

BHUTAN

ECONOMIC PROGRESS AND CHALLENGES

ANADI

BHUTAN'S ECONOMIC PROFILE

Bhutan is the most peaceful country in South Asia, with little upheavals until now. It has not recorded any terrorist incident in the past five years and is the only state in the region with a zero score on the Global Terrorism Index.¹ Although it is the most peaceful country in the South Asian region, it has faced its own share of challenges posed by global disruptions like the COVID-19 pandemic and the Russia-Ukraine dispute. Besides maintaining internal security, Bhutan's economic recovery shows its resilience in the face of external shocks. The nation has been able to maintain an annual real economic growth of nearly 5 per cent since Fiscal Year (FY) 2021-22 after facing an economic contraction due to the pandemic.² As tourism increased after the pandemic, the real Gross Domestic Product (GDP) of Bhutan

Ms **Anadi** is a Research Associate at the Centre for Air Power Studies, New Delhi.

1. Institute for Economics and Peace, "Global Terrorism Index 2024: Measuring the Impact of Terrorism" (Sydney, February 2024).
2. World Bank Group, "Bhutan Development Update", April 2024.

increased by 4.5 per cent in FY 2022-23.³ Moreover, with the rise of revenue and fall in expenditure, the fiscal deficit declined to 4.1 per cent of the GDP in FY 2022-23 from 7.0 per cent of the GDP in FY 2021-22.⁴ Furthermore, Bhutan has also graduated from the United Nations' Least Developed Country (LDC) status in December 2023.⁵ This achievement shows the remarkable development journey that Bhutan has undertaken over the past five decades and, furthermore, acknowledges its progress in reducing poverty and promoting sustainable development.

Bhutan, being a landlocked country as well as one of the smallest economies in the world, has shown an average annual real GDP growth of 7.5 per cent since the 1980s.⁶ This significant economic growth has contributed immensely to reducing poverty over the last two decades. By 2022, Bhutan had successfully eliminated extreme poverty, defined as living on less than US\$2.15 per day.⁷ The Gini index, which measures income inequality, has also shown a decline from 37 in 2017 to 28 in 2022.⁸

DRIVERS OF GROWTH

The economic growth has largely been driven by the 'hydropower' and 'tourism' sectors. For instance, the development of projects like the Tala Hydroelectric Power station in the mid-2000s helped Bhutan's economy grow a lot.⁹ Hydropower projects ensure that Bhutan's economy has access to clean and sustainable sources of power as well as help in enhancing its foreign reserve by exporting power to other countries. For instance, Bhutan exports hydropower to India, guided

3. Ibid.

4. Ibid.

5. United Nations, "Bhutan Graduate from LDC Status", December 13, 2023, <https://www.un.org/development/desa/dpad/2023/bhutan-graduates-from-ldc-status/>. Accessed on May 25, 2024.

6. World Bank Group, "The World Bank in Bhutan", <https://www.worldbank.org/en/country/bhutan/overview#1>. Accessed on May 25, 2024.

7. Ibid.

8. Ibid.

9. Sonam Tshering and Bharat Tamang, "Hydropower - Key to Sustainable, Socio-Economic Development of Bhutan", United Nations Symposium on Hydropower and Sustainable Development, pp. 27-29, 2004.

by the 2006 bilateral agreement and its 2009 Protocol.¹⁰ In addition to being the main destination for Bhutan's exports, India is also the country from where most of Bhutan's imports come. In fact, the trade between India and Bhutan has increased tremendously in the last few years, starting from US\$484 million in 2014-15 to US\$1,615 million in 2022-23, which comprises about 80 per cent of Bhutan's total trade.¹¹ There are four Hydro-Electric Projects (HEPs) amounting to 2,136 Mega Watts (MW) operating in Bhutan, providing electricity to India.¹² The 720 MW Mangdechhu project began functioning in August 2019 and was transferred to Bhutan in December 2022.¹³ In fact, as per the Government of Bhutan, India's import of electricity from Bhutan was valued around INR 2,448 crore in 2022.¹⁴

Bhutan's economy has also seen growth in other sectors like agriculture, tourism, and a budding industrial base. Though there is less arable land (2.7 per cent of the country's total area) in Bhutan, the agricultural productivity has been on the rise over the years.¹⁵ The contribution of agriculture, forestry and livestock to the GDP increased from 14.78 per cent in 2010 to 19.23 per cent in 2020.¹⁶

The tourism industry has played a significant role in driving economic activity in Bhutan. The tourism sector has been the biggest source of foreign exchange as well as the second-largest revenue generator after hydropower. In 2017, the tourism sector generated US\$79.8 million, which is a big leap from the late 1980s when tourism contributed only around US\$2 million to the government.¹⁷ Bhutan's

10. Ministry of External Affairs, "India-Bhutan Relations", https://www.mea.gov.in/Portal/ForeignRelation/Brief_on_India_Bhutan_Relations_March_2024.pdf. Accessed on May 15, 2024.

11. "5th Joint Group of Customs (JGC) Meeting between India and Bhutan was held on 6th-7th May, 2024 in Leh, Ladakh", Press Information Bureau, May 7, 2024, <https://pib.gov.in/PressReleaseIframePage.aspx?PRID=2019891#:~:text=India%20is%20Bhutan's%20top%20trade,80%25%20of%20Bhutan's%20overall%20trade>. Accessed on May 15, 2024.

12. n. 10.

13. Ibid.

14. Ibid.

15. Rinchen Wangmo, et al., "Climate-Smart Agriculture Technologies and Practices in Bhutan", SAARC Agriculture Centre, October 2023, https://c-suces.sac.org.bd/wp-content/uploads/2023/11/Bhutan_CSA-Technologies-and-Practices.pdf

16. Ibid.

17. Siok Sian Pek-Dorji, "Transforming the Economy Through Tourism", *The Druk Journal*, 2018, <https://drukjournal.bt/transforming-the-economy-through-tourism/>. Accessed on May 25, 2024.

Prime Minister (PM), Tshering Tobgay, while visiting India, urged Indian industries to utilise business opportunities available in the tourism sector of Bhutan.¹⁸ He emphasised that investors can establish hotels, restaurants and wellness centres in Bhutan. Furthermore, the Bhutanese PM has also requested India to assist with Rs 100 billion for the 13th Five-Year Plan and an additional Rs 15 billion for the economic stimulus package.¹⁹ These initiatives will help Bhutan revive its economy and improve its infrastructure.

GROSS NATIONAL HAPPINESS (GNH)

Bhutan's economic development has been inspired by the idea of Gross National Happiness (GNH), which lays greater emphasis on sustainable and equitable growth.²⁰ Due to the greater emphasis on GNH, Bhutan has been able to significantly improve its living standard and reduce poverty from 25 per cent in 2003 to just 2 per cent in 2012, based on the international poverty line of US\$1.90 per day.²¹ The GNH driven approach has improved the accessibility to healthcare, education, and other social services in the country.²² This has further resulted in reduced poverty and overall better living standards. The concept of GNH has influenced Bhutan's development policy since its articulation and has been mooted on the global stage. Bhutan's application of the concept of the GNH index has introduced a practical measurement tool in policy-making. The GNH index serves as an incentive to the Government of Bhutan, Non-Governmental

18. "Bhutanese PM Seeks Indian Investments in Tourism Industry", *The Economic Times*, March 16, 2024, <https://hospitality.economicstimes.indiatimes.com/news/travel/bhutanese-pm-seeks-indian-investments-in-tourism-industry/108544997>. Accessed on September 30, 2024.

19. Harsh V Pant and Aditya Gowdara Shivamurthy, "The India-Bhutan Story: India Understands the Urgency and Needs of its Neighbour", Observer Research Foundation, March 28, 2024, <https://www.orfonline.org/research/the-india-bhutan-story-india-understands-the-urgency-and-needs-of-its-neighbour>. Accessed on September 30, 2024.

20. Royal Bhutanese Embassy (India), "Economy and Development", <https://www.mfa.gov.bt/rbedelhi/bhutan-at-glance/economy-and-development/>. Accessed on May 25, 2024.

21. Tenzin Lhaden, "How Does Bhutan's Economy Look?" World Bank Blogs, <https://blogs.worldbank.org/en/endpovertyinsouthasia/how-does-bhutan-s-economy-look>. Accessed on May 25, 2024.

22. Gyambo Sithey, et al., "Gross National Happiness and Health: Lessons from Bhutan", *Bulletin of the World Health Organization*, August 1, 2015.

Organisations (NGOs), and businesses to bring societal well-being and happiness. This includes the comprehensive reflection of the general welfare of the Bhutanese people, surpassing 'happiness' as a subjective psychological ranking.²³

KEY ECONOMIC CHALLENGES IN BHUTAN

Despite sustained economic growth, Bhutan's economy is facing significant economic challenges today. The major issue is the growing gap between the trade revenue and the money being spent on imports, which carries the potential to adversely affect the country's financial health. The global economic slump and country-wide COVID shutdowns further disrupted the supply chains in the landlocked nation, worsening the trade gap. As a result, the cost of everyday goods went up, making life tough for small and mid-sized businesses.²⁴

Another key challenge that Bhutan is facing is with the manufacturing sector, which has been stagnant for over a decade, mostly relying on construction, mining, and electricity to drive the industrial sector. This has limited the country's economic diversification.²⁵ Also, the nation's growth is slowed down by the higher oil prices, rising costs, and an overall global economic downturn, leading to fewer jobs. So, it's been a rough mix of issues hitting Bhutan's economy.

Further, youth unemployment has surged to over 28.9 per cent in 2022, making the young people virtually flee to foreign countries in search of better job opportunities.²⁶ Bhutan's economy is particularly challenged in the area of finance, where access to well-

23. Organisation for Economic Cooperation and Development, "Bhutan's Gross National Happiness (GNH) Index", August 23, 2024, https://www.oecd.org/en/publications/well-being-knowledge-exchange-platform-kep_93d45d63-en/bhutan-s-gross-national-happiness-gnh-index_ff75e0a9-en.html. Accessed on September 30, 2024.

24. Murali Krishnan, "How Serious is Bhutan's Economic Crisis?" *The Business Standard*, August 20, 2022, <https://www.tbsnews.net/thoughts/how-serious-bhutans-economic-crisis-480406>. Accessed on May 26, 2024.

25. Ridipt Singh, "Challenges for the New Government in Bhutan", *CESCUBE*, March 3, 2024, <https://www.cescube.com/vp-challenges-for-the-new-government-in-bhutan>. Accessed on May 26, 2024.

26. Ibid.

priced financing is reportedly considered a major obstacle to growth in the private sector.²⁷

Moreover, Bhutan's interest rate spread has remained high over the years, reflecting inefficiency in the financial services sector. The result of financial reforms carried out in the late 1990s and late 2000s to restore competition and better manage credit or liquidity risks in loan pricing has been mixed, with Bhutan's interest rate spread not improving consistently. Furthermore, Bhutan has not yet been assigned a sovereign credit rating by the major global credit rating agencies; however, an approximation based on interest payments on external debt suggests it would likely be rated BB-, which is normally considered a below-average and speculative level.²⁸ The macro-economic factors influencing interest rates are tied to Bhutan's deep negative current account balance, which has been closely linked to its overall economic growth since 2006, presenting a broader financial challenge to the economy. These problems could hold back the growth of the private sector, which is highly significant for diversifying and developing Bhutan's economy.

CONCLUSION

Bhutan's economy has undergone significant growth and transformation in recent decades. It moved from an economy that was a traditional, subsistence-based system to one that is more diversified and strong. This shift was mainly due to its hydropower sector. Hydropower has not just made the country's GDP climb but also ensured Bhutan's energy security and earned it remittances through exports. All this has really pushed Bhutan forward in both its social and economic growth. Also, people's standard of living has improved significantly, and the nation has made great strides in cutting down poverty, all thanks to the country's focus on Gross National Happiness. However, Bhutan faces challenges and has vulnerabilities that hurt its economy: a large trade gap, over-reliance on hydropower and tourism, a lack of sectoral diversification for

27. Allen Koji Ukai, "Gross National Happiness-Based Economic Growth", John F. Kennedy School of Government, Harvard Kennedy School, 2016, https://ash.harvard.edu/wp-content/uploads/2024/02/gross_national_happiness-based_economic_growth_-_allen_koji_ukai_-_final.pdf. Accessed on May 26, 2024.

28. Ibid.

revenue generation, and a slow manufacturing sector. These problems got worse during the pandemic phase, clearly highlighting growing unemployment and inefficiencies in the financial sectors. Going ahead, Bhutan must focus on economic diversification, strengthening the private sector and improving access to affordable financing to ensure sustainable and equitable growth. Handling these issues well is crucial for Bhutan's future economic growth and strength.