

SECTOR ASSESSMENT (SUMMARY): PUBLIC SECTOR MANAGEMENT

Sector Roadmap

1. Sector Performance, Problems, and Opportunities

1. From FY1998 to FY2018, Bhutan's economy grew remarkably at an average annual growth of 7.0%. Poverty dropped sharply between 2007 (23.0%) and 2017 (8.2%), while extreme poverty is almost eliminated with only 1.5% of the population living on less than \$1.9 a day in 2017.¹ Dominated by the hydropower sector—which contributes about 25% of GDP annually, and accounts for 32% of exports and 25% of the government's domestic revenues—Bhutan's economy is highly vulnerable to volatilities in hydropower construction and operations.

Table 1: Macro Economic Indicators

Item	Fiscal Year				
	2015	2016	2017	2018	2019
GDP growth (% , constant prices)	6.2	7.4	6.3	3.8	4.4
a. Agriculture	3.7	4.4	3.6	3.7	3.8
b. Industry	6.0	7.6	4.6	(1.2)	0.4
c. Services	8.4	9.2	8.2	7.9	9.1
Inflation (CPI % change)	6.7	3.4	4.3	3.6	2.8
Current account balance (% of GDP)	(28.3)	(31.1)	(23.2)	(19.1)	(22.6)
Merchandise export (\$) growth (annual % change)	8.4	(14.7)	12.3	7.6	8.6
Merchandise import (\$) growth (annual % change)	8.8	5.0	(3.4)	(1.2)	0.5
Revenue and grants	28.8	29.9	27.2	31.9	24.5
Current Revenue	20.5	20.5	19.5	22.6	19.6
Expenditure and onlending	29.3	32.0	31.9	32.2	27.4
Overall fiscal surplus (deficit)	(1.5)	(1.1)	(3.4)	(0.3)	(2.2)

() = negative, CPI = consumer price index, GDP = gross domestic product.

Sources: Royal Government of Bhutan, National Statistics Bureau. National Accounts Statistics. 2014–2018; Royal Government of Bhutan, Royal Monetary Authority. Annual Reports. 2014–2019; Royal Government of Bhutan, Ministry of Finance. National Budget Report. 2014–2018; ADB Estimates.

2. Macroeconomic parameters (Table 1) prior to the COVID-19 pandemic highlight the economy's ability to sustain stability and longer-term development, notwithstanding short-term volatilities associated with being a small country. This year, Bhutan's economy was expected to rebound from two consecutive years of lackluster growth that witnessed 3.8% growth rate in FY2018 and 4.4% in FY2019. During this period of sluggishness, a substantial decline in construction for the second year tracked a large drop in government investment and as hydropower production, a major industry driver, suffered a marked fall. Growth in services, at 7.9% and 9.1%, once again picked up the slack, underpinned by broad expansion in wholesale and retail trade, transportation and storage, and hotels and restaurants. Offsetting a near stagnation in international tourist arrivals, a 25.0% increase in tourists from the region was a key driver of services.² Inflation was also at its decadal lowest at 2.8% in 2019. An anticipated rebound of 6.0% in 2020 was predicated on fiscal expansion as well as robust consumption growth.³ The COVID-19 pandemic has significantly dampened these prospects. The adverse socioeconomic impacts are also complex.

¹ World Bank. 2019. Bhutan Development Report: A Path to Inclusive and Sustainable Development. Thimphu.

² ADB. 2020. *Asian Development Outlook 2020: What Drives Innovation in Asia?* Manila.

³ ADB Estimates 2020. This is the baseline forecast. The growth rate of 5.2% highlighted in the ADO factors in some minor impacts.

3. Consequently, the detection of the first case in the country on 6 March 2020, and the rapid escalation globally has warranted stringent preventive measures to contain the spread of COVID-19. Immediate restrictions on the entry of foreigners by air was imposed. These measures have invariably resulted in either an unprecedented decline in economic activity or a complete standstill in sectors like tourism. The first sectors to feel the shockwaves were tour operators, hotels, restaurants, and transport. A 30% reduction in direct tourism receipts from the daily tariff is estimated for FY2020.⁴ Further restrictions were imposed on 18 March 2020 with the closure of surface entry points. This has resulted in significant supply-chain disruptions, especially of imports of goods and labor from India. The impacts have been felt by the construction sector with the manufacturing sector also facing disruptions in raw material supply. Furthermore, other precautionary measures such as social distancing are also dampening demand in the retail sector.

4. The outlook is highly uncertain, with developments suggesting that the pandemic is likely to be protracted. Preliminary forecasts indicate that growth will likely plunge to 1.0%—a 5.0% reduction from the pre-covid-19 estimates, translating into a loss of over \$176 million in GDP. Likewise, combined employment loss in the services, construction and manufacturing sectors is estimated at around 23,000. These are perhaps optimistic considering that estimates do not capture the informal sector which is inherently large in a developing country like Bhutan.

5. The directly affected sectors also have multiple linkages to the rest of the economy; in addition to being employment-intensive, they contribute tax revenue as well as convertible currency. The immediate fiscal impacts due to foregone revenues from tourism royalty, visa fees, and income taxes are estimated to be around Nu887 million. Further, fiscal space will shrink as a result of losses in sales taxes and corporate income taxes. Considering that government expenditure accounts for 27.4% of GDP, an inevitable weakening in the government's fiscal position will reinforce weak aggregate demand.

6. The implications on the financial sector is also apparent. The tourism and service sector accounts for 23.0% of total outstanding credit. With all sources of earnings frozen, defaults are imminent. Other sectors such as wholesale and retail trade with an outstanding debt of 14.0% and construction at 27%, are all likely to come under stress as well. With the sharp increase in nonperforming loans to 17.1% in March 2020 from 8.2% in December 2019, financial indicators are likely to further breach macro-prudential thresholds.

7. The pandemic has also forced a reprioritization of the government's development activities. Considering that growth was expected to receive an impetus from a 51.0% elevation in capital expenditure, the supply disruptions will severely impede infrastructure expansion and other development spending, thereby depressing longer term growth prospects as well.

8. An estimated 11,798 employees in the tourism and allied sectors will be directly affected. The hotels and restaurants in particular have a disproportionately large share of unskilled female employees. The informal sector also engages a large number of unskilled and vulnerable groups such as young school dropouts and migrants from rural areas. With an official youth unemployment rate of 15.7%, a surge in the jobless is inevitable.

⁴ ADB. 2020. [Asian Development Outlook 2020: What Drives Innovation in Asia?](#) Manila.

2. Government's Sector Strategy

9. The government has proactively developed the National Preparedness and Response Plan for COVID-19 aimed at enhancing the health sector's capacity in surveillance, early detection, control and prevention, response, and recovery from the COVID-19 outbreak in the country. The plan is flexible and being reviewed and updated as and when required by the Technical Advisory Group for COVID-19, Ministry of Health. Given the risks associated with local transmission, the country has managed to achieve its preventive objectives thus far. Bhutan recorded the highest testing rate in the South Asian region at 2,600 per million inhabitants as of 23 April 2020. The Ministry of Health has estimated a budget requirement of Nu1,000 million (about \$13 million) for COVID-19 prevention, containment, and treatment from April 2020 to August 2020. The government has spent about Nu672 million (about \$8.9 million) on preventive and preparatory activities such as quarantine facilities and the purchase of equipment and essential items. Additional \$25.6 million has been allocated to the Ministry of Health to prepare for worst-case scenario—local transmission and a lockdown.

10. While the public health measures have been all encompassing, the government is also rolling out a Nu30 billion, equivalent to about \$400 million, Economic Contingency Plan to extend relief to affected sectors and employees. To ensure a comprehensive response that reaches as many of the most affected people as possible, the government plans to execute its interventions through three approaches: (i) social relief package; (ii) fiscal and monetary measures; and (iii) targeted interventions.

11. The social relief package will be in the form of direct cash transfers to affected individuals, for an initial period of 3 months, extendable to 12 months depending on the situation. This will involve an outlay of Nu21,665 million (\$287.6 million). The relief package will directly benefit 8.2% (about 57,000 people) of the population living below the poverty line plus at least an estimated 23,000 displaced employees, unemployed people actively seeking jobs, and self-employed individuals in the informal sector.

12. Fiscal and monetary measures: monetary measures to ensure adequate liquidity in the market, include (a) a waiver of interest and a 3-month loan repayment deferment for all businesses and individuals; (b) subsidized working capital at a preferential rate of 5%; (c) a 3-month extension of the gestation period for ongoing projects (extendable by another 3 months); (d) working capital through the Cottage and Small Industries Bank for cottage and small industries at an interest rate of 4% for a 3-month period (extendable by another 3 months); and (e) micro-loans through Cottage and Small Industries Bank up to a ceiling of Nu0.5 million at an interest rate of 2% for a 3-month period (extendable by another 3 months) to rural and agriculture sector.

13. Fiscal measures to ease cashflow constraints on businesses include deferment of business and corporate income taxes, and deferment of sales tax for businesses and customs duty on essential imports. As an immediate measure, budgetary funds have been disbursed to procure 6 months' worth of essential commodities reserves, totaling Nu1.23 billion (\$16.33 million).

14. Targeted interventions that will execute targeted projects to engage the displaced people in the tourism, construction, and food security programs.

3. ADB Sector Experience and Assistance Program

15. ADB's support during such a challenging phase would strengthen the government's fiscal position to implement the countercyclical comprehensive COVID-19 response program. More specifically, the CARES program will mitigate the inevitable reduction in revenues during the economic downturn, enabling the government to continue addressing critical public health needs and administer stimulus measures.

16. ADB's sustained engagement in key sectors, accompanied by flexibility in approaches and modalities and quick response to country needs, is important for development effectiveness in Bhutan.⁵ The ADB's support to Bhutan has encompassed improving macroeconomic stability and resilience to shocks, strengthening debt management, government financial management, enhancing stability and integrity of the financial systems, developing nonbank financial systems, financial sector regulations and supervision, supporting capital market development, and capacity building. Significantly, ADB supported the government in addressing macroeconomic shocks and structural issues resulting from the Indian Rupee shortage in 2012–2013 through two policy-based lending programs for strengthening macroeconomic management.⁶

17. In response to COVID-19, ADB has already approved a grant of \$100,000 to support Bhutan in enhancing its capacity to prevent, detect, and respond to COVID-19 outbreak. The grant was used to procure necessary medical supplies, testing kits and reagents, medicines, and personal protective equipment for healthcare staffs. ADB is also collaborating closely with the government—the Ministry of Finance and the Prime Minister's Office—in analyzing the economic and fiscal impact of COVID-19 and identifying policies and response mechanisms including measures implemented under the ECP. The support will provide the government with much needed fiscal space to implement the National Preparedness and Response Plan for COVID-19 to manage and contain the pandemic, and other socioeconomic medium-term interventions in the tourism, construction, and agriculture sectors. These interventions include reskilling the displaced workers, improving tourism infrastructure, providing short-term employment for displaced people, and incentivizing farmers to increase agricultural production for greater food security. Overall, the program will contribute to enhancing macroeconomic resilience to external and internal shocks and deliver relief support to the most affected and economically displaced people.

⁵ Independent Evaluation Department. 2019. [Validation of the Country Partnership Strategy Final Review, 2014–2018 in Bhutan](#). Manila: ADB.

⁶ ADB. 2013. *Strengthening Economic Management Program*; ADB. 2015. *Strengthening Economic Management Program II*. Manila.

Problem Tree for Public Sector Management

