Bhutan’s Economic Vulnerability: Policy Challenges and Recommendations in relation to its LDC Graduation

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<th>Criteria</th>
<th>Graduation Threshold</th>
<th>Bhutan Score</th>
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<tbody>
<tr>
<td>GNI Per capita</td>
<td>US $1,242</td>
<td>US$ 2,478</td>
</tr>
<tr>
<td>HAI</td>
<td>66</td>
<td>67.9</td>
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<tr>
<td>EVI</td>
<td>32</td>
<td>40.2</td>
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</table>
Domestic Economy and Growth
Share of Value Added by Sector (as % of GDP)
Trend in Growth Rate of GDP by Sector (2002-2015)
Percentage share of employed persons by economic activity - 2014

Agriculture: 56.6%
Industry: 10.8%
Service: 40.6%

GDP:
Agriculture: 16.8%
Industry: 40.6%
Service: 32.6%
Export Composition - 2015
Fiscal Performance

• Constitution: “the government shall ensure that the cost of recurrent expenditure is met from internal resources of the country”.

• Domestic revenue not only able to meet recurrent expenditure but was also able to finance 23% of capital expenditure in 2015-2016.

• Corporate Income Tax and Dividends attributable to hydropower generation are the highest source of tax and non-tax revenues respectively.

• Government’s revenue performance has been volatile.

• Total external debt - 109.7% of GDP (30th June 2016)
Summary of Vulnerabilities

- GDP, Exports and Government Revenue highly reliant on hydropower fluctuations;

- Agriculture vulnerable to Climate change related disasters and human-wildlife conflict;

- Reliant on one major trading partner (India) - spill-over effects from India in the case of recession or political instability or inflation.
Summary of International research outcomes


- Bhutan’s continued reliance on one major sector and trading partner makes Bhutan vulnerable to sectorial and external shocks
- MSME sector was engaged in low value added and low productivity activities
- Hydropower and associated energy intensive industries do not create sufficient jobs
- **Recommended** Bhutan to broaden industrial base and diversify economic activity - (i) ICT, and (ii) Clean Manufacturing – handicrafts; agro-based manufacturing; dairy products; hydropower and ICT related parts

Common problems of landlocked countries:
• limited geographic connectivity with the global market
• small domestic market
• low level of technological competitiveness

Recommended industries for diversification:
• Base metal; Chemicals; Machinery & electrical equipment; Paper; Textiles; Agriculture & Agro-based industries

**Constraints to private sector growth**
- limited access to finance
- lack of skills,
- deficiencies in transport and logistical arrangements.

**Special features of Bhutan:** Political stability; good governance; cheap electricity and English-speaking workforce

**General Recommendations (reforms)**
- access to finance
- labor market
- market competition
- taxation awareness and accounting standards

**Recommended Sectors**
- Tourism
- agribusiness
- Manufacturing
- ICT
Key Challenges of Diversification

1. Landlocked – limited access to global market
2. Low economies of scale due to small size of domestic market
3. Lack of policy coherence, coordination and slow implementation progress
   - Infrastructure
   - Energy
   - Limited Land and cumbersome procedures
   - Access to finance
   - Skills mismatch and labor regulations

Objective of 11th FYP: “Self-reliance and Inclusive Green Socio-economic Development”

<table>
<thead>
<tr>
<th>Hard Infrastructure</th>
<th>Status</th>
<th>Soft Infrastructure</th>
<th>Year of Establishment</th>
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<tbody>
<tr>
<td>Development of Three Industrial estates</td>
<td>Under construction and expected to complete in the 12th FYP</td>
<td>Development of Brand Bhutan</td>
<td>2016</td>
</tr>
<tr>
<td>Development of Mini Dry Port at Phuntsholing</td>
<td>Ongoing</td>
<td>Introduction of Economic Stimulus Plan</td>
<td>2013</td>
</tr>
<tr>
<td>Establishment of Business Incubation Centre</td>
<td>Ongoing</td>
<td>Promotion of cultural industries/craft sector</td>
<td></td>
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<tr>
<td>Upgrading of Northern East-West Highway</td>
<td>Ongoing</td>
<td>Amendment of FDI Policy 2010</td>
<td>2014</td>
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<tr>
<td>Construction of Royal Craft Village</td>
<td>Ongoing</td>
<td>Revision of EDP 2010</td>
<td>2016</td>
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<tr>
<td>Development of Traditional Craft Clusters</td>
<td>Mostly Completed</td>
<td>Revision of Fiscal Incentives (in line with revised EDP)</td>
<td>2017</td>
</tr>
<tr>
<td>Expansion of Paro International Airport</td>
<td>Ongoing</td>
<td>Development of Mineral Development Policy</td>
<td>2017</td>
</tr>
<tr>
<td>Expansion of Yonphula Domestic Airport</td>
<td>Near Completion</td>
<td>Establishment of State Mining Corporation (SMC)</td>
<td>2015</td>
</tr>
<tr>
<td>Augmentation of TTI Dekiling Power Training Institute</td>
<td>Ongoing</td>
<td>Promotion of CSIs through improved access to finance</td>
<td>2014</td>
</tr>
<tr>
<td>Establishment of Bhutan Hydropower Services Limited</td>
<td>Completed</td>
<td>Revision of Companies Act of Bhutan,</td>
<td>2016</td>
</tr>
<tr>
<td>Connect 3rd International ICT Service</td>
<td>Ongoing</td>
<td>Development of PPP Policy</td>
<td>2016</td>
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Snapshot on EDP 2016

• Overriding policy document that identifies priority sectors - “Five Jewels” and six additional sectors that have the potential for export, revenue generation and employment creation.

• **Objective:** To achieve minimum average economic growth rate of 10% which is expected to propel Bhutan to the status of a middle income category by 2020.

• **Five Jewels:** Hydropower, Agriculture, Cottage and Small industries, Tourism and Mining

• **Other sectors:** education, health, ICT, financial, Information, media and cultural industry, transportation and related services, construction and manufacturing sector such as power intensive and mineral based industries.
Key Observations on EDP

• Good platform for structural transformation strategy
• Too many priorities – risks self-imposed challenges in terms of resource allocation and lack of focus

• Some industries (Others category) may not be “real winners” – disconnect between aspirations and resource endowments

  *Eg: value added manufacturing in electronics, electric vehicles and computer hardware*

• Ambitious deadline – 2020
WAY FORWARD
12th FYP (2018-23) and Eco. Diversification

• Economic diversification as one of the most important National Key Result Areas (NKRA 2)

• Complete the conceptual framework by December 2017

• Detailed plan on diversification will be developed by the end of 2018

• Roadmap: Revised EDP 2016
Recommendations: Complementary Policy Options

1. Cross cutting Policy recommendations
   • Accelerated development of infrastructure such as industrial estates and dry ports
   • Efficient allocation of increased firm power
   • Identification of land for industrial use and commercial agriculture
   • Guidelines for lease of land and simplification of leasing SRF procedure to encourage private sector investment
   • Consider specialized financial institution for cottage and small industries
   • Improve working conditions and incentives for attracting educated workforce towards private sector
   • Revisit regulations on import of labor, particularly from neighboring India.
GIFF ?
2. Comprehensive Economic Diversification Plan

• Focus on specific industry/product line against the conventional method of identifying broad sectors;

• Prioritization of viable industries/products that are likely to create employment and enhance export and substitute imports (domestic market);

• Consideration of both horizontal and vertical diversifications to realize untapped potentials;

• Clearly laid out Performance indicators for success and failure of each project tied with incentives support of the Royal Government;

• Multi-stakeholder engagement including the private sector throughout the plan formulation and implementation process;
3. Coordination

- Govt. & Pvt. Sector;
- Govt. and Development Partners;
- Among Government agencies
Effective implementation of EDP in a structured and coordinated manner supported by adequate resources will underpin Bhutan’s capability to unlock the potentials of its economy.