



Joint UN-WB Statement on Macro-economic issues 11th Round Table Meeting, Thimphu, September 02, 2011

To be read by Nicholas Krafft (Country Director, World Bank)

For much of the past decade, Bhutan has seen robust economic growth of eight percent, driven largely by construction activities associated with its hydropower development program. Sound macroeconomic policies underpinned this robust growth performance. Until recently, fiscal policy has coped relatively well with volatile revenues and expenditures, with fiscal balances remaining in near balance or surplus. Although borrowings for hydropower projects have led to a recent sharp increase in public debt, the risks are mitigated by their commercial viability and Bhutan's strong record of project implementation. On the external front, for the past decade, grant and loan disbursements have offset large current account deficits, allowing a comfortable reserve position. Bhutan's Tenth Five-Year Plan aims to sustain this growth trajectory by fostering private enterprise and reduce poverty.

Looking ahead, Bhutan's overall macroeconomic outlook is favourable. Real GDP growth for the remainder of the Tenth Plan period is projected to be robust, with hydropower as the key driver. But some risks to Bhutan's macroeconomic outlook remain.

- With high growth and elevated inflation, recent accommodative fiscal and monetary policies have contributed to the risks of overheating. Fiscal policy could be tightened to address this by saving revenue over performance and cutting non-priority expenditures. Similarly, monetary conditions could be tightened such that credit creation does not stoke excess demand and further increase the trade deficit. Such fiscal and monetary tightening would help contain balance of payments pressures.
- Dealing with revenue volatility and expenditure pressures would require deepening of public financial management reforms. This would include more robust implementation of the multi-year rolling budget framework and the strengthening public finance oversight institutions. Efforts are also needed to broaden the tax base and improve revenue administration – thus countering anticipated declines in foreign aid inflows and volatile hydropower revenues.
- While the hydropower sector will continue to drive growth for the foreseeable future, it is also important for Bhutan to promote diversification of the economy to create sufficient jobs to absorb the labor force productively. As such, as outlined in the Economic Development Policy, activities that foster private enterprise, attract foreign direct investment, and have job-generating potential need to be encouraged. Addressing investment climate challenges will help create an enabling environment to foster private sector development and attract foreign direct investment. It is important for growth to be pro-poor so that wider sections of the population have the opportunity to contribute to and benefit from the country's growth.

The World Bank Group, together with other members of UNCT and development partners, is fully committed to working with the Royal Government to realize Bhutan's growth potential through its lending, advisory and analytical work.