



United Nations
CDP
Committee for
Development Policy

CDP2021/PLEN/5B.ii

Committee for Development Policy 23rd Plenary Session

United Nations
22-26 February 2021
Virtual meeting

Monitoring of Countries Graduating from
the Least Developed Country Category:
Bhutan

**SUSTAINABLE
DEVELOPMENT** **GOALS**

Monitoring of Countries Graduating from the Least Developed Country Category: Bhutan

Contents

Summary.....	3
LDC indicators.....	5
Productive Capacity.....	6
Data gap.....	7
Smooth transition and country specific factors	7

Summary

Bhutan's income is almost three times higher than the graduation threshold, meeting the HAI and EVI criteria with a comfortable margin (about 20%). Productive capacity is comparable with that of non-LDC developing countries. With the COVID-19 pandemic continuing and not easing, Bhutan is experiencing an economic downturn, particularly tourism sector, and disruption of planned socio-economic developmental activities. Disruptions in education and learning may have long lasting impacts on improving human assets. Bhutan is making a good progress in preparing for a smooth transition strategy and plans for appropriate actions to address challenges posed by the LDC graduation and the impacts of the COVID-19.

Macroeconomic situation

Bhutan has seen robust economic growth over the past decade with more than 5% average annual GDP growth between 2010 and 2019.¹ The economy is closely linked to that of India, which is the source of more than 80% of imports and the destination of more than 80% of exports. The currency is pegged to the Indian Rupee, which has helped ensure macroeconomic stability over the same period. Hydroelectric power production, agriculture, forestry and tourism are the mainstays of the economy.

Table 1. Selected macroeconomic data for Bhutan, 2014-2019

Indicator	2014	2015	2016	2017	2018	2019
GDP growth rate (per cent, constant price)	6.6	6.6	8.0	4.6	5.3	6.0
Inflation rate (%)	8.3	4.5	4.3	3.9	2.7	3.0
Government revenue (billions of national currency)	37.8	36.2	42.0	42.7	52.1	42.0
Government expenditure (billions of national currency)	34.6	36.5	44.7	50.0	56.3	44.1
Government balance (billions of national currency)	3.2	-0.2	-2.6	-7.3	-4.2	-2.0
Government balance (per cent of GDP)	2.9	-0.2	-1.9	-4.8	-2.6	-1.1
Net ODA received (millions of US dollars)	130.6	97.3	51.6	118.5	105.5	
Balance of Payments (millions of US dollars)						
Current Account	-490.3	-548.3	-622.7	-540.4	-497.6	-511.6
Goods, Credit (Exports)	534.7	581.5	496.5	554.6	597.2	614.1
Goods, Debit (Imports)	928.8	1,008.6	1,029.9	1,025.1	1,019.6	1,009.5
Balance on Goods	-394.1	-427.0	-533.4	-470.5	-422.4	-395.4
Services, Credit (Exports)	124.5	125.4	145.8	161.7	181.4	167.8
Services, Debit (Imports)	189.5	195.1	207.4	209.8	241.3	232.1
Balance on services	-65.1	-69.7	-61.6	-48.1	-59.9	-64.3
Balance on Goods and Services	-459.2	-496.7	-595.0	-518.6	-482.3	-459.6
Balance on income	-128.1	-133.2	-171.7	-199.3	-216.1	-221.1
Balance on current transfers	97.0	81.6	143.9	177.4	200.8	169.1
Capital Account	276.3	226.3	191.7	186.4	165.5	124.6
Financial Account	-164.6	-347.5	-461.7	-263.5	-186.2	-338.0
Direct investment (net)	-23.5	-6.5	-11.9	16.6	-2.6	-13.0
Portfolio investment (net)	0.0	0.0	0.0	0.0	169.5	11.5

¹ IMF (2020). World Economic Outlook, accessed December 2020.

Other investment (net)	-211.6	-336.4	-639.2	-260.4	-423.9	-306.1
Change in reserves						
Total Reserves (Millions of US dollars)	70.5	-4.7	189.3	-19.6	70.9	-30.3
Reserves (months of imports)						

Source: GDP growth and inflation are from UN DESA, WESP, 2020 edition, accessed 18 Dec 2020. Government balance is from IMF, World Economic Outlook Database, October 2020 edition, accessed 18 Dec 2020. Net ODA is from OECD, OECD.Stat, accessed 18 Dec 2020. All external sector indicators are from IMF, Balance of Payment Data Reports, accessed 18 Dec 2020.

In an effort to diversify the economy the Government of Bhutan have targeted the agriculture, cottage and small industries, hydropower, tourism, and mining sectors to help expand domestic production and reduce import dependency². The country is currently implementing its 12th five-year plan, which is based on the country's Gross National Happiness philosophy and closely aligned with the 2030 Agenda and the SDGs. The Government has particularly highlighted the importance of SDGs 1 (No Poverty), 13 (Climate action) and 14 (Life on land) for development in Bhutan³.

While Bhutan has had a relatively low rate of infections, and to date (28 January 2021) only one death from the COVID-19 pandemic, the economic impacts have been severe. Borders were closed on March 20 with devastating impact on tourism. The manufacturing, construction and non-hydro exports have also suffered from trade disruptions, foreign labour shortages, and depressed external demand². Conversely, the completion of the Mangdechhu dam has boosted growth. The GDP growth for 2020 was estimated at 0.5% by the IMF in October¹, while the Government's own assessment is that GDP contracted by 6.1%. Significant uncertainties in near- and medium-term forecasts will persist.

On October 2020, the Ministry of Finance estimated that the unemployment would reach 8.3% in 2020 in a "best case" scenario, while in a "worst case" scenario it could go as high as 14.4%⁴. In 2019 the unemployment rate was 2.7%. The tourism sector, which 16% of the working population are dependent for work, has been hit particularly hard and 32 percent of employees in the sector have either lost their jobs or been sent on leave without pay. Returning migrants workers also make up a significant share of the unemployed.

Near to medium term risks to the economy are dominated by the impacts of the COVID pandemic. Further lockdowns and disruptions to trade and migrant labour could be particularly damaging. Weakened external demand, in particular from India, which is expected to see a marked economic contraction in 2020 and slow recovery in 2021 and beyond, is also a major concern. Inflation has accelerated, reaching 4.2 percent in May 2020, largely driven by an increase in food prices⁵. Rising unemployment and falling incomes combined with higher inflation is threatening to reverse some of the progress on poverty alleviation.

Longer term risks include a slow pace to implement structural change and diversify the economy. The impact on cottage and small industries is a particular concern, as such enterprises are particularly vulnerable. Bankruptcies and contraction in this sector could severely hamper efforts to expand and broaden the country's economic base. The country is heavily reliant the hydropower sector for revenues

² IMF (2018) Article IV Consultation: Bhutan.

³ Gross National Happiness Commission (2018). 12th Five Year Plan 2018-2023 Retrieved from: <https://www.gnhc.gov.bt/en/wp-content/uploads/2017/05/Finalized-Guideline.pdf>

⁴ The Bhutanese (2020). Unemployment to jump from 2.7% in 2019 to 8.3% in 2020 in best case scenario: MoF. Retrieved from <https://thebhutanese.bt/unemployment-to-jump-from-2-7-in-2019-to-8-3-in-2020-in-best-case-scenario-mof/>

⁵ World Bank (2020). Bhutan Development Update

and state-owned enterprises for goods and services and will need to pursue an enabling environment for growth and employment including incentives for private sector investment². Furthermore, the dependency on hydropower and agriculture brings environmental risks, such as vulnerability to low rainfall which could lower output. The current account deficit has narrowed to 21% of GDP and is expected to decrease further in coming years as capital inflows to finance hydro-power development slows down^{1, 6}. Falling revenues has increased the fiscal deficit estimated at 5.5% by the IMF¹ and 8.4% by the Government (see the Government's report to the CDP). This adds further to public debt, which has increased rapidly from 61% of GDP in 2010 to an estimated 121% in 2020¹. However, most of this debt is directly linked to the hydropower construction projects, where the credit is secured against long term power purchase agreements. The external debt is therefore unlikely to lead to a debt crisis.

Challenges to a smooth transition from LDC status include the mobilization of domestic resources and prudent management of hydropower revenues to substitute for declining foreign grants and maintain macroeconomic stability. Overall ODA flows were around \$ 100 million in 2018, up from \$52 million in 2016, but down from \$160 million in 2012⁷.¹¹ Bhutan is also receiving support through the Global Environment Facility (GEF) ¹² and the Green Climate Fund (GCF). While the Least Developed Countries Fund (LDCF), managed by the GEF, will cease financing new projects after graduation from the category, general support through the GEF remains open. Development partners have pledged around \$865 million for the implementation of the 12th five-year plan, half of which has already been received. The Government has received financial and in-kind assistance from a range of multilateral and bilateral donor agencies to combat the impacts of COVID-19. It has not requested nor received any support aimed specifically for LDC graduation.

LDC indicators

The GNI per capita is estimated at \$ 2,982 in 2021 which is almost three times the graduation threshold established at the 2021 triennial review (\$1,222). The HAI score exceeded the threshold of 66 for the first time in 2013 and has increased ever since. For 2021 the HAI is estimated at 79.4, up more than 5% since 2017. Following the change in methodology for vulnerability index, Bhutan's EVI is now 25.7 in 2020 and is now well below the graduation threshold.

Table 2. Indicators for LDC identification, Bhutan, 2017-2021

	GNI per capita	EVI	HAI
2017	2,522.4	26.0	75.4
2018	2,578.3	25.9	76.7
2019	2,663.8	25.8	78.3
2020	2,803.4	25.9	79.0
2021	2,982.0	25.7	79.4

Source: CDP Secretariat

⁶ According to the Government's own estimate the deficit was 7.7% in 2020 as per the "Report on the preparation of Bhutan's Smooth Transition Strategy from the Least Developed Countries category". See annex 2.

⁷ World Bank (2020). World Development Indicators (Accessed December 2020
<https://data.worldbank.org/indicator/DT.ODA.ALLD.CD?locations=BT>)

Productive Capacity

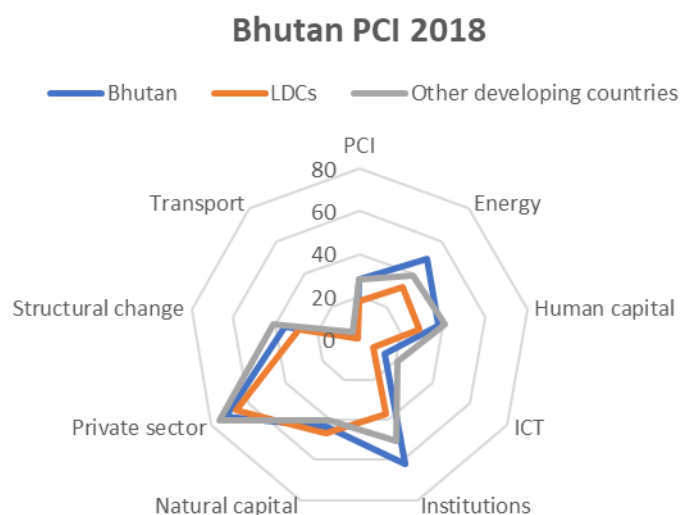
Bhutan performs remarkably well in its development of productive capacities as measured by the PCI not only vis-à-vis the LDC average, but even when compared with ODCs. In the latter case, the overall PCI score of Bhutan is at the same level as the ODC average (see table 3). Bhutan exceeds the ODC average in the components of energy, natural capital and institutions. This reflects at once its production and export specialization (and dependence on electricity exports), but also the high standards of institutional development that the country has achieved. When compared with LDC peers, Bhutan achieves higher scores in the overall PCI and in the sub-components, with the only exception of natural capital. For the future, priority areas are investment in transport and ICT infrastructure.

Table 3. Productive Capacity Index, Selected Countries, 2018 value

Country	PCI	Energy	Human capital	ICT	Institutions	Natural capital	Private sector	Structural change	Transport
Angola	14.5	34.1	23.8	5.0	30.2	48.1	57.6	21.5	0.3
Bhutan	28.5	49.7	37.9	13.8	62.4	43.7	72.0	35.3	2.4
Equatorial Guinea	18.0	25.1	24.4	8.0	22.3	37.9	64.8	31.7	1.3
Samoa	29.1	39.9	37.4	10.5	66.3	32.4	81.9	39.2	4.7
Sao Tome and Principe	19.9	28.4	34.6	9.9	47.9	36.7	69.4	33.4	0.6
Solomon Islands	22.4	33.9	29.9	6.0	46.3	50.1	78.3	26.1	2.2
Vanuatu	25.1	29.2	31.3	8.7	55.0	34.4	78.5	36.5	3.6
LDCs	17.7	32.0	28.3	7.4	36.9	46.5	66.6	28.9	1.1
ODCs	28.4	39.3	40.7	20.7	50.8	40.4	76.0	40.7	4.4

Source: UNCTAD.

Figure 1. Productive Capacity Index 2018, Bhutan



Source: UNCTAD

Data gap

Bhutan's statistical capacity index was 63.6 in 2019, higher than the LDC average (59.9), but lower than the lower middle-income country average (68.4). Data required for monitoring are readily available from international and/or national sources.

Smooth transition and country specific factors

Bhutan has started its preparations for a smooth transition with the support of the United Nations system and has reported to CDP on its initial steps in the preparation of the transition strategy (see the report). Bhutan's smooth Transition from LDCs category is premised on the full implementation of its 12 FYP (2018-2023). 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. 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. As of November 2020, out of the total development partners' support for the 12 FYP which is around Nu. 63 billion, about a half has been received.

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 Government, its development and trading partners and other interested stakeholders. 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 is going to be rescheduled in 2021.

Bhutan requested for a 3+2 years preparatory 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. Some of the high priority national issues 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. 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. The tourism sector was immediately and disproportionately affected transmitting multidimensional socio-economic impacts to tourism-related and allied sectors. 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. 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. 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. The COVID-19 crisis has resulted in large increases in the cost of basic goods, and disruptions to education and learning at all levels which 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. Overall, Bhutan is making a good progress in preparing for a smooth transition strategy and plans for appropriate actions to address challenges posed by the LDC graduation and the impacts of the COVID-19. Further assistance from the UN entities would be essential help the country building national capacity.