

Country Statement: Bhutan

Introduction

1. Bhutan is a small landlocked country located in the ecologically fragile Himalayan Ranges with a population of less than 700,000. Bhutan has a total 677 glaciers and 2,794 glacial lakes and has experienced no less than 21 glacial lake outburst floods in last 2 centuries of which 4 outbursts were reported in the last forty years. It lies in the seismic zones IV and V and is thus highly vulnerable to landslide, floods, wind storm and forest fires. Bhutan cannot escape its geographic reality of being a small landlocked nation with a small population surrounded by economic giants and the particular challenges as well as opportunities that these conditions pose.
2. Bhutan has always strived to take careful measured steps to pursue development that is best suited for our country and its people. The best example of this careful measured approach is our unique development philosophy of Gross National Happiness or GNH. It was conceived by His Majesty the 4th King in 1972 and is a development approach that seeks to achieve a harmonious balance between material wellbeing and the spiritual, emotional and cultural needs of our society. GNH broadly encompasses four pillars which are sustainable and equitable socioeconomic development, preservation and promotion of culture, conservation and preservation of the environment and promotion of good governance. Bhutan consistently pursues policies that places its people at the center of development. The Constitution of the Kingdom also mandates the state to promote those conditions that will enable the pursuit of GNH. A GNH index is composed of 9 domains which consists of 5 conventional and 4 non-conventional variables and indicators has been put in place to measure our progress.
3. Bhutan follows a five year planning cycle that articulates the socio-economic development priorities and programmes to be implemented over a five-year period. Bhutan launched its first FYP in 1961 with a focus on development of basic infrastructure aimed at reducing Bhutan's physical isolation and building transportation links and improving internal communications. With each successive Plan, the level of investment has increased. Along with it the development priorities have also evolved from building up basic infrastructure to investment in services, achieving economic self-reliance and has been accompanied by greater decentralization of powers and authorities.
4. Bhutan's development journey since the inception of the first five year plan has been positive. In the last 10 years alone, the GDP in Bhutan has more than tripled and per capita income has increased to \$ 2,719. Sectoral share of agriculture has gone down from 43% to 17% while share of industry has increased from 12% to 41% reflecting some level of structural transformation of the economy. In the area of social development we have achieved remarkable progress. Today all our children go to schools; education is completely free. All our citizens receive free healthcare; essential drugs are provided through the proceeds of the Health Trust Fund. As a result, between 2007 and 2012, poverty in Bhutan more than halved.

5. However, Bhutan is still facing numerous serious challenges and vulnerabilities which need to be carefully considered.

Challenges and vulnerabilities

Single resource driven economic growth

6. While Bhutan has been experiencing relatively high growth rate this growth has been driven mainly by the Hydro Power sector. Spikes in GDP occur when a new hydropower project is commissioned indicating the predominant role of hydropower in the economy rather than actual structural transformation.

Capital intensive

7. As a resource based economy, Bhutan's growth has always been driven by construction and generation of hydro-electricity. Given its capital intensive nature, the industry has not generated meaningful employment opportunities. Consequently growth of the secondary sector has not resulted in a commensurate shift in workforce from agriculture to manufacturing. While the sectoral share of the agriculture to GDP has decreased from 43% in 1980 to 17% in 2015, 57% of our labor force is still dependent on this highly unstable sector with limited productivity for their livelihood.

Subsistence agriculture

8. Bhutan's agriculture sector is still at a subsistence farming level marked by low returns and productivity. Human wild life conflict and climate change further aggravates the problem. Given that the majority of our labor force is still engaged in the agriculture sector, it is a key source of vulnerability for Bhutan.

Youth unemployment

9. At the national level, unemployment rate remains low at just 2.5%. However, youth unemployment is extremely high at 10.7% and female unemployment as well remains above the national average at 3.1%.

Narrow economic base

10. Given our small domestic market with limited scope for expansion, building export capacity is essential in view of Bhutan's vision for sustainable growth and economic self-reliance. While the export composition has undergone some degree of transformation during the last three to four decades from primary based exports to higher value added products, the export basket still remains highly concentrated with narrow range of commodities and is highly susceptible to exogenous shocks. For instance, the top ten export commodities constituted on an average 81.5% of the total export during the past five years (2012~2016). The degree of vulnerability becomes more apparent when we look at the composition of export basket at

product level largely dominated by few range of products besides electricity, namely: Ferro-silicon, Steel, Portland Cement, Calcium Carbide, Silicon Carbide, Cardamom, Dolomite, and Gypsum. Disruption in the demand and supply of any of these products would have detrimental impact on the overall economy. Lack of diversity in exports lends little opportunity to expand its productive capabilities to new product categories and limited scope of technical transferability of its current set of capabilities, hence presence of market failures. In addition, given the insignificant size of trade both in terms of value and volume, Bhutan has always been price taker, which makes the economy more vulnerable to the global price fluctuations. Further, it may be noted that most of the manufacturing industries, such as ferro-silicon, iron, steel, and chemicals, are highly energy intensive in nature; therefore, the industries are equally exposed to the risk of natural shocks on the hydropower sector.

Limited market access

11. The export vulnerability is further aggravated on the account of high export market concentration. With an average share of 82% of the total trade, India has been the major trading partner for decades. In 2016, export to India constituted 85.58% of the total export followed by Bangladesh at 10.79%. In terms of import, India alone accounted for 82% of the total imports last year. The acute dependence on single market makes Bhutan's export industries highly vulnerable to the price fluctuations and other policy shocks in India. The recent introduction of Goods and Services Tax (GST) in India has not only disrupted smooth flow of cross-border trade, it has also adversely affected some key export industries, notably export of cement to India. Although Bhutan may be seen relatively less remote to the international market compared to other LDCs, the underdeveloped trade infrastructure facilities coupled with high transportation costs due to rough geographical terrain makes it expensive and less competitive for international business. For instance, the World Bank's Logistic Performance Index ranks Bhutan 135th out of 160 countries, putting Bhutan among the countries with poor logistical infrastructure necessary for trade.

Trade deficit

12. Bhutan also faces the challenge of increasing imports without a corresponding increase in exports. This is evident from the sustained trade deficit that Bhutan has been experiencing for decades except in 2007, which shows an overall trade surplus for the first time. The positive trade balance in 2007 was primarily driven by the increased supply of electricity to India, following the commissioning of Tala Hydropower Project in 2007. The trade deficit in 2016 stood at about USD 518 million, which constituted 21.59% of the nominal GDP and formed substantial part of the current account deficit as high as 86%. Therefore, the macroeconomic challenge posed by increasing current account deficit on account of high trade imbalance and pressure on limited foreign currency reserves have become a grave national concern for overall macroeconomic stability in the medium to long term in light of Bhutan's probable graduation from the LDC category.

High reliance on external aid

13. Government expenditure accounts for about 40 percent of GDP with high levels of expenditure on social sectors such as health, education and communications. A substantial portion of the capital expenditure is sustained through bilateral and multilateral ODA. In the 11th plan, more than 55 percent of the budgetary expenditure constituted ODA compared to 100 per cent in the first five year plan. The growth in the overall resource has been supported by a combination of large inflows of grants and increasing domestic revenue. In terms of sectoral contribution, hydropower sector has remained the highest contributor to revenue since the commissioning of Chukha Hydro Electricity Project (HEP) in mid '80s and revenue growth followed closely the commissioning of HEPs which demonstrates the low levels of diversification and narrow economic base.
14. It is clear that while the Bhutanese economy is transforming, it is far from resilient. Efforts to build our resilience and increase our productive capacity is high on the national agenda and have been identified as key priorities for the 12th Five Year Plan, but these require significant investments. The UNCTAD Vulnerability Profile Report also clearly echoes this through what it has termed as the "Bhutan paradox". The reports asserts that *while, transformational progress is visible in Bhutan, making it a prime candidate for graduation, yet the risk of losing LDC treatment arises at a time when the resilience-building agenda of the country to alleviate its unique vulnerabilities is complex and costly*

Key Policy interventions

15. We would like to take this opportunity to share with the CDP some of the key policy interventions that Bhutan is taking to strengthen our economy.

Economic Development Policy 2016

16. Bhutan has adopted the Economic Development Policy 2016 which provides the strategic direction for growth and will be the key guiding policy in Bhutan's drive towards economic diversification through development of sectors that have the highest potential. The EDP has a total of 252 Policy provisions and provides the overall enabling environment to continue creating a transparent and conducive environment for business and investment in the Bhutanese economy.

Fiscal Incentives Act of Bhutan 2017

17. In order to complement the EDP 2016, the Parliament of Bhutan enacted the Fiscal Incentives Act of Bhutan 2017. This Act effectively grants fiscal incentives in the form of both direct and indirect tax exemptions and concessions to stimulate economic growth, foster private sector development and generate employment. Incentives and exemptions ranging from income tax holiday, reinvestment allowance, tax rebate, income exemption, additional expenditure deduction, TDS exemption, sales tax exemption, customs duty exemption, and concessional customs duty have been granted. The general incentives are applicable to all the sectors of the

economy and the sector specific incentives are applicable to the priority sectors identified under EDP including the five jewels.

Five jewels of the economy

18. In addition to creating an enabling environment for private sector growth, the government continues to emphasize on prioritizing the Five Jewels of the economy, namely-Hydropower, Tourism, CSIs, Mining and Agriculture; enhancing service delivery and reducing administrative burden for businesses; diversifying exports and enhancing productivity; and progress towards becoming a knowledge based and self-reliant society.

Commercialization of agriculture

19. Complementary efforts to promote commercial agriculture and non-agri based CSIs are underway on multiple fronts. Currently, the flow of credit from financial institutions is highly skewed towards meeting the demand for housing in the urban centers. Only 4.9 per cent of credit was for the agriculture sector.
20. To remedy this, the Central Bank of Bhutan has devised and launched the Priority sector lending guidelines this month which is an integrated platform that coordinates interventions from several Government agencies to stimulate the CSI sector through improved access to finance. Under the guideline, financial institutions must meet their annual incremental priority sector lending targets.

Conclusion

21. We in Bhutan view our graduation as something to be celebrated and remain committed to graduation from the LDC category. It is the ultimate testament of the success of our national development efforts under the guidance and wisdom of our monarchs; the generosity and cooperation of our development partners and the hard work and dedication of our people. We welcome the assessment of the 2015 triennial review to include Bhutan as one the countries eligible for graduation.
22. Having said that, we are also deeply aware of the structural impediments that makes us highly vulnerable and for which we will need to continue the hard work. We would like to graduate on a sure footing for which continued robust international assistance and support would be required.
23. Given that our ultimate common objective is to achieve sustainable graduation, Bhutan is seeking an extension of the transition period to coincide with our 12th Five Year Plan Period. The 12th Five Year Plan coinciding with the triennial review and the start of the graduation process presents a good opportunity to devise a smooth transition strategy and time frame to ensure that Bhutan's graduation from the LDC category is smooth, sustainable and successful.
24. The 12th Five Year Plan will be our last plan as an LDC and shall address the last mile challenges in all sectors and ensure that Bhutan graduates on a sure footing with a strong economy. This will be achieved through an economic diversification drive that translates

growth into jobs, increase resilience to exogenous shocks, broaden the base for government revenue and improve the prospects for future generation. The 12th Plan has identified 16 National Key Result Areas for development. It presents a unique opportunity to mainstream the transition strategy into the national development plan and incorporate our obligation to fulfill the target of the 17 Sustainable Development Goals. In fact, the 16 NKRA's find close alignment with the SDGs and initial Rapid Assessments reveal a high level of integration of the SDGs with our national plans.

25. Bhutan is making concerted efforts to overcome its challenges and vulnerabilities. These efforts will extend well beyond the requested transition period. However, the longer transition period will allow us to position ourselves in the best possible manner through targeted interventions. We hope that the CDP will consider the nature of the vulnerabilities that Bhutan faces and support our submission for a longer transition period.

March 2, 2018
