



**Report on the preparation of Bhutan's Smooth Transition
Strategy from the Least Developed Countries category**

December 2020

1. Background

Bhutan's graduation from the UN's list of Least Developed Countries (LDCs) category was endorsed during the 73rd Session of the UN General Assembly held in December 2018. Bhutan will be graduating in 2023 coinciding with the end of the 12 Five Year Plan (12 FYP/2018-2023).

Bhutan was found eligible for graduation from the UN's list of LDCs for the first time during the 2015 Triennial review of the Committee for Development Policy (CDP) under UN Economic and Social Council (ECOSOC). Bhutan successfully met and fulfilled the threshold levels for the Gross National Income (GNI) per capita and Human Asset Indicator (HAI) criterion which a country must meet in order to be recommended for graduation, or meet twice the Income threshold in two consecutive Triennial reviews. Bhutan did not meet the threshold required for the Economic Vulnerability Indicator (EVI), however Bhutan has made slight improvement in EVI from 2018.

Bhutan's achievement of graduation thresholds of GNI per Capita and HAI, and improvement in EVI in two consecutive Triennial reviews (2015 & 2018) are as tabulated below.

Table: Bhutan's performance in the CDP Triennial Review

Criteria	Graduation Threshold	Bhutan's Performance	
		1st Triennial Review(2015)	2nd Triennial Review(2018)
GNI Per Capita (Income only criteria=twice the threshold)	<ul style="list-style-type: none"> • USD 1242 (2015) • USD 1230 (2018) 	USD 2277 (83.3% above threshold)	USD 2401 (95.2% above threshold)
HAI	66	67.9 (2.9% above threshold)	72.9(10.45% above threshold) (10.45% above threshold)
EVI	32	40.2 (25.6% below threshold)	36.3 (13.44% below threshold)

Source: Committee for Development Policy(CDP), United Nations

2. Consultative Mechanism

Bhutan's smooth Transition from LDCs category is premised on the full implementation of its 12 FYP (2018-2023) which is Bhutan's National Development Plan spanning a 5 year's time period for which national level consultations have been undertaken in the preparation process to discuss, prioritize and build consensus on the socio-economic issues, goals and objectives of the FYP with LDC graduation and SDGs in context. Comprehensive consultations and dialogue have been carried out between 2016 and 2018 fiscal years with all levels of government, ministries, sectors, local governments, parliamentarians, communities at the grassroots level across the nation, and all other potential stakeholders including CSOs through participatory planning approaches, processes and engagement. Desk reviews, research and analysis, immersions and field visits, consultation/learning and sensitization workshops and trainings, data sourcing and data validation, results based activity identification and budgeting, and the annual performance agreement signing by the Prime Minister with the implementing agencies and local

governments were/are the methods, procedures and tools used in the plan formulation, finalization and implementation process.

The Country Programme Board (CPB) Meeting is held yearly with heads of Resident UN agencies and Non-Resident agencies including government agencies implementing UN supported programmes mainly to review the achievements of results and issues and challenges faced in the implementation of the United Nations Sustainable Development Partnership Framework (UNSDPF) 2019-2023 and endorse the Joint AWP for the following year.

Coinciding with the 12 FYP, the UNSDPF reflects the collective aspirations of the UN in Bhutan and the Royal Government of Bhutan (RGoB) towards achieving the objectives of the 12 FYP and the SDGs. The formulation and finalization of the document also involved several rounds of discussions within the RGoB and exchange of comments and inputs between the RGoB and the UNCT.

Consultations have also been initiated with the UN system through the UN Resident Coordinator in Bhutan and the UNCTAD to draft the smooth LDC transition strategy for Bhutan.

3. International support for graduation

The 12 FYP is also a transition strategy for Bhutan and has reflected all pertinent socio-economic and environmental programs and projects for implementation.

The 14th Round Table Meeting (RTM) which is the highest forum for the policy dialogue between RGoB and its development partners was held from 20th – 21st March 2019 in Thimphu, Bhutan organized by RGoB in collaboration with the UN system in Bhutan.

The RTM gave an opportunity for Bhutan to deepen and revitalize partnership with its development partners, share experiences and showcase developmental gains, and most importantly, apprise partners on the 12 FYP as the last five year plan as an LDC that seeks to address the last mile socio-economic challenges and priorities. With the adoption of the UNSDPF 2019-2023, coinciding with the implementation of the 12 FYP, the UN in total committed resources of USD 120 million to the 12 FYP.

So far out of the total development partners' support for the 12 FYP which is around Nu. 63 billion, Nu.31.070 billion (around 49%) has been received as of November 2020.

On the international support measures for LDC graduation, Bhutan have not requested nor received any support. Bhutan has also not received any specific support for maintaining or phasing out from LDC graduation.

On the support received for COVID 19 pandemic measures, the external assistance received from development partners have substantially capacitated Bhutan in handling and managing the pandemic thereby also helping in the implementation of the 12 FYP. Till date, RGoB has received financial and in-kind assistance from the World Bank, ADB, GoI, EU, Government of Japan (JICA), Austria, Republic of Korea, KOICA, Honorary Consul of Korea in Bhutan, Bangladesh, USA, Canada, Singapore, Save the Children, UN Secretary General's Trust Fund for COVID-19, WHO, UNICEF, Global Fund (GFATM), FAO, UNDP, UNFPA, WFP, UNRCO, Bhutan Foundation (USAID) and Helvetas.

Besides the external grant, RGoB has also received loans from the World Bank and ADB: Interest free loan from the World Bank investment project financing and Cat DDO windows and concessional borrowing from ADB. These loan supports are specific to the pandemic response, and in addition to the regular country partnership assistance..

4. Progress of Transition Strategy

As a contribution towards the national process of crafting a smooth transition strategy, UNCTAD had prepared a white paper outlining key elements for consideration by the RGoB, its development and trading partners and other interested stakeholders. Bhutan's smooth transition strategy is expected to accord special consideration to the challenges that pose a potential hindrance to Bhutan reducing its economic and natural vulnerabilities and adjusting to the loss of LDC-associated benefits, through the targets and expected outcomes of its 12 FYP. It is also expected to consider the support that Bhutan could receive from the UN system in cooperation with Bhutan's bilateral, regional and multilateral development and trading partners during the transitional period to enhance the country's ability to adapt to functioning in the global economic and trading landscape post-graduation. The paper thus identifies and discusses LDC-associated benefits that are likely to be vital for Bhutan's continued growth and development and that merit being retained beyond graduation to avoid a roll back on Bhutan's development gains and the disruption of the country's current development trajectory. This information will go into the smooth transition strategy, the main components of which will be the targets and focus areas of the 12 FYP.

Joint consultations on the white paper originally scheduled for March 2020 were postponed on account of the global outbreak of the COVID-19 pandemic and have been rescheduled for the latter half of January 2021. A key expected outcome of the joint consultations in January 2021 will be the finalization of the national smooth transition strategy for submission in February 2021.

UNCTAD has in the meantime commissioned a study on COVID-19 impacts in Bhutan to ascertain possible consequences for the country maintaining graduation momentum and progress on sustainable development. Accordingly, UNCTAD is updating the white paper with the view to submitting the revised and finalised white paper to the RGoB in early January 2021.

As the smooth transition strategy can be expected to build upon the gains realized from the implementation of the 12 FYP, complement the overall national development strategy and inform the implementation of the 13 FYP, the competent authorities in the RGoB are also undertaking complementary reviews on the progress so far achieved in the implementation of the 12 FYP.

Bhutan's 11 FYP included graduation from the LDC category by 2020 as one of three development milestones to be achieved. Now on its track towards graduation by 2023 since the endorsement of the CDP, the 12 FYP focuses on devising and realizing a sustainable graduation for Bhutan. The 12 FYP will be Bhutan's last five year plan as an LDC and has been approached with the agenda to address last mile challenges in all sectors and ensure that Bhutan's graduation is sustainable and irreversible. The focus therefore is on improving productive capacity, building the economy's resilience and meeting the last mile challenges in areas of poverty, health and education.

The 12 FYP has identified 17 socio-economic and environmental National Key Result Areas (NKRAs) to achieve the plan objective as it prepares to graduate in 2023. In addition to the agency and local government plan programmes, the 12 FYP will see the implementation of priority flagship programmes. These are in the areas of tourism development, CSI and Startups, digitalizing Bhutan, ICT-ising schools and ICT skilling of students, water security, organic agriculture, health, education and waste management.

A distinct feature of the 12 FYP is the flagship programme that consists of interventions to address high priority national issues requiring multi-sectoral collaboration and coordination in a concerted manner. The Flagship programmes have been designed as salient means to achieve the NKRAs through implementation of high impactful activities, in addition to the regular programmes. Bhutan requested for a 3+2 years transition period coinciding with the implementation of the 12 FYP. The longer transition period was requested to address the last mile challenges in all sectors and ensure sustainable graduation. In view of this, the flagship programmes will play a strategic role in complementing a sustainable graduation from the LDC category.

Some of the high priority national issues to be addressed through the flagship programmes are economic growth and diversification, employment generation, access to reliable and safe drinking water, rural income generation, efficiency and effectiveness of public services, and waste management.

5. Implications of COVID 19

With the COVID-19 pandemic continuing and not easing, Bhutan is experiencing an economic downturn and disruption of planned socio-economic developmental activities. And at the current trend it is likely that Bhutan will suffer greater economic damages in the coming year and will face bigger challenges in rebuilding the economy. Bhutan has suffered far lighter health-related impacts from the COVID-19 pandemic because of the Government's proactiveness and ability to mobilize resources and implement effective and whole of government approaches and interventions to the pandemic in a timely manner.

While considerable uncertainty remains about the extent of the socio-economic damages due to the pandemic, what is immediately evident is that the containment measures, including the nationwide lockdowns, brought large parts of the economy to a standstill, decelerating the country's economic growth. The tourism sector was immediately and disproportionately affected transmitting multidimensional socio-economic impacts to tourism-related and allied sectors. Tourism is a key growth driver and a major source of hard currency earnings. Around 16% of the country's working population¹ work directly in the sector or in allied activities and the sector represents a major source of employment opportunities for a growing number of youth. According to a rapid assessment undertaken by UNDP and the National Statistics Bureau, 32 percent of employees in the sector had lost their jobs or been sent on leave without pay. For the majority of households (63%) surveyed, income from tourism was their only source of livelihood with 74 percent of affected households reporting a significant drop in income (declines of more than 50%) and many having no other source of subsistence or means to carry them through the crisis.

¹ As reported by Foreign Minister, who is also the Chairperson of the Tourism Council of Bhutan (TCB), in the December 2020 Parliamentary session.

The economic fallout has spread to other key sectors, such as construction and manufacturing, with industrial production suffering severe supply chain disruptions, rising input and transaction costs and labour shortages due to restrictions imposed on the foreign workers on which these sectors are dependent. According to the Ministry of Labour and Human Resources (MoLHR), total demand for foreign workers across the country stood at 35,567, of which 53 percent skilled, in June 2020. As a result of pandemic-related restrictions, the supply of both skilled and unskilled workers fell short by 41 percent. Labour shortages also had negative implications in the implementation of 12 FYP capital projects and activities, much of which are front loaded in the 2020/21 fiscal year. Five months into the 2020/21 fiscal year only 6 percent of the capital budget² has been used due to prevailing shortages in the supply of workers and inputs. The resultant delays in implementation will likely contribute to foreign labour bottlenecks in the post pandemic period as domestic labour is not able to pick up the slack.

With cottage and small industries accounting for 90 percent of non-hydro productive activities in 2018, the pandemic has dealt a potentially heavy blow on a still nascent productive base and seriously hurt the export of non-hydro goods and services. Smaller firms are by default less resourced and have severely limited ability to withstand shocks. This has negative implications for the 12 FYP goal of expanding and diversifying the country's economic base, diminishing the reliance on imports and narrowing the country's trade deficit. It also has serious implications for the creation of decent work and addressing rising unemployment, especially among educated youth. A slow recovery from COVID-19 will have negative implications for the 12 FYP target of 2.5 percent overall unemployment and less than 6.5 percent youth unemployment. While overall unemployment stood at 3.4 percent or in 2018, youth unemployment was staggering at 15.7 percent³. As of December 2020, 27 percent of those registered with the MoLHR as unemployed were laid off due to COVID-19 and about 4 percent were returned migrants (also laid off due to COVID-19). These numbers likely underestimate the real number of unemployed because they account only for registered job seekers and those permanently laid off and not those who are on reduced pay, leave without pay, leave with partial pay and businesses that are only partly operational.

Bhutan has a strong track record of reducing poverty but due to the impacts of COVID-19, many are at risk of falling below the poverty line. Many sections of society, mostly in urban areas have been affected with job lay-offs, furloughs, leave without pay or working at reduced wages triggering spikes in poverty and more than 5000 laid off youth returned from foreign countries and are without proper jobs. Most are beneficiaries of the Royal Kidu⁴ and this, in addition to other forms of fiscal stimulus and monetary measures have served to support livelihood and businesses greatly.

Nevertheless, the COVID-19 crisis has resulted in large increases in the cost of basic goods. While the pandemic has motivated farmers, laid-off youth and others to venture into commercial production and marketing of agriculture goods, many still depend on income from the cash remittances of family members who work and live in urban centres that will have dried up. Rural handicrafts, one of the main sources of off-farm income has been negatively affected by COVID-19 containment and preventive measures and impacts on tourism.

In addition, disruptions to education and learning at all levels may have lasting impact on the ability of many to overcome the challenges of poverty and to capitalise on future opportunities in the job market,

² As reported by Finance Minister during the Question and Answer session of the December 2020 Parliament session

³ 2018 Labour Force Survey Report, Bhutan

⁴ Druk Gyalpo Relief Kidu, Income support to affected individuals

while impeding progress on improving human capital and Bhutan's productive capacities. Some estimate that 30 percent of students have missed out on availed e-learning programmes due to access issues, a figure likely to underestimate the magnitude of the problem given that access to e-learning platforms does not guarantee that students' performance necessarily remains at the same level as with face-to-face learning.

Following the first nationwide lockdown in August, GDP growth previously forecast at 6.9 percent pre-COVID-19, is now projected to nosedive to -6.1 percent, the lowest ever in Bhutan's economic history. Estimates place the economic loss across all sectors at around Nu 3.4 billion in 2020⁵. This will have knock-on impacts on tax revenue (compounding revenue losses from diminished trade) and the fiscal space available for the Government's continued ability to provide stimulus packages and other financial support for the duration of the pandemic and beyond. Growth in 2021 is projected to recover to 4.3%, contingent on continued support extended by the RGoB to productive sectors and to the population.

The 12 FYP set the target to maintain the average fiscal deficit below 3% of GDP and to fund at least 80 percent of FYP expenditure through domestic revenue. Bhutan has thus far maintained a high reliance on external grants and achieving this target looks increasingly uncertain in the light of the elevated expenditure requirements linked to COVID-19 mitigation and recovery and the downward pressure on non-hydro revenue sources. The 2020/21 fiscal deficit is expected to widen to about 8.4 percent of GDP and to remain elevated for the medium term, likely necessitating recourse to borrowing on foreign markets should access to grant funding be diminished by COVID-19 impacts on donor countries. The public debt projected for FY 2020-2021 is 126.5 percent of GDP, an increase of 8.4 percent from the previous year—as both external and domestic debt are expected to increase mainly on account of loan disbursement for Kholongchu Hydropower Project, and the borrowings from the domestic market through issuance of T-bills and Government Bonds to meet the resource gap. As of 30 September 2020, total public debt stood at 120.8 percent of GDP. In addition, local currency suffered a 5.19 percent depreciation against the US dollar in 2020. All these developments place a premium on the establishment of a robust fiscal management plan and have implications for Bhutan graduating with momentum.

On the upside, electricity exports remained a reliable source of trade earnings (also offsetting the reduction in the domestic electricity sales resulting from subdued productive activity, especially energy-intensive industries) and have been boosted by the commissioning of Mangdechhu Hydropower project. In addition, subdued imports have been a bonus for macroeconomic health. In the nine months since the start of the COVID crisis, total trade volume dropped by 30 percent with non-hydro exports reduced by 43 percent and imports by 25 percent. The trade deficit declined by 32 percent in the first half of 2020 and the current account deficit is expected to narrow from 15.3 percent of GDP to 7.7 percent of GDP because of COVID-19. Bhutan's foreign exchange reserve was USD 1,403 million as of December 2020⁶ sufficient to cover more than 21 months of essential imports or more than 15 months of merchandise imports and well within the country's constitutional requirement. However, due to the impact of COVID-19 on the tourism sector, reserves are expected to fall by around 4%.

The impact on the implementation of the planned activities of the 12 FYP has resulted in low physical progress and low budget delivery. Thus, continuous and vigorous rationalization, reprogramming and

⁵ Prime Minister's State of the Nation address during the December 2020 Parliamentary session.

⁶ This information is from the Prime Minister's State of the Nation address during the December 2020 Parliamentary session.

debottlenecking exercises are being carried out to fast track implementation of 12 FYP projects and activities with priority to major ones, implement COVID 19 mitigation and adaptation programs and activities, implement economically productive and growth oriented projects and activities, and implement important health and education projects and activities
