</table>

Source: Own elaboration.
Dyadic correlation with 50000 permutations, between Kinship and Potato networks without public and private organisations.

Similarly, the kinship network is strongly correlated with the network associated with the newly created tourism support network between community members and - more weakly but still significant - with the tourists' trade network.

Table 27: Dyadic Correlation. Kinship and tourism networks

<table>
<thead>
<tr>
<th>Obs Value</th>
<th>Significa</th>
<th>Average</th>
<th>Std Dev</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Prop &gt;= O</th>
<th>Prop &lt;= O</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pearson</td>
<td>Corr</td>
<td>0.5625</td>
<td>0.0000</td>
<td>0.0000</td>
<td>0.0279</td>
<td>-0.0254</td>
<td>0.1986</td>
</tr>
</tbody>
</table>

Source: Own elaboration.
Dyadic correlation with 50000 permutations, between Kinship and Tourism networks without public and private organisations.

Table 28: Dyadic Pearson Correlation. Kinship and tourists networks

<table>
<thead>
<tr>
<th>Obs Value</th>
<th>Significa</th>
<th>Average</th>
<th>Std Dev</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Prop &gt;= O</th>
<th>Prop &lt;= O</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pearson</td>
<td>Corr</td>
<td>0.1612</td>
<td>0.0005</td>
<td>0.0002</td>
<td>0.0258</td>
<td>-0.0120</td>
<td>0.2190</td>
</tr>
</tbody>
</table>

Source: Own elaboration.
Dyadic correlation with 50000 permutations, between Kinship and Tourists networks without public and private organisations.
While diffusion happens more quickly in tight networks, non-redundant ties might encourage the adoption of new practices. From the theory of structural holes actors in looser networks can benefit from new ideas coming from “outside” the usual networks (Burt, 1992). The analysis of ego-network structures (efficiency specifically) were shown to be associated with non-agriculture economic livelihoods and assets (e.g. 7.2.2.4). Nonetheless, this does not mean that a household decide to change strategy just as a consequence of being part of less cohesive networks. Therefore, what is the underline mechanism by which people can benefit from structural holes? The following two sections will try to answer whether kinship has helped diversification into tourism. In fact, from sections 5.5 and 6.2.4, kinship seems to be an important enabler at the “vertical” level allowing links to the private sector.

**Kinship underpinning vertical ties**

Section 6.3 explained why relational aspects are important in the Bhutanese tourism value chain. In brief, managing tourists can be very profitable but it is a complex activity, it requires the provision of services that cannot be replaced if something goes wrong in service delivery. In addition, the provision of tourism products requires skills that are completely different from agriculture.

A process of triangulation with interviews data allow a deeper understanding of how tour operators engage in partnerships with the households in the valley. In fact, three farm-houses and one of the hotels were developed in partnership with tour operators that have family ties with villagers. One of the tour operators interviewed (operator #11) said “we came across few new farm houses but those were totally new… We did ask others if they were interested. They were saying - people are really shy - ‘we don’t have much, we have nothing ... we are poor’… so okay we did not want to force them. That was after two-three houses checking and then only we went to [11028]”. Nonetheless, during the administration of the survey and the interviews in Thimphu, strong family ties emerged for households 11028 and 11009.

In their cases the tour operator provided contributions in kind (by providing trainings) and provided a financed mechanism to refurbish the house to a tourist standard. The operator #11 stated “… we brought them here [to Thimphu], we
kept them in our hotel and then we gave them training; of course our people from the hotel [are also sent] from here to show them how to prepare food because that was one of the criteria of the TCB”. This operator invested BTN XXXXX in the two farm houses under a contract of semi-exclusivity with the households. Reservations are done through the reservation unit of the tour operator in Thimphu. The farmhouses therefore are fully integrated into their operations and booking system.

Other villagers benefited from a system of extended family. The land remained property of the household and its members were able to engage in a learning-by-doing process for some years while their partner in Thimphu operated. This mechanism lasted until the household was able to buy-back the infrastructure. Interviewing the beneficiary of this partnership “… what happened was that the land belong[ed] to my mother and [the investment] was on a partnership basis and of course they [were] the major share-holders with XXpercent and my mother had YYpercent and during those days I was in college… and my mother and father had no clue about of course when compared to farmhouse, the [hotel] down there, is a big property. We needed professional management and all, so that’s why management and everything was done by [company X] for 6-7 years... Then what happened was we bought the property from them and now I am looking after it” (Hotel 6).

Other arrangements are present in the valley. Community members that left the valley also created a bridge between the rural and the urban areas. This is the case of household 11010. It is operated by people not originally from the community but the investment was done by a community member now based in Thimphu involved in tour operating. These different patterns were generically identified by the monograph on social capital summarised in section 5.5 (Dorji, 2013). However, it was not expected that it would be so important for rural entrepreneurship and particularly for tourism.

None of those that made investments in tourism in the community did so in isolation. Household 11029 owns other businesses and it is able to travel outside the community to urban areas in a regular basis. He markets the guest-house business through the guides who come to Phobjikha or directly in the capital. The role of the guides was highlighted in section 6.2.1 and they are considered important enablers to spot new opportunities in rural areas,
especially when they are originally from the community. In the case of actors 11008 and 11023, they both benefited from advance payments (on occupancy) by some tour operators with whom they establish long-term relationships. This practice enabled them to overcome shortages of financial resources to make investments based on feedbacks or to repay liabilities. At the same time the tour operator benefited by blocking-booking a certain numbers of rooms for the high season. These arrangements are not sealed by kinship relationships but they are based on long-term relationships, repeated interaction and mutual advantage.

Therefore, the successful bridging between the rural ventures and the tour operators seems to happen mainly through *kinship* as discussed in 5.5 and 6.2.4 or repeated interaction. It has also been reported that external investors have increasingly bought land in the valley due to the perceived increased in tourism activities and the opportunity of build and operate in the future.

Additional aspects that emerged during a workshop\(^92\) held by RSPN, with the CBST group and the tour operators, is the formal recognition of community enterprises. In fact, formality of a rural business is of secondary importance when they are integrated in package tours. In this case, the legal responsibility falls under the tour operator. Nonetheless, the formality of rural enterprises outside these networks is a way to protect the clients and the entrepreneurs from liabilities.

While being a formal business is an important step for achieving higher productivity in the provision of goods and services\(^93\), it emerged that community enterprises are not formally registered in Bhutan and there is no legislation that applies to them. The Cooperatives Act can be the framework and in the case of home-stays they can also be registered individually under the cottage and small business framework as independent entrepreneurs. At the moment the CBST group is under the legal umbrella of the RSPN and evidence from the workshop suggests that the business model will adapt by following the trajectory of the business (if the group will not succeed, households will be allowed to operate individually). Beyond the effects that this could have on the broader success of

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\(^{92}\) Workshop attended in Thimphu on 22 January 2014.

\(^{93}\) There is a range of literature in tourism development by Harold Goodwin and Caroline Ashley under the pro-poor tourism paradigm on the importance of formal enterprises for integration in value chains. There is also a wide recognition and empirical literature of the link between formality and productivity (Ayyagari et al., 2014).
the CBST group in Phobjikha or other communitarian initiatives elsewhere in the country, these legal aspects add another element that explains why trust (through kinship or repeated interaction) is a relevant mechanism.

7.3 Conclusion of the chapter

This chapter answered the question to what extent rural households are able to diversify into activities with higher productive like tourism. To do this it investigated the relationships of selected intra-household variables (gender, time constraints, and number of people residing in the household) as well as tested the relationship of social capital variables (households’ position in the community network and households’ ego-centred networks) with other key variables related to assets and livelihoods.

At the household level, gender of household head seems to follow trends observed in surveys conducted countrywide. In fact, by following traditional institutions of land tenure, female-headed households in this sample specialised around agricultural based livelihoods. Relationships with other variables - such as number of people in the household, number of activities carried out in crop and non-crop agriculture and time constraints - suggest increasing labour-land ratios that can negatively affect returns in agricultural based livelihoods.

The role of social networks to sustain diversification into non-farm activities, particularly for more productive tourism related ones, was explored and tested. To follow jargon used by Dorji (2013), the analysis was conducted at the “horizontal” and “vertical” levels. At the horizontal level the interaction between the households in the sample was explored through the extraction of measures of centrality, correlated with assets and livelihoods variables. The analysis show that these correlate just with few agricultural assets and livelihoods variables.

The reason is that relationships at the horizontal levels in agricultural livelihoods (mainly crop agriculture) are underpinned by pre-existing institutions associated with the exchange of labour between close friends, neighbours and family (defined as kinship ties) that are used in potato cropping. Section 7.2.2.5 shows how these support networks for potato cropping correlate with kinship ties. The fact that members of the CBST group are significantly more present in
the potato network also help to understand why at the horizontal level the new tourism related network created through the intervention in tourism of the RSPN, correlates with pre-existing networks, given that it uses the same networks based on kinship.

The potential advantage of these overlapping networks at the horizontal level is to strengthen collaboration and coordination, in effect to lower transaction costs among the CBST members in providing tourism services to the market. This should be further incentivised by RSPN, linking households between the lower valley (Phobji) and the upper valley (Gangtey) even without the intermediation of the CBST chairman.

Yet measures associated with households’ social embeddedness (that include the relationships with the public and private sectors – the “vertical” level) show that those embedded in denser network structures have stronger correlations with agricultural livelihoods and assets, while those embedded in less dense networks, correlate with non-farm activities, particularly tourism. In fact, the network structure of those households that have already diversified into tourism and that do not belong to the RSPN intervention group (the CBST), are embedded in less dense networks that correlate with tourism flow variables and other non-farm incomes. This ultimately shows that different types of social capital can affect diversification in different ways, as it seems that the social capital needed to sustain ventures into tourism is not the same which plays a role in sustaining potato cropping for example.

Kinship is identified as a relevant driver also at the vertical level (beyond the community’s members). It emerged that kinship enables the link between tourism actors and rural entrepreneurs or potential entrepreneurs. There are also some important elements that are channelled through kinship when it comes to the adoption of tourism using those vertical links:

1 – Knowledge and information – tour operators know how to organise and deliver a product, and they know the standards and the expectations that need to be fulfilled for their markets of reference and they share this information and knowledge with their partners in rural areas impacting in specialised human capital;

2 – Finance – linked to the previous point is also the need to refurbish and adapt houses and infrastructure that can facilitate the tourist trade.
Accommodation services, therefore, are the main form of investment but they require considerable financial capital.

3 – Reliable flows of tourists – as a consequence of these partnerships a reliable number of tourists helps to maintain a level of operation that is significant for the household to been able to maintain an adequate level of practice and learning by doing, as well as to obtain an adequate return on investments for those involved.

Those tour operators involved in Phobjikha leveraging personal networks, developed or supported accommodation services mainly as a response to a perceived increase of market demand for rural related tourism activities. Those that could spot opportunities tried to anticipate investments especially if geographical areas and locations were strategic for their business operations.

At the same time, investments in accommodation services are ways to retain value, as tour operators themselves provide the demand that is needed for yielding the needed returns. Other factors include avoiding transaction costs and other monetary and reputational costs which are additional drivers for this type of investment.

The fact that organisations such as the RSPN, JICA or SNV are experimenting in community tourism (home-stays, campsites or nature trails), signals to the private sector the potential for new products and helps to spot locations where the Government would develop infrastructure. The readiness to respond to changes in regulations (not yet materialised) has also pushed first movers to enter this segment despite binding Government regulations.

The long-term interventions and stewardship of the RSPN in Phobjikha created circumstances that are typical of this case. Despite the constraints evidenced for diversifying into tourism, Phobjikha is considered a flag-ship for rural development in the Bhutanese context. Yet, problems that arise related to diversification can be common to other rural communities in other part of Bhutan. The objective of the RSPN is to build a local economy and, by leveraging tourism, it tries to support the development of a destination with good enough services to justify a longer stay in the valley and capture value-addition. This would eventually trickle-down to generate a sustainable source of income for many of the valley inhabitants. This is not yet happening and few locals benefit directly from tourism.
The national tourism policy intention still clashes with the development of community tourism or the involvement of rural communities. This is not something new. However, this can be extended to the concept of rural entrepreneurship or to every attempt to decentralise governance. It is important to note that as long as tour operators need to provide integrated services following the current regulation, they are responsible for the delivery of those services and they have little incentive to outsource services beyond their established networks or direct control. A rural entrepreneur that is not part of these networks might not be trustworthy enough not only in relation to potential transaction costs but also to maintain competitive advantage\textsuperscript{94} and ultimately retain value. Both elements are linked to the competition within the small Bhutanese tourism market.

All these different aspects translated to a national scale can be considered both constraints and opportunities for diversification in rural areas. When networks are tight and exclusive they might prevent investments from increasing (as evidence in 6.2.4). However, if well channelled through policy and strategies, networks can be a driver for rural entrepreneurship, self-employment and upgrading both in tourism and complementary services (for example by incentivising partnerships). All these issues will be explored in the concluding section.

\textsuperscript{94} Tour operators do not invest just financial resource but they give away know-how that is part of their competitive advantage. Detailed mechanisms were explained in section 6.2.1.
Section IV - Reflections and Conclusions

A central aspect underpinning the “inclusiveness” paradigm is related to the “pace and pattern” of growth. A rapid “pace” of growth is a necessary condition for poverty reduction, but research has also demonstrated that is not a sufficient condition. To be inclusive and sustainable in the long-run, growth should be broad-based across sectors. This means that policy approaches to inclusive growth should encompass the discovery of unexploited potentials by strengthening productive resources and capacities. This also means creating opportunities for productive employment and productivity growth, avoiding low equilibrium traps.

An institutionalist perspective was used in this research to explore the socio-economic processes associated with growth at a sectoral level. The following sections contain reflections and policy recommendations rooted in the institutional analysis and how this perspective can enhance the understanding of governance in value chains, uncovering how growth is generated and who can benefit from it. These reflections refer principally to theoretical and conceptual elements of the value chain framework while policy recommendations based on these considerations will be given further below.

Conceptual reflections and contributions

Expanding the concept of governance in value chains

The success of “Northean” work on institutions has driven international organisations to implement what is called the “good governance” agenda. The idea is that a transition to a market economy cannot be operational and successful without a set of underlying formal institutions that support economic activity and govern contractual relations (Dutraive, 2009). Nonetheless, researchers working in the field of development economics and in transition economies have acknowledged the limitation of transplanting “foreign” market-enhancing institutions and have advocated the diversity and the evolutionary perspective related to institutions (e.g. Roland, 2008; Rodrik, 2008; Williamson,
This perspective helps to trace a distinction between “fast moving institutions” like political and legal rules and “slow moving institutions” associated with culture and social norms (Dutraive, 2009).

The NIE considers that the cultural background plays a role in economic choices and it incorporates the idea that local systems of institutions matter as much as crucial institutions like the legal system or the political system. This hypothesis was tested by Williamson (2009) with a cross-country study.

Economic development policies and sectoral strategies in developing countries need to take the specific context into account. Hence, a need to provide precise descriptions of the mechanisms through which institutions play a role in determining development outcomes has been argued to be much needed beyond cross-country analysis through micro-studies (e.g. Casson et al., 2010).

This also implies that institutions (of various types and various levels) must form a consistent system that is not easy to define (Dutraive, 2009). As stated by Dutraive (2009), the analyses in this field are not without problems and do not lack ambiguity:

“…. For some ones [sic], institutions are seen as the social glue which produces cohesion and [the] social dimension seems to come to the fore, bringing about cognitive aptitudes and predispositions. But for other ones, following a rule, conforming to a social norm is understood as a rational behavior, coping with moral hazard, imperfect or incomplete information, and compatible with self-interest hypothesis” (p.9)

The work of North and other institutionalists help sustain the idea that institutional structures are not entirely exogenous in economic analysis. Economic institutions such as property rights and other institutional support systems have emerged as processes of social interaction and so does their application and evolution (Langlois, 1989, p. 15). Nonetheless, the more institutions are considered endogenous to socio-economic processes the more their understanding requires the inclusion of sociological variables such as norms and social relationships “to understand motivation to follow the rules”
(Nee, 2005, p. 54), to explain the alignment of interests of economic actors to specific rule, and ultimately to understand economic behaviour and performances.

Nee (2005) points at two challenges in this sense. One is methodological, as the integration of sociological variables needs to follow a manner consistent with economic methodology (despite the fact that pluralism is also advocated by institutional economists). The other is to “explicate the social mechanisms determining the relationship between the informal social organisation of close-knit groups and the formal rules of institutional structures monitored and enforced by organisations and states” (ibid, p.55). In fact, informal mechanisms embedded in ongoing social relationships might facilitate and organise the interests of actors that can lobby for changes of formal rules to make them closer to their interests (see discussion in section 2.1). They coordinate their actions to improve the chances for success. If completion and alignment to rules is linked to the group’s success, it is more likely that motivation to follow formal rules will increase. The contrary is also valid, that is, if completion to formal rules means undermining the group’s interest, opposition would arise through non-alignment (ibid).

The analysis in sections 6.1 and 6.2 offer a description of the relevance of local systems and institutional contexts. Recent confrontational stances in tourism policy making in Bhutan are evolving from a situation where ideology and shared beliefs had the purpose to align economic action. Section 6.1 provides evidence on the policy process and the diverging interests of an increasingly critical civil society (with competing interests among CSOs and between CSOs and the Government). Section 6.2, provides a detailed description of social norms underpinning social networks that facilitate and “stabilise” economic exchange in an increased competitive environment.

The analysis in section 6.2 showed that complementarities between governance mechanisms overcome important coordination and contracting failures despite the presence of market-enhancing institutions. It also emerged that despite the effort to categorise trust in the Bhutanese context as underpinning two relational categories - “kinship” and “calculative” relationships - this informal governance mechanism (that allow a cooperative behaviour at least between members of specific networks), follows a rather rational stance,
compatible with a more “self-interest hypothesis” associated to the use of informal mechanisms. Nonetheless, whichever angle one decides to take in relation to institutions, the interaction between formal and informal arrangements can help integrate the role of social structures in economic analysis and with it their effects on economic outcomes (in this thesis the effects of social network variables on outcomes are analysed in chapter 7 and implications explained in 7.3 and the following section).

As such, the use of a theoretical framework based on new institutional theory is relevant to bridge a gap identified in relation to the value chain literature. Authors had stressed the importance of bringing the social context back into the concept of governance (Gibbon et al., 2008).

In fact it is evident from the literature that some scholars considered the idea of “governance as coordination” between lead firms and first tier suppliers developed by Gereffi et al. (2005) to be too reductionist. One of the main critiques is that the excessive focus on the verticality of relationships excluded the influence “of extra-transactional structural constraints such as those emanating from dominant regulatory systems” (Gibbon et al., 2008, p. 324). In addition the analysis of governance structures has also neglected domestic conditions and particularly socio-cultural aspects. For some authors (e.g. Bair, 2008) the “network” concept in the GPN framework (that borrows from the relational perspective of the new economic sociology), is not compatible with the GVC that draws on transaction cost economics whose objective was to develop “a parsimonious theory of global value chain governance as inter-firm coordination” (Gibbon et al., 2008, p. 327). Nonetheless, as explained above, the work of institutionalists in the tradition of new institutional economics can be used to bridge these distances (e.g. Nee, 2005).

Therefore, a more realistic and encompassing picture of the functioning of value chains, and how value is generated and distributed is portrayed by extending the concept of governance, introducing a wider institutional perspective. Gibbon et al. (2008) also argued that theory in value chain studies has been used sporadically and when subjected to theorization, empirical studies follow a process of “importing blocks of analysis fashioned in unrelated traditions” (p.330). Therefore, a new institutional economic perspective that
integrates the role of formal and informal institutions can be considered a coherent body of theory that can bridge this gap.

Ponte (2014) for example, suggested a focus on “multipolar governance” in value chains, allowing the integration of a plurality of “drivers” and actors, not only firms. In a value chain framework these institutional factors have been analysed as part of the institutional architecture surrounding a value chain, as exogenous, hence they have not been examined as possible “governance actors”. The analysis of chain dynamics and governance mechanisms can be expanded in complexity to include for example governments “that actively shape the terms of participation in value chain, inclusion and exclusion mechanisms, and value creation, appropriation, and (re)distribution along the chain” (Ponte, 2014, p.360). Nonetheless, Ponte does not refer to institutional theory as the “umbrella” under which multipolar governance can be analysed or any other theoretical framework. This could have captured the role of other actor’s ability to shape and lobby policy for growth (see for example debates on sectoral policies capable to address various types of market failures and to sustain the successful insertion in global markets in Kaplinsky and Gereffi in the literature review), or more in general regulatory systems. So, how does the interaction between the formal and informal institutions and the role of informal mechanisms materialise in the realm of the case?

In Bhutan, informal mechanisms - that represent private constraints stemming from norms, culture, and customs that are not designed or enforced by governments (Williamson, 2009) - proved to be very important in the Bhutanese context. Yet, what emerged in chapters 6 and 7 is the role of multiple actors in shaping governance through mechanisms that include formal rules and regulations, policies but also informal mechanisms based on trust, that influence economic inclusion and upgrading.

Following the methodology chapter, the analysis in chapter 6 identified the “context” that influence behaviour of economic actors and the “mechanisms” that enable economic participation in the tourism value chain and answered the research questions aimed at understanding institutional elements (formal and informal) characterising governance. In fact, the literature review on value chains revealed that the terms of participation in value chains (not just upgrading) are strongly determined by governance structures.
Chapter 6 traced an historical trajectory of tourism development and took into account the role of different actors involved in the industry evolution. The aim was to understand how production and value-addition take place, identify the distribution of rewards along the chain and more importantly, elucidate the processes of economic inclusion and upgrading.

The Bhutanese Government with its tourism “tariff” system is a central actor interposed between the global market and its global firms (involved in the production and distribution of tourism packages and the trade of tourists), and the local firms arranging local services to sell in global markets. In the Bhutanese context the Government is the main actor that historically established tourism and that is still determining how value is created. In section 6.1 it was shown how the Government “protects” the sector and still establishes a threshold price under which national tour agencies cannot sell their tour packages to global markets. With its regulatory framework, the Government influences also how rewards from the trade of tourists are distributed and provides regulatory constraints for national tour operators (that can be considered actors equivalent to first tier suppliers) and other tourism actors in the country, “forcing” them to upgrade their services to international standards.

The way rewards are distributed following the tariff system is still very much centred on redistribution rather than on broadening the base of participation, even though with the liberalisation of licences the supply-side has grown substantially. On the one hand, the royalty system (a percentage of the tariff) has ensured a contribution to the capability of the Government to deliver key public services. The State has used the royalty as a redistributive mechanism to make tourism an important contributor to Bhutan’s development trajectory (financing the general budget that would contribute to free education and healthcare) together with establishing capital controls of a more and less permanent nature.

On the other hand, by providing rents to entrepreneurs it provides a strong incentive to enter the tourism market. The Royal Monetary Authority showed how borrowings from financial institutions grew in September 2015, after capital controls were lifted following the “crisis of rupees” of 2012. Credit towards service and tourism sector grew by about BTN 3Billions (USD 47.4million).
reaching BTN 11Billions (USD 173.8million) in May 2015. In eight months before the restrictions were lifted, credit towards this sector grew by BTN 700M (USD 11million).

By focusing on upgrading of the national tourism industry, the Bhutanese government have also established rules for attracting FDIs in tourism, and influenced ownership to ensure that national firms participate in the production of tourism services and have a significant share from the tourist trade. International tour operators cannot operate directly in Bhutan unless they invest in “luxury” tourism FDI. Therefore the Government has set the rules concerning about who can participate and under what conditions. Nonetheless, this focus on upgrading, preclude the full participation of rural communities and rural ventures that should be able to follow and meet those international standards. By focusing on sustainability (through its GNH framework), the Government also set specific “preferred” products that became the dominant one after the opening to the private sector: cultural and trekking packages to be sold in global markets.

Despite a regulatory and policy framework set to provide incentives and constraints for upgrading and sustainability, this proved to be easily challenged from different fronts. As a by-product of the liberalisation of licences the incentives to enter the market under the tariff system contributed to an overpopulated supply-side of core tourism actors (guides, tour operators as well as accommodations services). Their interaction showed how within the Bhutanese national system power structures between the tourism core-actors are constantly challenged as documented in 6.2.1 even though national tour operators have a central role.

While the Government as the regulatory body is the “real” central actor, the process of transition to a democracy gave rise to four main civil society organisations that represent the private sector interests in tourism (ABTO, HAB, GAB, BCCI). The section on the policy process has shown how there are increasing confrontational stances between the Government and an increasingly critical private sector on the different instances related to policies, rules and regulations.

95 In 15 May 2015 1INR=0.0158USD. The Bhutanese Ngultrum (BTN) is pegged 1:1 to the Indian Rupee (INR).
The inability of the Government to adapt, modernise the legislation, and modify the institutional setting to monitor and effectively enforce current rules and regulations, creates uncertainty and favoured free-riding. Transaction costs are bridged through informal arrangements that seem to be important to provide stability to economic exchange, providing the required standards for product development and delivery to international tour operators.

The core actors within the Bhutanese tourism value chain use trust as the principal governing element that strongly influences participation and upgrading. The conclusions in section 6.3 argue that given these uncertainties, the role of social networks associated with trust and underpinned by socio-cultural norms provide stability to economic exchange within the Bhutanese tourism value chain. Trust among core actors, along with regulation can be considered a governance mechanism because it has been demonstrated to influence economic exchange, value creation and capture. In fact, trust also relates to the capacity of local firms to develop and maintain competitive advantage. Trust operates also between international lead firms and first tier suppliers in Bhutan and this is how competitive advantage is acquired, while at the same time creating barriers to entry through quasi-hierarchical structures and/or network-based/relational contracting (for a detailed discussion from a theoretical and empirical perspective on informal mechanism based on trust see section 6.3).

International and regional tour operators, who incorporate and sell Bhutan in tour packages to global markets, can be considered lead-firms. Their influence can be felt through the bargaining power they have with national tour operators despite the protecting tariff. This bargaining power can drive national tour operators to undercut on the tariff (illegally). From the interviews it appears that this is particularly true for regional tour operators. At the same time, international and regional tour operators can add any mark-up on the Bhutanese tour “tariff” that would be beyond the control of the Government or their national partners. They are therefore able to influence value capturing.

A strategic action by the Government is represented by the creation of the Tourism Council of Bhutan that should serve to coordinate the development effort in tourism, regulate and monitor the multifaceted tourism industry. However, it seems it has fallen short of fully achieving its role.
The “tariff” system and the current organisational setting of the TCB can be related to Rodrik’s view of industrial policies. Rodrik (2004) considers councils a very important institutional setting and a way to strengthen collaboration between the public and the private spheres, with the important aim to bridge coordination and information externalities. Both aspects are related to the successful diversification and the development of capabilities in targeted sectors.

The problem of information externalities seems to have been bridged through the tariff system. In fact, Bhutan tourism exhibits high productivity with respect to other sectors of the economy. The tariff allows rents for entrepreneurs providing above-normal profits to those who try to diversify into tourism and are successful. However, the lack of conditionality and monitoring in the rent allocation system, combined with the lack of investments in key infrastructure and proper destination management, facilitate imitation, excessive entry and undercutting that are jeopardising the desirable effects on the overall “upgrading” of the industry.

The other element that Rodrik considers is the coordination externality. “The coordination failure model places a premium on the ability to coordinate the investment and production decisions of different entrepreneurs” (Rodrik 2004, p.13). To be profitable and to avoid economic leakages tourism requires simultaneous upstream and downstream linkages and sometimes large-scale investments. In fact, tourism uses generic (e.g. hospitals, roads, airports) and specific (e.g. hotels, parks) infrastructures and it is served by different industries which makes the ability to coordinate investment and production decisions of different entrepreneurs, a key aspect.

In the Bhutanese tourism context trust and networks have bridged coordination problems. However, this should be far from being considered a success. The role of the State is very strong in Bhutan and as such it should play a more reliable, professional, transparent and impartial role to sustain economic restructuring and interact strategically with the private sector to reduce transaction costs, improve coordination and with it, entrepreneurial and employment opportunities.

While Rodrik was more concerned with the diversification of the economic base and the development of capabilities in new sectors, Kaplinsky and Morris,
(2016) consider as specific set of productive policies for a gainful insertion into the global export market dominated by global value chains. The idea of “thickening” policies in resource sectors like tourism is relevant for the implications about inclusion. In fact, they are related to building production linkages and deepening value-added in tourism products. In any case the coordination problem remains central particularly if tourism has to be linked more strongly with other sectors (agriculture, but also IT, construction, etc.).

The discussion on NIE above links to the arguments deployed by Kaplinsky and Morris on productive/industrial policies in value chains - and their classification of endogenous (e.g. Schumpeterian rents - endogenous to the participants involved in the chain of production that would stimulate various forms of upgrading), exogenous (policy induced rents) and resource rents (a “gift of nature”) - as well as to the argument deployed by Ponte (2014) on the role of multiple actors in governance. The intuition about the inclusion of multiple actors in the analysis of governance in value chains is that the interests of individuals, firms, groups and governments (actors beyond just the lead firm and first tier suppliers in the industry) can influence regulatory frameworks and policy-induced rents. This can have strong implications for sustainable income flows and competitive insertion in global markets. Kaplinsky and Morris conceptual distinction between exogenous and endogenous rents became blurrier if institutional mechanisms (formal and informal) influenced by the interaction of multiple actors are taken into account, impacting allocation of activities and resource, and enhancing or hindering inclusion and upgrading.

**Diversification of rural livelihoods - the relevance of social networks and “agency” variables to understand livelihoods dynamics and successful integration in value chains.**

Chapter 7 looked more closely at different forms of social capital and how they related to different livelihoods strategies in rural areas. As such it contributes to three objectives: one is to “test” the outcome of specific governance mechanisms identified in chapter 6; the other two are related to neglected aspects in the literature outlined in chapter 3. In fact, the micro-level analysis of livelihoods’ diversification contributes to the understanding of: the
role of social networks in sustaining diversification and specialisation in economic livelihoods and it helps to rebalance the idea that diversification is not just an economic process but is also a social one; - the “dynamism” of livelihoods strategies.

In the Bhutanese context, social networks reflect informal arrangements based on trust that sustain entrepreneurship in rural areas and are fundamental channels to sustain non-farm livelihoods activities (like tourism). As such the understanding of livelihoods strategies as dynamic processes is facilitated by linking the local level analysis of livelihoods with different “processes of exchange, extraction and empowerment” (Scoones, 2009, p. 188) happening within and beyond the locality. The network analysis provided metrics on network structures based on the linkages between households and among households and private and public organisations.

A description of the evolution of a valley’s livelihoods over 30 years was provided as a background to the livelihoods and networks analyses. By examining the relationships between livelihoods, assets (including less tangible assets like social networks and their structures) and other variables such as time constraints (based on the contribution of Anderson, 2012), the analysis showed that these relationships can explain the capacity of a household to follow processes associated with economic livelihoods strategies of “hanging in”, “stepping up” and “stepping out” (as defined by Dorward, 2009) associated with diversification and specialisation.

The results of the network analysis are consistent with consolidated theories in this field. The central argument in this body of theory is that structurally diverse networks, low in cohesion and rich in structural holes, provide access to diverse information and opportunities. Even though the analysis in section 7.2 was not aiming at contributing to or testing any specific network theory, in this sample, ego-network measures of structural holes showed a positive correlation with non-farm activities and particularly tourism. This reflects the idea that information and knowledge that is scarce in local networks is acquired outside the usual channels (e.g. Burt 1992 and Granovetter, 1983). In this case households in less dense networks were able to successfully diversify into tourism.
However, the results from this small sample open up questions related to the latest advances in theories of social network structures. In fact, one of the aspects that remained open in this literature is “to understand the information-arbitrage mechanism by which people harvest the value buried in structural holes” (Burt 2005, p.60 cited in Aral and Van Alstyne, 2011). In other words, the fact that an economic actor is “sitting” in less cohesive networks does not automatically translate into the possibility to access, let alone adopt, new information or ideas. As pointed out by Aral and Van Alstyne (2011) information exchange is a social process and it is discretionary. “Networks are not simply pipes into different pools of information; they reflect the nature of the relationships, interactions, and information exchanges taking place among those they connect” (Ibid, p.95).

This network analysis in Phobjikha has revealed how kinship (one of the two categories of trust identified) operates simultaneously at two different levels: 1. with diverse but high-bandwidth networks - people have diverse and distant ties with possibly less frequent interaction but sealed by social norms associated with trust and kinship that bridge relevant assets otherwise missing from local networks; 2. with cohesive but low-bandwidth networks - characterised by redundant information but nonetheless sealed by social norms that enable traditional institutions to work.

The recommendations below are given considering the reflections in the previous section and under the – well-documented – assumption that rural non-farm growth to be effective for poverty reduction, needs to provide an increase in rural non-farm incomes and investments in the productive capacity and productivity of the rural tradeable goods and services sectors (see Haggblade et al., 2010, p. 1438).

Policy Implications

Key principles for a new tourism policy

It is still unclear whether the new tourism policy will take into consideration “high-value; low-impact” criteria, other new principles or an usher in complete liberalisation. But a well-designed policy can contribute to a more inclusive
tourism sector. As noted by Rodrik (2004) “the policy setting has to be one in which public officials are able to elicit information from the business sector on an ongoing basis about the constraints that exist and the opportunities that are available” (p.17). As noted by Kaplinsky and Morris (2016), resource sector productive policies (tourism can be considered a resource sector given the importance of natural and cultural resources for its success) should focus on creating clusters to capture more value-added and this would be particularly advantageous to Bhutan given its geography.

- The tariff has served the purpose to contain power asymmetries with international markets giving rents to many entrepreneurs as well as to the State through the royalty system and capital controls. If the tariff is maintained it is important that market intelligence is gathered periodically and professionally by the TCB to counteract information asymmetries with international source markets.
- The TCB need also to set-up clear monitoring routines for the sector. At the moment monitoring is skewed towards the demand-side with data easily available through the Visa electronic system, but the supply-side needs to be monitored through an electronic information system. This would contribute to reduce transaction costs of various types. The Tourism Satellite Account could be a feasible solution but it is only going to be operational in the long-run and requires substantial efforts in data collection, management and analysis. Intermediate monitoring systems should be set-up.
- The improvement of data availability and management would also serve the purpose to control viable investments. Credit institutions can benefit from that to assess private sector ventures in tourism.
- At the moment the Government has conducted a partial liberalisation in tourism. Maintaining the tariff system works as an incentive to entry and a bottleneck to access the global demand. If the tariff is maintained the Government should introduce conditionality to tour operating activities, control excessive licencing and incentivise professionalism. In tour operating possible solutions could be progressive thresholds in terms of tourism arrivals, below which licences will be revoked, or a system of
controlled licencing to avoid overpopulated and highly fragmented markets. Professionalization of the sector by issuing licenses after a process of qualification or accreditation (either by exams, education levels or working experience) is also very important for every tourism actor. The Government can also determine how many new licences to be issued every year, but more importantly establish standards and norms for guiding, tour operating and hotels easily accessible and interpretable.

- An additional element for economic inclusion comes from the opportunities driven by the Indian and regional markets. It is perceived as a “downgrading” market and disregarded by many entrepreneurs that work with the high-end market, but for many hoteliers and small businesses the Indian and regional tourism market has a smoothing function, ensuring a certain level of cash flow to cover fixed costs, countering asymmetries of power (with national tour operators) and high seasonality. Better destination management practices should be able to assuage the negative externalities coming from this market (particularly pollution, over-crowded sites, and cultural insensitivity) and by creating new opportunities for entrepreneurs. A new electronic “road permit” for Indian tourists that has been recently launched is actually serving the purpose of controlling these inflows.

- More effective “experiments” associated with liberalisation can be conducted given the isolation of different parts of the country. The idea of liberalising completely is much contested with valid reasons from both sides. The bottom line in this controversial and ideological issue is that by experimenting the Government can observe and analyse what is the change that is more appropriate. Experimenting with local tourism clusters with different configurations is an option. Liberalising the access to the Eastern part of Bhutan can be an option but prerequisites need to be put in place by the Government (especially from the infrastructural side) and the initiatives be marketed strategically.

- There should be promotion of new activities that can stimulate cluster formation and value chain linkages. Incentives can be designed to foster linkages and discourage imports of labour, goods and technology, together with improvements to coordination with relevant ministries by
focusing on specific projects. Setting targets and a monitor system associated to these initiatives is also important to assess their long-term viability and eventually adapt the models to different circumstances.

- In LDCs where knowledge is missing at decentralised level for non-traditional industries, centralised governance (if well managed) can be an advantage particularly if multi-sectoral policy and strategies need to be coordinated. However, coordination needs to be strengthened in localities if a cluster approach is followed. Deploying “destination stewards” (an initiative piloted by a UNIDO project between 2013-2014) in key areas where investments, projects or coordination efforts in related sectors need to materialise, can be strategic to guide and enhance local knowledge and provide hands-on expertise in collaboration with the private sector.

- Non-farm employment opportunities on related value chains (e.g. specialised maintenance workers for emerging tourism clusters and hot-spots) should be encouraged. This can be done by working more closely with rural communities not just in their direct participation as tourism entrepreneurs but also in increasing human capacities through vocational trainings and placements.

- Formal organisations like the TCB need a stronger mandate (whether the tariff will be eliminated or maintained). The organisation is at the moment part of the bureaucratic apparatus of the Government but there is the potential to partially detach the organisation to ensure that its personnel are not part of the civil service. Highly motivated, experienced, trained as well as properly remunerated personnel are needed to respond to the needs of an industry that is constantly evolving. The organisation can still be chaired by the Prime Minister giving a strong signal of commitment to international investors and managed by highly experienced civil servants with a budget allocated by the different Ministries (members of the board) without excluding contributions from international donors or private sector partnership.

- By detachment from the Civil Service, the organisation could manage funds working directly with international organisations and the private sector based on the identification of new programmes and projects,
thereby increasing its implementation capabilities. This is already happening but it seems that demanding these duties to external organisations is preferred by policy makers.

- The TCB should be able to enforce the regulations, reduce transaction costs in a systematic, transparent and less discretionary ways and work hand in hand with the private sector to professionalise the industry. Small incremental changes to strengthen impersonal institutions starting from the TCB can contribute to more inclusiveness and higher quality services.

- Unless coordination externalities are resolved, the elimination of the tariff will not eliminate free-riding and opportunism, increase inclusion or benefit automatically the rural communities. Entrepreneurs will keep working with their established networks as a way to self-regulate the market, maintain competitive advantage and safeguard themselves from transaction costs.

- Beyond the mandate of the TCB, the tourism bill needs to be approved. Institutional uncertainty (lack of a national tourism policy and updated legislation) creates opportunism. This favours arrangements such as relational contracting and hierarchical and semi-hierarchical forms of coordination including quasi-vertical integration. This is not necessarily negative, but more perceived transparency and professionalism can sustain processes of go-betweenness identified in section 6.2. In fact, the small society and the referral mechanisms that are often used provide the intuition that the more professionalised the industry becomes the more open to integrate new entrants into closed networks will be. The importance of the referral mechanism is that it can solve the commitment problem. This aspect, combined with the professionalization of the sector (through trainings, certifications and professional placements with the active role of the TCB for example) can potentially overcome the problem associated with the closed networks.

- Overall, public institutions should be able to operate as “enablers” of trust and trust, will operate as enabler for inclusiveness.
Fostering rural development in Bhutan

Despite the importance of tourism in Bhutan, tourism to support diversification of livelihoods’ strategies and income portfolios in rural households has been used with scepticism by some Government agencies and more actively by others and often in uncoordinated ways. The Government in collaboration with some development agencies have piloted small-scale initiatives in Nobji-Korfu, Adha-Rukha, Merak-Sakten, in Trong gewog (Zhemgang district), Phobji-Gangtey valley and more recently (2016 to present) Haa valley.

The main motivations driving the intervention of the RSPN in tourism in Phobjikha valley were to reduce the excessive economic dependency on potato monoculture and spread the economic benefits of tourism to sustain conservation activities. By looking at a small sample in the valley encompassing the two communities of Phobji and Gangtey, it was observed that some actors have been going through a process of diversification and specialisation with kinship being a strong driver.

Kinship operates in both horizontal (bonding) and vertical (bridging) ties in Phobjikha and it is an important mechanism to sustain income portfolios in both traditional and new economic livelihoods. The sample was purposively selected and it shows that less dense ego-network structures are associated with non-farm livelihoods (particularly tourism), while more cohesive ones are associated with agricultural livelihoods. The cohesive networks are linked to agriculture and operate at the horizontal level, underpinned by traditional institutions of labour exchange between neighbours, close friends and family.

In Phobjikha “vertical” ties in tourism operate between the community members, the private sector in the valley as well as with entrepreneurs in urban areas. Kinship links tour operators to rural ventures as explained in section 6.2.4. This suggests that the ability to diversify into more favourable livelihoods strategies is affected not only by the availability of material assets or skills and education. Social networks also play an important role.

In the Bhutanese tourism context, kinship “pipes” knowledge and investments in rural communities. It also operates as a control mechanism in the presence of uncertainty in an environment characterised by high transaction
costs. Therefore, working through networks might be very beneficial and rewarding for few households, but it generates barriers to entry for others who wish to diversify into tourism but are not connected to relevant networks. This is aggravated by the small and undifferentiated tourism market.

While from an individual perspective a rural entrepreneur in tourism can register as a small cottage industry (available data showed a spike of these registrations in recent years at national level), for communitarian initiatives in particular, it emerged that regulatory uncertainty is the challenging element to the integration in tour packages. The lack of legal recognition of community enterprise (a gap that the RSPN has been lobbying to fulfil) is side-lining the integration of more communitarian initiatives. The NGO in Phobjikha also follows an adaptive management strategy. This means that the business model can change depending on households’ performances and interaction. This can bring a change from communitarian to individual management of the home-stay network. In fact, those households that are better located and offer better services have benefited moderately from tourism. Yet, they are far from receiving a reliable flow of tourists.

Globally, tourism has proved to be an industry subject to global shocks (e.g. Hall and Gössling, 2006). In regions neighbouring Bhutan (e.g. China and India) tourism “on the ground” and for small operators has proved to be characterised by hyper-competition (see the analysis of Christian and Nathan, 2013). Within the Bhutanese “protected” environment, social networks in rural areas contribute to strengthen resilience given that links are sealed by long-term trustworthy relationships. This gives entrepreneurs a margin to withstand unexpected shortfalls in arrivals and incomes from tourism that can affect their ability to honour their financial commitments, for example. In fact, resilience ultimately depends on the ability of tour operators in particular (acting as gatekeepers) to cope with shocks or changes in international markets which they try to overcome themselves by establishing long-lasting relationships with international players (see 6.2.1 and 6.2.2). Outside these networks, vulnerability to sudden downturns in international or regional tourism demand is intuitively higher: benefits from tourism can be more volatile for those small entrepreneurs not connected to a steady demand stream secured through kinship.
Examples of these dynamics at work have recently been reported in the national press. In central Bhutan, community members are giving up to the Gewog administration an eco-lodge developed in 2009 (Wangdi, 2017). Some complains also arrived from Phobjikha particularly from the households in the more isolated lower valley that despite participating in the CBST programme are not receiving enough tourists and worry about their ability to honour their investments (Gyelmo, 2017b; Dema, 2014a).

As previously mentioned, kinship also operates in more traditional productive networks. For example, in potato cropping it operated as an adoption and diffusion mechanism (as observed by Phuntsho 2010b and corroborated in section 7.2.2.5). However, the positive correlations between the number of activities in crop and non-crop agriculture, time constraints and the number of people living in the household gives an indication that households can be involved in numerous subsistence activities with implications for increasing labour to land ratios that could damage the productivity of agricultural livelihoods. Consequently this can have also implications for the households’ ability to switch livelihoods activities due to a vicious cycle of low productivity that would ultimately impact on assets.

The lack of opportunities for establishing non-farm income sources in the valley might have an additional negative impact. Ellis (1998, p.22) noted how non-farm incomes sources can be beneficial for agriculture and how extra incomes can be used for agricultural investments and innovation, eliminating capital constraints and improving farm output growth. It has been shown in past research that extra sources of stable income can provide an incentive to tap into new techniques in agriculture and to incentivise risk taking. Diversifying in non-farm incomes provide households with a form of insurance against the risks of farming (e.g. Evans Ngau, 1991). This can be linked to the willingness of the Government to promote organic farming and the resistance of the farmers in changing their consolidated practices.

Therefore, diverse livelihoods strategies and income portfolios in the context of Phobjikha should be further encouraged. In fact, the NGO choice for a direct participation in tourism alone in such an environment may not be yielding the expected results. Probably, by taking advantage of existing bridging ties in tourism could help to spot those households with the potential to be
successful in diversifying into tourism and target them, while targeting others with different interventions.

In fact, given the considerable levels of investments\(^\text{96}\) that are needed and the difficult mechanisms associated with participation in tourism for entrepreneurs in rural areas, it might be more important to work on the creation of skills for local non-farm jobs and placements by targeting educated youths to lower the pressure on the farming activities. These could take the form of specialised training delivered between the NGO, the TCB (through its hotel school) and hoteliers in the valley. As a matter of fact one of the recently opened hotels claimed it employs 22 local people (a figure reported in an interview by the hotel manager) but with more hotel-related investments it could be a good strategy to work on capacity building as an entry channel into the hotel sector. This would provide local youths with training, experience and exposure - all elements that could potentially be used to start their own business in tourism or related activities in later stages.

There is also much room for improvement in the tourism-supply chain for hotels. A range of products can be produced by the communities but hoteliers need centralised suppliers to deal with. In addition the valley is too dependent on the potato monoculture. Working more closely with hoteliers to spot entrepreneurship opportunities in the tourism food supply-chain would be a useful programme to be developed by the NGO in collaboration with the hotel sector. Supported by contract farming, local cooperatives can be created to produce diversified crops. Cooperatives at the moment are non-existent in the valley.

As argued by Ellis (1998, p.20), opportunities coming from processing and trade of agricultural outputs to increase non-farm income are especially useful if growth in farm outputs has reached its limits. Some initiatives have been currently pushed by the association of tour operators under an EU funded project\(^\text{97}\) as well as by a recent memorandum of understanding signed between

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\(^{96}\) A regression analysis not presented in this study shows the importance of non-agricultural assets (principal component obtained from number of rooms and houses and financial capital) as predictors of tourism incomes. This suggests that the current trend in the sample relates to investments in accommodation services which require considerable financing capabilities. Agricultural capital (principal component of land owned, land under cultivation and livestock) impacts negatively on the outcome variable.

\(^{97}\) ABTO was awarded in 2012 of a project for low carbon tourism by the European Union Switch Asia Programme.
a cooperative in Gasa village and the hotel sector in Thimphu (Palden, 2017). An initiative by ABTO shows awareness and willingness to maximise the linkages between the cooperative movement in the agricultural sector and hoteliers. The initiative saw a five-day training of 40 participants at the end of 2014 from various cooperative in Thimphu, Paro, Tsirang, Wangdue and Punakha, facilitating a forum for networking and a mutual commitment to work together though the signing of memoranda of understandings (Dema, 2014b).

Considering the increasing investment in the hotel sector in the valley, specialised carpentry for hotel construction and maintenance can also open up an important stream of possible non-farm waged jobs (see also recommendations in the previous section). A strategy to link vocational training programmes in construction skills would match the recommendations made by the evaluation study of Chun & Watanabe (2012) cited in the literature review. The study assessed the impact of a vocational training programme in construction skills. They suggested that greater attention should be placed to connect these types of training with income-generating opportunities particularly placement services and entrepreneurship mentoring services to increase the potential of value-addition in more competitive labour markets (ibid).

From a gender perspective, specialisation patterns identified in section 7.2.2.2 seems to follow trends at national level related to feminisation of agriculture that are linked to a traditional matrilineal inheritance system. The traditional system is a way to tackle land fragmentation in a country where agricultural land is scarce. However, the current modernisation of these practices is exacerbating land fragmentation. The work of the RSPN adopted a gender perspective by giving opportunities for non-farm incomes particularly to women-headed households. At the moment however time constraints seems to be experienced more significantly by women-headed households linked to agriculture livelihoods (that beyond potato cropping is mostly subsistence) and this can impact negatively the sustainability of the intervention. Yet, support networks seem to be stronger among women-headed households and this could be a positive driver for sustaining the adoption of new livelihoods in general.

Overall, great attention should be attached to tourism development in the context of Phobjikha. It can be said that if potato cropping was identified as an
equalising force tackling disparities in income distributions (see Phuntsho, 2010a, b for the observation and Ellis, 1998, p.19 for the theory), tourism, if not well managed, might turn into a dis-equalising force, creating greater disparities among community members. Operating multiple strategies to sustain livelihoods diversification matters for inclusiveness and for promoting an inclusive business model for the Bhutanese tourism industry as a whole. This would involve local farmers and fostering interlinkages between sectors (see for example ITC, 2010). Up until now, however, initiatives have been limited in scope and implemented at a very slow pace in Bhutan.
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Appendixes

Appendix – A

List of participants interviewed

The content of Appendix – A has been removed to further strengthen anonymity of participants.
Appendix – B

Open-ended interview items*. Items for tour operators

1. INSTITUTIONS AND REGULATION
Did you encounter any difficulties when start-up your business? If “yes”, How or In what way?

Are you aware of the public sector institutions that are responsible for creating policies and strategies for tourism development in Bhutan? If yes, how well do you think these institutions work together?

Do you participate in tourism policy and strategy development in Bhutan? If yes, how? If not, why?

How do the existing regulations affect (in positive and negative ways) the way you ran your business?

What would you change in the regulations and the policies to improve tour-operating activities in Bhutan?

What do you think about mobilization and allocation of financial resources for tourism development in Bhutan?

In what ways public sector institutions support the business environment?

2. MARKET
What is your opinion about the tourism demand? What are your views about the type and characteristics of tourists who visit Bhutan?

Is the number of hotel rooms and alternative accommodation enough to meet the demand from tourists?

In your opinion, how the tariff system is impacting the market in Bhutan?

In your opinion, do you see any benefit of working with high-end markets? If yes, which are they? And why?

How many partners (Tour Operators or so) do you work with and which markets you are covering?

On average, how much does your tour package cost your partners?

On average, what is the price that your packages are sold in foreign markets by your partners? (In other words, do you know the mark-up that is applied to your package tours?).

Can you comment on how much of the market share do you manage?

Would like to improve your market share? If yes, which measures would you take?

Have you created new products or services in the last 2 years? If yes, explain further. If not, please explain why.

In your opinion, what are the main constrains to market development in Bhutan?

3. INNOVATION
What does the word “innovation” mean to you?
How do you go about innovation or intend to go about it?
Are there any issues that affect your interest or intentions to innovate in your business? If so, what are these and how could these be overcome?
Do you perceive any problem with existing services/products in tourism that can affect your business?
Have you received any suggestion from your national/international partners? If yes, please explain further.

4. NETWORKS
How do you normally select your national services providers?
On what bases do you negotiate the prices with your national service providers?
How do you choose your international/national partners (tour operators/guides)?
Have you created any new package following the suggestions of international tour operators or national partners?
Are there any external factors that influence your capacity to develop new business linkages and get new tourists? If yes, please explain further.
What do you think about the prospects of having more entrepreneurs in tourism related business? (E.g. involvement of the local community, different providers of accommodation and other tourist services in your city, just to give a perspective).
Do you experience any problems when working with partners (local or international)?
If yes, what are the most common? (Follow-up on Why do you think these problems arise? How could they be addressed? By whom?).

5. INTERNAL STRUCTURE
Do you own any accommodations services?
How many people do you employ?
How do human resources in Bhutan impact your business?
Do the international TOs/partners assist you with investment?

6. POVERTY REDUCTION
Do you see any potential to integrate other productions/activities to your operations?
If yes, why?
What kind of coordination (e.g. with public institutions or NGOs or other business) do you need to integrate other productions/activities to your operations?
In your opinion, what do you think are the incentives and constrains to establish linkages between tourism and other sectors of the economy?
How do you think the tariff system is contributing to poverty reduction?
How the philosophy of GNH is impacting your business?
Have you ever worked directly with the communities in rural areas? If yes, how?
7. **INTERNET**

Do you use any kind of ICT for your business? If yes, explain which one.

What form of communication do you commonly use with your business partners and clients?

What operations do you usually undertake with the Internet?

Do you have a website for your business? What do you use it for?

If yes, How often do you update the information on your webpage?

Does the internet connection in Bhutan meet the expectations of your business?

How important is ITC to your business?

8. **GENERAL**

Do you think the country has a shared vision to create value in tourism and other sector of the economy? If yes, how?

What are your thoughts about a liberalized market for tourism in the Bhutan?

How do you see competition for your business?

What actions would you take to improve tourism in Bhutan?

Source: Own elaboration.

* The interview items summarise the questions applied to the three core actors of the tourism value chain. The items incompletely convey the diversity of the interactive and face-to-face discussions whose complexity and length changed depending on the background of the interviewee. These items were slightly adapted to the characteristic of each actor interviewed (guides, tour operators or hotels managers) but without changing their substance or objectives. This strategy was suggested by Fritz et al. (2009) to better understand different perspectives.
Appendix – C

Survey questions to collect relational information for social network analysis

1. **To whom do you relate in the community if you need assistance in a work related situation for the different productive activities in which you are involved?**

   Assistance in a work-related situation was conceptualized as assistance in production and marketing. Productive activities included only the most significant: potato cropping, livestock, tourism services and handicrafts. They were chosen based on previous observations and corroborated as the most relevant ones. Once a person was named I asked to indicate the two full names and if he/she was part of the project or the sample, then I asked whether if he/she was a relative, a neighbour or another community member. The household ID was used if the named person was a member of the sample. This would have helped to locate the corresponding household. Other questions were related to the frequency of the interaction and the strength. The frequency and strength of ties were collected in a way that would have given a spectrum of options to the respondents (frequencies of ties included the choice between daily, weekly, bimonthly, monthly, quarterly). However, some studies (e.g. Harris et al., 2008) have dichotomised this kind of variables choosing an arbitrary cut-off point. Nonetheless, this additional set of data was not used in the analysis.

2. **To whom have you been giving assistance in the community for the different productive activity?** This is the “reciprocity” question with the same supplementary questions about the relationship (frequency and strength). The reciprocity question would have helped to reconstruct the network in case of missing data (see Borgatti, et al., 2013, p.76).

3. **Please name up to five hotels in the area to which you have been providing crops or non-crop products in the last year.** This question was asked to see if any household had any relationship with hotels in the area and if they were part of their supply chain. Additional questions were related to type of products, frequency of interaction, name of the hotel, name of the person and if he/she was a member of the community, if the contact person was a friend, a family member and if they had a formal agreement.

4. **Please indicate up to five tourism actors (hotels, national or international tour operators, senior guides) that are providing you with tourists/guests.** This question was asked to understand which kind of relationships and arrangements people had in the trade of tourists. Like for the other questions, frequency of interaction, type of actor, name of the contact person, belonging to the
community and friendship or family link, number of tourism in the last year, were also asked as follow up questions. I also asked how much they were receiving for improving their services. The reason for this is that interviewed revealed that some farmhouses have used kinship relationships with people working in the tourism industry in the capital city.

5. *If you produce handicraft, please name up to five companies to whom you have been selling in the last year.* The related sub-questions are the same as the question number four.

6. *To which government or non-governmental organisation do you turn if you need assistance for the different productive activity in which you are involved?* This question was purposely asked to see the level of interaction with government or non-government institutions operating in the area though extension offices that would have helped households in production and marketing.

Source: Own Elaboration.
## Appendix – D

List of selected statistics for the network analysis in section 7.2

<table>
<thead>
<tr>
<th>Category</th>
<th>Measure/Technic</th>
<th>Definition</th>
<th>Meaning</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Centralities</strong></td>
<td><strong>Degree</strong></td>
<td>It is the number of ties (directed or undirected) a node has.</td>
<td>How connected is a node.</td>
</tr>
<tr>
<td></td>
<td><strong>In-degree</strong></td>
<td>Number of directed ties an actor receives from others in the network.</td>
<td>Prestige.</td>
</tr>
<tr>
<td></td>
<td><strong>Out-degree</strong></td>
<td>Number of directed ties an actor sends to others in the network.</td>
<td>Influence.</td>
</tr>
<tr>
<td></td>
<td><strong>Betweenness</strong></td>
<td>With binary data, betweenness centrality views an actor as being in a favoured position to the extent that the actor falls on the shortest path between two other nodes in the network.</td>
<td>Power. How important a node is in terms of connecting other nodes.</td>
</tr>
<tr>
<td><strong>Embeddedness</strong></td>
<td><strong>Clustering</strong></td>
<td>The clustering coefficient $CC_i$ for an actor $i$ is the proportion of links between the <em>alters</em> within its neighbourhood divided by the number of possible links that could exist between them. This reveals the extent to which an actor’s ego-centred network is formed by alters that are connected to each other.</td>
<td>It is a measure of cohesion that uses undirected ties. Clustering corresponds to the density measure with undirected ties.</td>
</tr>
<tr>
<td></td>
<td><strong>Out-neighbourhood density</strong></td>
<td>Network density (ND) is defined as the proportion of possible linkages that are actually present in a graph. ND is calculated as the ratio of the number of linkages present, $L$, to its theoretical maximum, $n(n-1)/2$, with $n$ being the number of nodes in the network (Wasserman and Faust, 1994 cited by Giuliani &amp; Pietrobelli, 2011). Density based on out-neighbourhood considers the ego-network density which considers only actors with a tie from ego.</td>
<td>The number of ties divided by the number of pairs, times 100.</td>
</tr>
<tr>
<td><strong>Structural holes</strong></td>
<td>UCINET provide various measurements for structural holes. The most representative of this concept is probably “efficiency”, that is, the proportion of ego’s ties to its neighbourhood that are not redundant. The definition of redundancy (that is if A is tied to both B and C, and B is tied to C, A’s tie to B is redundant,</td>
<td>When an actor’s alters are poorly connected to each other.</td>
<td></td>
</tr>
</tbody>
</table>
because A can influence B by way of C), underpins the concept of structural holes (Hanneman & Riddley, 2005, p.138). Other authors (Borgatti and Li, 2009, p. 9) have suggested the use of “constraint” that measures the extent to which an actor is both directly and indirectly invested in specific alters. High constraint scores indicate low structural holes.

The QAP correlation is carried out considering pairs of networks (Krackhardt, 1987). This methodology is based on a two-step algorithm. First, it computes the correlation between corresponding cells of the two data matrices. Second, it randomly permutes the rows and columns of one matrix and recomputes the correlation. The second step is carried out for a minimum of 50000 permutations to calculate the p-value on the random assignments, that is to say the probability that permutations are yielding a correlation as large as the one observed (suggested by Borgatti et al. 2013,p.127). Permutation is a technique similar to bootstrapping. The observations in networks are not independent and distributions are not normal or unknown. In these conditions the use of standard inferential tests is problematic. Permutation allows an estimation of the p-value comparing the observed correlation, and the one based on random assignments of the scores. In other words it provides the probability (p-value) that the proportion of random assignments yield a correlation as large as the one actually observed. It compares the observed correlation against the distribution of correlations obtained if two variables were independent (Borgatti et al. 2013,p.127).

Source: adapted from Borgatti et al., 2013; Giuliani and Pietrobelli, 2011; Hanneman and Riddle, 2005; Jackson, 2010; and UCINET help menu.
Appendix – E

Links between relevant policies

**Economic Development Policy (EDP) 2010**

The EDP policy is the main policy instrument. It is of reference for many priority sectors including tourism. Accelerating economic growth is its main objective and it sets the agenda and the general direction for the development of sectors that have the highest potential. Accelerate economic growth means that the Royal Government shall work towards achieving a minimum economic growth rate of 9 percent annually and strive to be a middle-income nation with economic self-reliance and full employment by 2020. The strategies encompass:

1. Diversify the economic base with minimal ecological footprint; 2. Harness and add value to natural resources in a sustainable manner; 3. Increase and diversify exports; 4. Promote Bhutan as an organic brand; 5. Promote industries that build the Brand Bhutan image; 6. Reduce dependency on fossil fuel especially in respect to transportation. There are many aspects in this policy that affect tourism (from land use, to strategies for cottage and small industry, from FDI to external diplomatic action, from trade to financial services, from agriculture and organic production, to general incentives). For tourism specifically the EDP sets the following guidelines: “the tourism policy shall continue to be guided by the principle ‘high value - low impact’; TCB should reduce seasonality and facilitate market development; The tourism policy should support equitable distribution of tourism benefits; TCB shall be created as statutory body and develop an enabling environment and institutional framework; Tourism shall promote socio-economic development; The government shall continue to promote high-end exclusive tourism but at the same time broaden the participation and make the sector inclusive; Regulation shall be strengthened and incentive provided to improve facilities and services to higher standards and with a specific focus on green features; Product diversification and promotion of rural tourism should be a priority including community based tourism and the development farmhouses and guesthouses guidelines to meet minimum standards” (this last point interact with CSI policy as it is not clear if minimum standard refers to the rule about 3 stars minimum requirements).

**Monetary Policy**

An important aspect of monetary policy in Bhutan involves the management of foreign reserves. Convertible currency constitutes close to 90 percent of foreign reserves despite the fact the major share of the Bhutanese current account transactions are
denominated in INR (11th Plan p.11). Furthermore, the EDP highlights the importance for creating reserves. The nation’s foreign exchange reserves have been built meticulously over the years. The sustainability of the reserves is important through the development of trade and industry. To continue building the reserves and to encourage the private sector to generate its own foreign exchange requirements EDP proposes guidelines for the eligibility and use of foreign exchange. These guidelines affect export oriented industries and FDI. There is no mention of tourism, a sector that has been a net contributor of hard currency. RMA’s recent efforts have focused on managing recurrent pressures on Indian Rupee reserves. They established a reserve management policy that ensures adequate composition of reserves between the Indian Rupee and other convertible currencies to position for Indian Rupee needs.

**Foreign Direct Investment policy (FDI) 2010 and FDI Rules and regulations 2012**

FDI is encouraged by the Government of Bhutan to augment productive capacity and industrial capabilities. However the policy also imposes performance requirements on investors to upgrade domestic skills, value-addition and technology (EDP, p.9). FDI are also encouraged in existing companies and in construction activities as infrastructure development is of major importance for Bhutan. Nonetheless the FDI policy has very specific focus to encouraging: 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. The policy provides a list of priority sectors that shall be fast tracked for approval and the FDI policy establish minimum project cost, maximum foreign investor’s equities as well as conditions and requirements. Tourism investments are part of this category.

Hotels and resorts categorised as 5-stars (and above) can be own completely by foreign investors (they qualify for 100percent of foreign invers’s equity) under the condition to belonging to internationally reputed hotel-chains, with a minimum project cost of BTN 200 Million. 4-star hotels can have 74percent of the equities owned by foreign investors, they do not required to be part of international reputed chains and the minimum investments should be of BTN 25 Million.

Infrastructural facilities instrumental to tourism include airfields, golf courses and outdoor and recreational facilities, health and wellness centres. Infrastructural development can all be 100percent foreign owned but the policy requires a public private partnership (PPP) model wherein the facility returns to the Government on expiry of the term. Agro-industries are categorised under manufacturing and are included in the priority list with no specific requirements but with a maximum foreign
investor’s equity of 74percent and a minimum project cost of 20 Million Ngultrum. Other policies that cover specific sectors can have specific requirements and characteristics that can build upon the FDI policy. What is particular about the Bhutanese approach to FDI is that it wishes to prevent predatory behaviours and it has specifications on repatriations of dividends, repatriation of capital, access to foreign exchange, local borrowing and taxation (for which apply the same principles than Bhutanese firms), expatriate employment as well as an list of forbidden sectors (for example Mining). All FDIs need to be approved by a commission. The policy is complemented by the FDI Rules and Regulations 2012. Yet, the Government as recently soften the FDI policy to make the country more attractive to foreign investors. Particularly in tourism, FDI companies involved in service activities in the priority list like hotels, where investment in the project was made in convertible currency and earning non-convertible currencies, are now allowed to purchase convertible currency (US dollar, Euro and UK Pound) up to USD 5M per annum from Royal Monetary Authority (RMA). Another aspect that might impact tourism development is that the new policy allows FDI companies to own or lease land in accordance with the land Act.

Cottage and Small industries policy (CSIs) 2012
The CSI policy recognises the importance of small and medium industry as a key element for poverty alleviation, employment generation and sustainable economic development. The rational of the policy is based on the idea that small and medium industry stimulates pro-poor growth with equity and inclusion. The overall objective of the policy is to foster job creation and enhance income generation by promoting the creation of new CSMI and improving the performance and competitiveness of existing ones to increase their participation and contribution to the Bhutanese economy. The CSMI development framework comprises of three inter-related instruments:
- CSMI Policy sets out the overall policy framework for CSMI development until 2020.
- CSMI Development Strategy (2012-20) sets out the strategies and measures for achieving the CSMI Policy and;
- CSMI Action Plan (2012-2014) which sets out the activities, responsibilities, deadlines and resources for achieving the CSMI Development Strategy in three year phases; there will be three such CSMI Action Plans covering the overall timeline of the CSMI Policy and Strategy.

The policy is structured around 6 main themes:
1. Strengthening the Policy Environment and Institutional Framework. This includes
the capacity of the CSI department as well as the set-up of inter-ministerial mechanisms to ensure effective implementation and a Private Sector Development Committee to ensure dialog with the private sector.

2. Strengthening the Legislative Framework and Enterprise Environment. This theme includes the implementation of the enterprise registration act to ensure that all enterprise become legal entities; Streamline the process of registration and licensing to stimulate entrepreneurship (e.g. through Community Centres one-stop-shops, Enterprise Registration Act, online registration, etc.); Simplify the tax administration system; Raise the accounting standards of Small and Medium Industry (SMI) to align with internationally accepted norms.

3. Facilitating Access to Finance and Incentives. This includes improving access to commercial bank finance, venture capital, business networks.

4. Enhancing Competitiveness and Innovation. This includes stimulating the development of business clusters and/or value chains with the potential to increase the competitiveness of CSMI products and services, guided by the MoEA competitiveness studies. Develop a network of business incubators to accelerate the development of start-up companies through an array of business support services, including access to business premises orchestrated by incubator management; Develop Special Economic Zones with a focus on CSMI (see EDP, 2010).

5. Improve Market Access.

6. Enhance Employment and Develop a Culture of Entrepreneurship. The EDP considers CSIs as important instruments to generate employment, support equitable distribution of income and balanced regional development. Special focus on women’s enterprises shall be given within the CSIs industries development framework (EDP, p.12). The EDP also recommends that businesses classified under cottage and small (services only) shall not be required to obtain a licence to start operations as long as the activity is not classified as prohibited. The business must register itself with the Regional Trade and Industry Office within 30 days from start of business activity (EDP, p.9). This can impact tourism as farmhouses and homestays can classify under this categories.

Source: Own elaboration based on the Cottage and Small industries policy (CSIs) 2012; Foreign Direct Investment policy (FDI) 2010 and FDI Rules and regulations 2012; Monetary Policy; Economies Development Policy (EDP) 2010.
Appendix – F

List of variables and descriptive statistics

<table>
<thead>
<tr>
<th>Variable</th>
<th>Description</th>
<th>Mean</th>
<th>S.D.</th>
</tr>
</thead>
<tbody>
<tr>
<td>PROJ</td>
<td>Membership to the CBST project. Dichotomous (0=no/ 1=yes).</td>
<td>0.718</td>
<td>0.456</td>
</tr>
<tr>
<td>HD_GNDR</td>
<td>Gender of household head. Dichotomous (0=male; 1=female).</td>
<td>0.615</td>
<td>0.493</td>
</tr>
<tr>
<td>EDU_F</td>
<td>Education recoded as dichotomous. (0=no education/ 1= any level of education).</td>
<td>0.308</td>
<td>0.468</td>
</tr>
<tr>
<td>EDU_M</td>
<td>Education recoded as dichotomous. (0=no education/ 1= any level of education).</td>
<td>0.385</td>
<td>0.493</td>
</tr>
<tr>
<td>CMNTYROLE</td>
<td>Role in the community of any member of the HH. Dichotomous (0 =no; 1= yes).</td>
<td>0.256</td>
<td>0.442</td>
</tr>
<tr>
<td>TOT_EXPTR_MPC</td>
<td>Total non-food consumption (total non-food expenditure minus project contributions). Continuous variable expressed in 2013 BTN.</td>
<td>182,000</td>
<td>283,000</td>
</tr>
<tr>
<td>TOT_INCOME</td>
<td>Total Income from all livelihoods sources. Continuous variable expressed in 2013 BTN.</td>
<td>989,000</td>
<td>4,800,000</td>
</tr>
<tr>
<td>WLTH_PRCPTN</td>
<td>Households’ perception of relative poverty/wealth. Scale variable (from 1 to 7).</td>
<td>4.077</td>
<td>0.422</td>
</tr>
<tr>
<td>N_INHOUSE</td>
<td>Number of members living in the households. Continuous variable.</td>
<td>5.41</td>
<td>1.956</td>
</tr>
<tr>
<td>MGRTNRATIO</td>
<td>Ratio variable between members living outside the household and the total number of people that form the household. Continuous variable.</td>
<td>0.1</td>
<td>0.178</td>
</tr>
<tr>
<td>TOT_FNCIALK</td>
<td>Total Financial Capital (sum of unearned transfers, borrowing and savings). Continuous variable expressed in 2013 BTN.</td>
<td>354,000</td>
<td>1,640,000</td>
</tr>
<tr>
<td>LND_OPERATED</td>
<td>Total land owned in acres. Continuous variable.</td>
<td>2.453</td>
<td>1.396</td>
</tr>
<tr>
<td>LND_OWNED</td>
<td>Land under potato cultivation. Continuous variable indicating the acres of land cultivated exclusively under this specific crop.</td>
<td>1.869</td>
<td>1.222</td>
</tr>
<tr>
<td>LND_POTATO</td>
<td>Land under potato cultivation. Continuous variable indicating the acres of land cultivated exclusively under this specific crop.</td>
<td>0.009</td>
<td>0.056</td>
</tr>
<tr>
<td>LND_CROPOTR</td>
<td>Number of Livestock. Continuous variable.</td>
<td>8.359</td>
<td>6.827</td>
</tr>
<tr>
<td>NLVSTOK</td>
<td>Total operational costs. Continuous variable expressed in 2013 BTN.</td>
<td>656,000</td>
<td>3,200,000</td>
</tr>
<tr>
<td>TOT_NTRSTS</td>
<td>Total number of tourists received. Continuous variable.</td>
<td>46.462</td>
<td>148.072</td>
</tr>
<tr>
<td>CASHECON1</td>
<td>Income from crop agriculture. Continuous variable expressed in 2013 BTN.</td>
<td>138,000</td>
<td>92,230</td>
</tr>
<tr>
<td>CASHECON2</td>
<td>Income from non-crop agriculture. Continuous variable expressed in 2013 BTN.</td>
<td>5,913</td>
<td>9,406</td>
</tr>
<tr>
<td>Variable</td>
<td>Description</td>
<td>2013 BTN</td>
<td>2013 BTN</td>
</tr>
<tr>
<td>---------------------</td>
<td>------------------------------------------------------------------------------</td>
<td>----------</td>
<td>----------</td>
</tr>
<tr>
<td>CASHECON3</td>
<td>Income from artisanal activities. Continuous variable expressed in 2013 BTN.</td>
<td>10,513</td>
<td>42,299</td>
</tr>
<tr>
<td>CASHECON4</td>
<td>Income from transport activities. Continuous variable expressed in 2013 BTN.</td>
<td>13,590</td>
<td>53,483</td>
</tr>
<tr>
<td>CASHECON5</td>
<td>Income from professional activities. Continuous variable expressed in 2013 BTN.</td>
<td>2,128</td>
<td>12,044</td>
</tr>
<tr>
<td>CASHECON6</td>
<td>Income from tourism services. Continuous variable expressed in 2013 BTN.</td>
<td>812,000</td>
<td>4,800,000</td>
</tr>
<tr>
<td>CASHECON7</td>
<td>Income from commercial activities. Continuous variable expressed in 2013 BTN.</td>
<td>2,308</td>
<td>14,412</td>
</tr>
<tr>
<td>CSHPOTATO</td>
<td>Income from the sale of potato. Continuous variable expressed in 2013 BTN.</td>
<td>139,000</td>
<td>92,931</td>
</tr>
<tr>
<td>QNTYPOTATO</td>
<td>Quantity of potato produced in the year. Continuous variable expressed in 2013 BTN.</td>
<td>1894.872</td>
<td>1541.18</td>
</tr>
<tr>
<td>TOT_AGRINCOME</td>
<td>Total Income from all agricultural (crop and non-crop) sources. Continuous variable expressed in 2013 BTN.</td>
<td>144,000</td>
<td>94,501</td>
</tr>
<tr>
<td>TOT_NNAGRINCOME</td>
<td>Total Income from all non-agricultural sources. Continuous variable expressed in 2013 BTN.</td>
<td>840,000</td>
<td>4,790,000</td>
</tr>
<tr>
<td>CLSTRNG</td>
<td>Ego-network structure. Continuous.</td>
<td>0.263</td>
<td>0.157</td>
</tr>
<tr>
<td>EFFICIENCY</td>
<td>Ego-network structure. Continuous.</td>
<td>0.715</td>
<td>0.16</td>
</tr>
<tr>
<td>CONSTRAINT</td>
<td>Ego-network structure. Continuous.</td>
<td>0.427</td>
<td>0.183</td>
</tr>
<tr>
<td>OUTDENSITY</td>
<td>Ego-network structure. Continuous.</td>
<td>11.639</td>
<td>25.938</td>
</tr>
<tr>
<td>TIME_CNSTRNT</td>
<td>Ratio variable between total number of hours employed for subsistence activities generating no income to those that generate income. Continuous variable.</td>
<td>0.396</td>
<td>0.434</td>
</tr>
<tr>
<td>CROPact</td>
<td>Total number of activities undertaken by the households in crop agriculture. Continuous variable.</td>
<td>0.897</td>
<td>0.384</td>
</tr>
<tr>
<td>NNCROPact</td>
<td>Total number of activities undertaken by the households in non-crop agriculture. Continuous variable.</td>
<td>2.231</td>
<td>1.512</td>
</tr>
<tr>
<td>NNAGRIact</td>
<td>Total number of activities undertaken by the households in non-agricultural activities. Continuous variable.</td>
<td>1.513</td>
<td>0.644</td>
</tr>
<tr>
<td>TOTALNact</td>
<td>Total number of activities undertaken by the households in agricultural (crop and non-crop) and non-agricultural activities. Continuous variable aggregated.</td>
<td>4.641</td>
<td>1.784</td>
</tr>
<tr>
<td>OutDGR</td>
<td>Out-degree centrality. Continuous variable.</td>
<td>1.641</td>
<td>2.748</td>
</tr>
<tr>
<td>InDGR</td>
<td>In-degree centrality. Continuous variable.</td>
<td>1.641</td>
<td>1.181</td>
</tr>
<tr>
<td>DGR</td>
<td>Degree centrality. Continuous variable.</td>
<td>3.282</td>
<td>3.162</td>
</tr>
<tr>
<td>BetwnDGR</td>
<td>Betweenness centrality. Continuous variable.</td>
<td>9.154</td>
<td>17.149</td>
</tr>
</tbody>
</table>

Source: Own elaboration.