Bhutan and LDC Graduation
Implications and Challenges

Formulating National Policies and Strategies in Preparation for Graduation from the LDC Category

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Outline

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• Graduation Criteria
  • GNI Per Capita
  • Human Assets Index
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Bhutan Overview

• Population: 768,577
• GDP: $2.2 billion (2016)
• Major economic sectors: hydropower, energy intensive industries, construction and tourism
• Agriculture, livestock & forestry share of GDP: 16.52%
Bhutan Overview

• LDC graduation is in sync with national policy goals

• 11^{th} Five Year Plan (2013-2018) goal of self reliance
  • “ability to finance 80% of capital expenditure without relying on ODA”

• Effective window for graduation (2018-2021) falls within 12^{th} Five Year Plan period (2018-2023): opportunity to enhance policy priorities related to LDC graduation
Current Situation

GDP growth

- Agriculture, livestock, and forestry
- Industry minus elec.
- Services
- Electricity and water
- Nominal GDP Growth rate
- Real GDP growth rate
Current Situation

Debt Burden

- Hydro Power Debt
- Non-Hydro Power Debt
- Hydro Power Debt % of GDP
- Non-Hydro Power Debt % of GDP
- Debt service to exports
Current Situation

Balance of Payments

CURRENT ACCOUNT
CAPITAL ACCOUNT
FINANCIAL ACCOUNT
Current Situation

Major challenges:

• Small economic base: hydropower-dependent, lack of value addition
• Low factor productivity: 1.6 total factor productivity (ADB 2014)
• Debt: 70% is self-liquidating hydropower loans, projected to reach 25% of export revenue
• Balance of payments: high levels of import during hydropower construction stage, need to manage reserves
Parameter 1: GNI per Capita

- Requirement: $1,242 (3 year average) or double for income-only criterion
- Bhutan: $2,242
- Growth has slowed in recent years: 15.33% in 2007, 7.72% in 2011 and 2.08% in 2015
- Growth driven by capital formation in infrastructure and hydropower sectors
- Need to strengthen contribution of other sectors for post-hydro period
Parameter 2: Human Assets Index

LDC criteria: Human Assets Index

- Adult literacy
- Under 5 mortality
- Gross secondary enrolment
- % undernourished
Parameter 2: Human Assets Index

• Bhutan’s HAI score improved from 45 in 2000 to 73.8 in 2015
• Improvement driven mainly by increase in gross secondary education enrollment
• Challenges in funding and management of education and health infrastructure
Parameter 3: Economic Vulnerability Index
Parameter 3: Economic Vulnerability Index

- Bhutan’s EVI improved from 43.04 in 2000 to 37.46 in 2015
- No country has fulfilled the EVI criteria to date
- Major bottlenecks: landlocked, mountainous terrain, small domestic market
- Commercialization of agriculture is crucial
  - The Bhutan govt. has provided farm machinery to all 205 gewogs (blocks) in the country
- Must emphasize productivity improvements over diversification alone
Implications of Graduation: Financial

• ODA currently comprises 10% of GDP
• The Constitution requires all recurring expenses be met by domestic revenue, ensuring fiscal prudence
• India-Bhutan relationship would be unaffected by LDC status (India provided 81% of grant inflow in 2015/16)
• Withdrawal of bilateral grants has implications for currency reserves; estimated to be about 10%
• 12th Five Year Plan projects 20.5% drop in ODA grants
Implications of Graduation: Financial

- Concessional Loans: likely unaffected since multilateral FIs base lending rates on per capita income status (WB already treats Bhutan as middle income) or criteria that include GNI per capita and credit worthiness (ADB)
Implications of Graduation: Trade

Exports

- India Hydro
- India Non-Hydro
- Other Countries
Implications of Graduation: Trade

• Countries fear loss of trade preferences due to graduation

• Bhutan’s trade scenario would be largely unaffected
  • Trade with India comprises 85% of exports and 80% of imports
  • Exports to EU and US would suffer slight competitive disadvantage
    (investment in energy intensive industries such as Fe-Si would be stalled)

• WTO membership: framework allows for an adjustment period of up to 6 years; irrelevant if Bhutan does not join

• Rules of origin requirements would have implications for manufacturing sector
Policy Priorities

• Diversification:
  • Support growth of energy intensive industries through friendlier domestic energy tariffs
  • Strengthen agricultural productivity through commercialization and technology

• Strengthen reserve management in short and medium term

• Long term policy must focus on improving productivity as diminishing returns from hydropower sector set in
Policy Priorities

• “[G]raduation does not represent a solution to all the graduating country’s development challenges; neither does a new set of challenges emerge out of nothing at this point. Rather, the challenges of the post-graduation period are a continuation of those that characterized the pre-graduation period.” (UNCTAD)

• Avoid policy compartmentalization
• Shift policy focus from quantity to quality
• Build a transition strategy into the 12th Five Year Plan