BHUTAN DEVELOPMENT UPDATE

Special section: Labor Market and Jobs in Bhutan

April 2024

Macroeconomics, Trade, and Investment Global Practice

WORLD BANK GROUP
Macroeconomics, Trade & Investment

Abbreviations and Acronyms

ADB	Asia Development Bank
ALMP	Active Labor Market Program
ATS	Annual Travel Scheme
BDU	Bhutan Development Update
CAD	Current Account Deficit
CAR	Capital Adequacy Ratio
CIT	Corporate Income Tax
CPI	Consumer Price Index
CRR	Cash Reserve Ratio
DGPC	Druk Green Power Corporation
DHI	Druk Holding and Investments
DSA	Debt Sustainability Analysis
ES	Establishment Survey
ESC	Employment Services Center
FDI	Foreign Direct Investment
FYP	Five-Year Plan
GNH	Gross National Happiness
GoI	Government of India
GST	Goods and Services Tax
IDA	International Development Association
IT	Information Technology
LDC	Least Developed Country
LMIS	Labor Market Information System
MC	Mindfulness City
MoESD	Ministry of Education and Skills Development
MoICE	Ministry of Industry, Commerce, and Employment
MoSPI	Ministry of Statistics and Programme Implementation
MTI	Macroeconomics, Trade, and Investment
NBFI	Non-Bank Financial Institution
NEET	Not in Education, Employment, or Training
NPL	Non-Performing Loans
NRF	National Resilience Fund
NSB	National Statistics Bureau
PPG	Public and Publicly Guaranteed
RGoB	Royal Government of Bhutan
RMA	Royal Monetary Authority
ROA	Return on Assets
SCF	Standby Credit Facility
SDF	Sustainable Development Fee
SEZ	Special Economic Zone
SOE	State-Owned Enterprise
TVET	Technical and Vocational Education and Training
UN	United Nations
WB	World Bank

List of Figures

List of Tables

List of Boxes

PREFACE AND ACKNOWLEDGMENTS

The Bhutan Development Update (BDU) is published annually. It assesses recent economic and social developments, prospects, and policies in Bhutan. The BDU also provides an in-depth analysis of selected economic and policy issues. In this edition, the special section focuses on Bhutan's labor market and jobs. The section discusses the characteristics of Bhutan's labor market, nature of jobs in the private sector, and existing challenges of improving the labor market conditions. The report is intended for a wide audience, including policy makers, business leaders, researchers and academics, the community of analysts monitoring Bhutan's economy, and the general public.

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The Bhutan Development Update was prepared based on published data available on February, 2024. The BDU draws on data reported by the government and information collected through the World Bank Group's regular economic monitoring and policy dialogue. Data sources include the World Bank, International Monetary Fund, Royal Monetary Authority, Ministry of Finance, National Statistics Bureau, and press reports.

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EXECUTIVE SUMMARY

Bhutan's economy has recovered from the series of shocks resulting from the COVID-19 pandemic and Russia's invasion of Ukraine. After two consecutive fiscal years of economic contraction following the pandemic, the economy has maintained a robust annual real growth nearly 5 percent since FY21/22. Real GDP is estimated to have grown by 4.5 percent in FY22/23, supported by the reopening of borders for tourism following the pandemic. On the demand side, increasing exports and investment have positively contributed to growth. The fiscal deficit narrowed significantly from 7.0 percent of GDP in FY21/22 to 4.1 percent of GDP in FY22/23, driven by moderate increase in revenues and a fall in expenditures. However, the country faces macroeconomic challenges on the external front. The current account deficit (CAD) widened significantly to 34.3 percent of GDP in FY22/23, driven by a fall in hydropower exports and a large increase in imports. As a result, gross international reserves declined from US$833 million in June 2022 to US$574 million in June 2023. In December 2023, Bhutan achieved the milestone of graduating from the United Nations (UN) least developed country (LDC) status.

Overall CPI inflation rose marginally after moderating in early 2023 and monetary policy was tightened. The rise in inflation was driven by food inflation, which rose to 6.2 percent in December, increasing by 5.4 percentage points since Mach 2023. The increase was driven by the rising prices of domestic dairy products and meats. The Royal Monetary Authority (RMA) raised the Cash Reserve Ratio (CRR) by one percentage points to 8 percent. The broad money growth remained moderate at 9.8 percent in FY22/23, supported by growth in demand deposits. The banking sector non-performing loans (NPL) ratio declined by 1.1 percentage points from November 2022 to reach 7.7 in November 2023, but the NPL ratio of the Non-Bank Financial Institutions (NBFIs) remained elevated at 17.4 percent.

The economy is projected to grow by 4.9 percent in FY23/24, supported by higher growth of tourism. Growth is expected to be supported by the service sector, including higher growth in tourism, and a gradual increase in mining and manufacturing (base metals). On the demand side, growth will be supported by services exports and consumption, reflecting higher government spending. Medium term growth is expected to be supported by a robust growth in exports, construction, and services sectors, driven by the commissioning of the Puna II hydropower plant and robust inflow of tourists. Moreover, timber woods and wood product exports, along with activities from the carbon markets being established, are expected to provide additional resources for growth. The new Government is mulling a BTN15 billion stimulus package to support private sector growth and the promotion of Special Economic Zones/Autonomous Areas to attract FDIs. This would be aligned with the vision of the Gelephu Mindfulness City.

However, the fiscal deficit is projected to increase to 5.0 percent of GDP in FY23/24 as expenditures outpace revenue. Current expenditure is expected to increase due to a major salary hike between 55 and 74 percent for public servants. Nevertheless, the fiscal deficit is expected to narrow beyond FY24/25, driven by additional revenue from the Puna II hydropower plant and reduced capital expenditure. Capital expenditures are expected to be lower in the first year of the

13th Five Year Plan (FYP) covering 2024-28 given that capital spending is typically lower in the first two years of the FYP.

The CAD is projected to fall sharply as lumpy IT equipment imports fall and to moderate further in the medium term supported by an increase in tourism and electricity exports. The expected improvement in the CAD in FY23/24 to 15.7 percent of GDP is driven by a lower trade deficit, led by a significant reduction in goods imports. This reflects the decline of lumpy imports of cryptocurrency related IT equipment, which accounted for 6 percent GDP in 2022. The CAD is expected to moderate further in the medium term due to an increase in tourism exports from FY24/25, the on streaming of the Puna II hydropower project in FY25/26, as well as a decline in imports following the completion of the hydropower projects. International reserves are expected to be at US$516 million in FY23/24 (equivalent to 3.8 months of import coverage).

Downside risks to the economy persist. Domestic risks include delays in hydropower projects, which could affect fiscal and external balances. Delayed fiscal consolidation and the materialization of financial sector contingent liabilities could further erode buffers. External risks include rising and volatile commodity prices due to geopolitical tensions, which could exert further pressure on the external balance and international reserves. Lower than expected returns from cryptocurrency operations and continued emigration of the educated workforce could also weigh on the economy in the medium term.

Bhutan's long term economic prospect will depend on effective implementation of its plans. The government's strategic support of the hydropower sector involves large fixed-capital investments over a long-term horizon. The government has also placed big bets on several national initiatives, such as the investment in cryptocurrency mining to accelerate the country's digital transformation and generate additional revenues, and the government's plan to establish a Mindfulness City in Gelephu near the southern border with India. These transformative projects can potentially bring considerable rewards, but the risks can also be high given large financing requirements that could affect Bhutan's macroeconomic fundamentals and therefore must be carefully weighed alongside the rewards.

Bhutan needs to address its labor market challenges to foster sustainable growth[1]. Bhutan's labor remains predominantly employed in the low productivity agriculture sector and the public sector. Opportunities for women in meaningful employment remain constrained. Employment quality outside of the public sector remains weak, leading to public sector queuing, rising unemployment among urban workers, and a record number of Bhutanese emigrating. The private sector struggles to create jobs that can absorb the increasingly educated workforce and fill existing vacancies in low and semi-skilled positions. The more productive sectors have experienced higher job creation rates, but these sectors are relatively small and have limited capacity to absorb the rising number of high skilled workers. Hiring difficulties for low and semi-skilled positions are negatively affecting firm performance. Existing employment support programs and delivery systems can be enhanced to better support women in becoming more active participants in the

[1] This paragraph summarizes the special section on labor market and jobs in Bhutan.

workforce, equipping them with relevant job-related skills, and assisting firms in recruiting trained labor. Addressing Bhutan's labor market challenges requires pursuing vertical growth policies that are sector-specific to support private sector development and job creation, as well as horizontal reforms that improve the business environment, strengthen human capital accumulation, and increase the effectiveness of employment support programs are needed.

A. RECENT ECONOMIC DEVELOPMENTS

1. Context

Bhutan's economy has recovered from the series of shocks resulting from the COVID-19 pandemic and Russia's invasion of Ukraine. After experiencing contractions of 2.5 percent and 3.3 percent in FY19/20 and FY20/21, respectively, the economy exhibited signs of recovery in subsequent years. As pandemic-related relief measures were gradually phased out and capital expenditures moderated, the fiscal deficit saw a decline in FY22/23. Borders were open for tourists in September 2022, though tourists' arrivals remained below the pre-COVID level. In December 2023, Bhutan achieved the milestone of graduating from the United Nations (UN) least developed country (LDC) status. Yet, the country faces several macroeconomic challenges. Fiscal deficit is widening due to slowdown in revenue and increase in current expenditure. The national investment in cryptocurrency mining operations resulted in a significant decline of international reserves and a widening of the current account deficit (CAD) due to imports of information technology (IT) equipment and related goods for cryptocurrency mining. Going forward, a fiscal consolidation to keep the fiscal deficit and public debt at a sustainable level and improvement in the external balances would be important to achieve Bhutan's medium to long term goals.

2. Real Sector

Growth

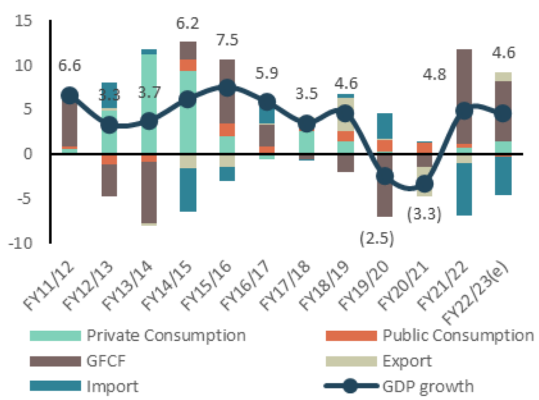
Bhutan's real GDP growth rate slowed marginally but remained robust in FY22/23. The real GDP is estimated to have grown by 4.6 percent in FY22/23, the second consecutive year of positive growth following the contractions in FY19/20 and FY20/21. The growth was supported by the hydropower sector and the re-opening of borders in September 2022. On the demand side, increasing exports and investment have positively contributed to growth (Figure 1). Public and private investment increased in real terms, reflecting higher public investments and resumption of hydropower construction. Private consumption bounced back as consumer confidence recovered. Net exports contributed negatively to the overall GDP growth, as imports grew more than exports.

The industry sector is estimated to have grown by 5.6 percent in FY22/23, supported by growth in the hydropower, mining, and construction sectors (Figure 2). While hydropower production remained moderate in FY22/23, non-hydro industry sector is estimated to have grown by 6.0 percent in FY22/23, driven by the construction and manufacturing sectors, which benefitted from improved labor supply and access to raw material with the easing of COVID-19 restrictions (Figure 3). The housing sector experienced a notable increase in loans, driven in part by pent-up demand. Concurrently, there was a significant uptick in approvals granted for the importation of foreign laborers. Despite the six-month loan moratorium imposed on the housing and hotel construction by the RMA, the impact on the credit growth in FY22/23 was limited since the directives on the housing loan moratorium came into effect only from June 2023. Meanwhile, growth in the mining sector was bolstered by a robust 26.0 percent year-on-year surge in base metal exports during FY22/23, underpinned by sustained high commodity prices.

The services sector is estimated to have grown by 5.0 percent, supported by gradual recovery of tourism and transport- and trade-related services. Transport, communication and trade services were the largest contributors to services growth, reflecting the continued normalization of economic activity after the pandemic. Output in the hospitality sector, which historically has been about 6 percent of GDP, is estimated to have increased by 22.0 percent (y-o-y) in FY22/23 after the reopening of boarders in September 2022. However, the tourist arrivals remained below the pre-COVID level in FY22/23 because of weaker consumer confidence globally and the new tourism levy act, which tripled the sustainable development fee (SDF) for international tourists (Figure 4). The SDF was halved starting in September 2023, which helped to attract more tourists in the first half of FY23/24 compared to the last half of FY22/23.

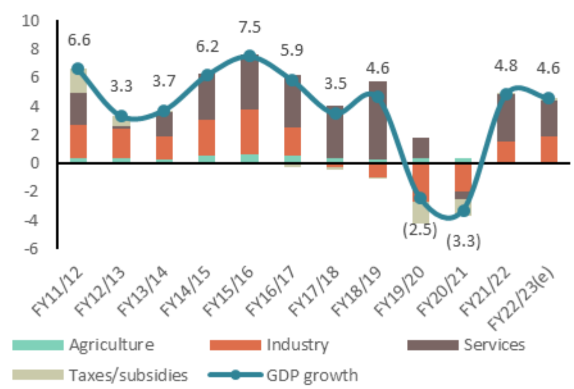
The agriculture sector is estimated to have grown moderately at 0.4 percent in FY22/23. The agriculture sector showed resilience during the pandemic, but growth has been moderate since then, primarily due to reduced crop production. However, continued government support to boost domestic food production through infrastructure development including farm roads, input support for seeds and fertilizers, and a continuation of the public buyback schemes for domestic producers supported the agriculture sector. While this sector generates about 40 percent of total employment, its share in GDP have declined to less than 15 percent, indicating that workers continue to be engaged in the sector despite transition of economic output from this sector.

Figure 1 Contribution to GDP growth, demand side (percentage points)



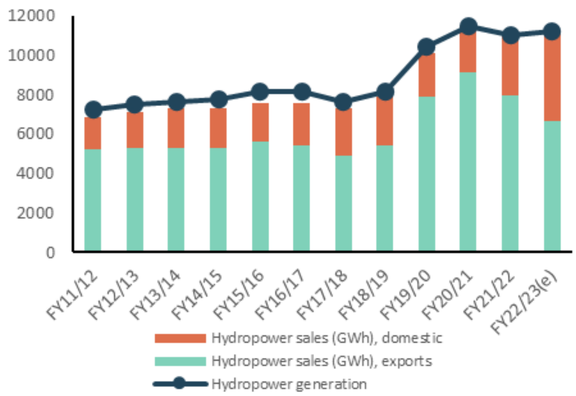
Source: NSB, WB staff estimates.

Figure 2 Contribution to GDP growth, supply side (percentage points)



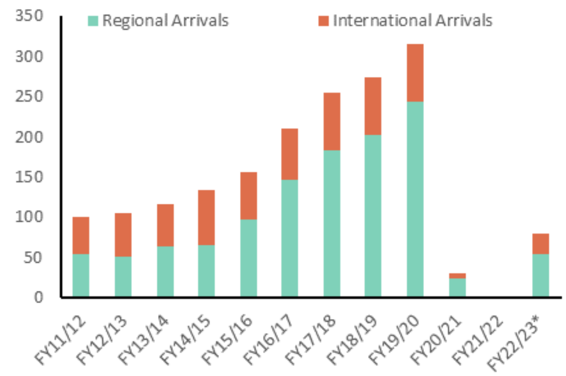
Source: NSB, WB staff estimates.

Figure 3 Hydropower production and sales (GWh)



Source: NSB, WB staff estimates.

Figure 4 Tourist arrivals (thousand person)



Source: NSB, WB staff estimates.
Note: *FY22/23 data is from September 2022 till August 2023 due to data availability. Bhutan's international boarder reopened in September 2022.

Employment

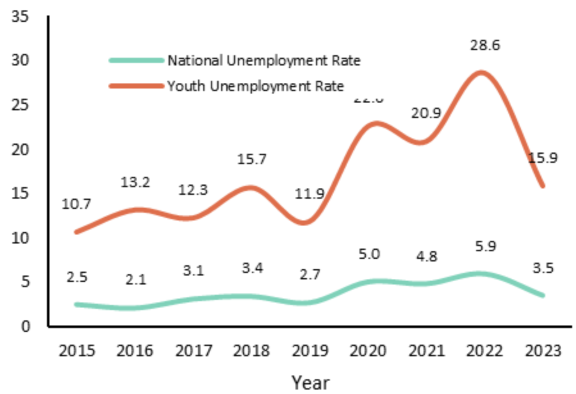
The labor market is recovering to pre-COVID levels with national and youth unemployment trending down. The unemployment rate is at 3.5 percent in 2023, 2.4 percentage points lower than in 2022 and slightly higher than the 2015-2019 average of 2.8 percent (Figure 5). It is significantly higher among females (4.5 percent) than males (2.7 percent) and appeared more of an urban phenomenon (6.3 percent in urban areas compared to 1.9 percent in rural areas) with Thimphu district having the highest unemployment rate (5.2 percent), followed by Samdrup Jongkhar (4.9 percent). The youth unemployment rate[2], which was already high before the COVID-19 pandemic, almost doubled between 2019 and 2020 from 11.9 percent to 22.6 percent and reach a new high at 28.6 percent in 2022 before moderating to 15.9 percent in 2023. The majority of unemployed youth were females (53.5 percent). Youth and female unemployment are predominant in urban areas, where 9.7 percent of women are unemployed (compared to 3.9 percent men).

With limited economic diversification and nascent private sector development, jobs remain concentrated in agriculture and the public sector. Recent studies suggest that skills mismatch, a lack of employment opportunities in the private sector, and youth not being keen on taking blue collar jobs are among the main reasons behind the high youth unemployment rate. A large number Bhutanese have migrated to Australia to find better job opportunities with the possibility of sending remittances back home. The average number of Bhutanese migrating from Paro International Airport increased significantly with the reopening of the boarders in mid-2022, to more than 5,000 per month in early 2023, compared to below 500 on average per month prior to

[2] Youth unemployment rate is defined as the percentage of unemployed persons in the age group 15-24 years to the labor force (also known as economically active population) in the same age group (NSB, 2022 Labor Force Survey Report).

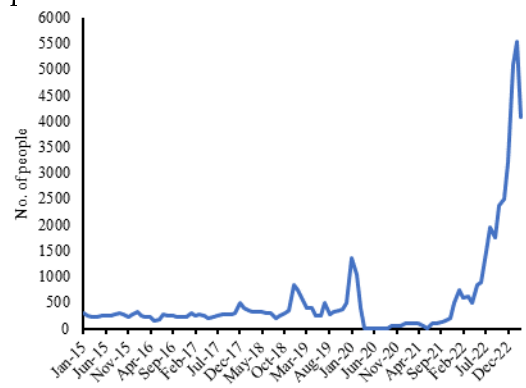
the pandemic (Figure 6). This has raised concerns about significant brain drain from the country. A special section of this BDU (section C) discusses Bhutan's labor market issues in more details.

Figure 5 Unemployment rate (percent), 2010-21



Source: NSB, WB staff estimates.

Figure 6 Monthly migration, Paro International Airport



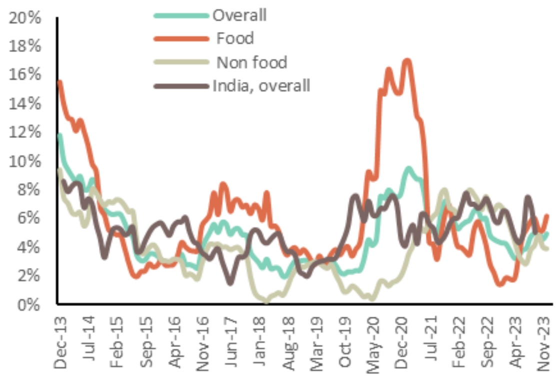
Source: Kuensel (May 20, 2023)

Inflation

Overall CPI inflation rose marginally after moderating in early 2023. From January to March 2023, CPI inflation moderated by 110 basis points to 3.2 percent, the lowest since the pandemic (Figure 7). CPI inflation thereafter started to rise again gradually to reach 5.0 percent in December 2023. The rise in inflation was driven by food inflation, which rose to 6.2 percent in December, increasing by 5.4 percentage points since Mach 2023. The increase was driven by the rising prices of domestic dairy products and meats. Rise in global fertilizer prices and the surge in the price of imported food items from India including vegetables, tomato and onion exerted pressure on the domestic food inflation. Bhutan's inflation usually follows India with a time lag since about 70 percent of Bhutan's imports come from India and the currency is pegged to the Indian Rupee.

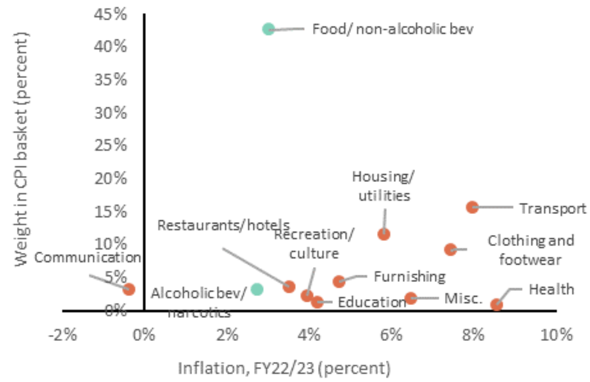
However, non-food inflation declined. Non-food inflation (comprising of 54.1 percent of weight in CPI inflation) declined by 2.8 percentage points since January to reach 4.0 percent in December 2023. The decline was largely driven by imported items, for which inflation dropped significantly to only 0.3 percent in December 2023 from 8.2 percent in January 2023. The price of transport, which was a key driver of the non-food inflation during the pandemic, declined substantially as a result of moderation in global fuel prices, and had knock-on effect on other sectors of the economy including mining, construction and manufacturing.

Figure 7 Inflation, Bhutan and India (percent)



Source: NSB, MoSPI India.

Figure 8 CPI categories and inflation drivers in FY22/23 (percent)



Source: NSB.

Poverty

Rapid economic growth has contributed to substantial poverty reduction over the last two decades. Results from the 2022 Bhutan Living Standard Survey suggest that an estimated 12.4 percent of the population lives below the national poverty line (Ngultrum 6,204 per person per month), with poverty being more prevalent in rural areas, where 17.5 percent of the poor live. The rural poor are also much further below the poverty line (poverty depth) than the urban poor, indicating that they will require much more resources and support to help them escape poverty. Extreme poverty based on $2.15/day was eliminated by 2022. Less than one percent of people live on less than $3.65/ day (international poverty line for lower-middle income countries), while 8.5 percent of people live with less than $6.85/ day. Poverty reduced significantly in the last five years, partly driven by growth in real per capita consumption and income distribution (through social transfers)[3] and increases in remittances during the period. Declines were particularly salient in rural areas. Non-monetary aspects of welfare such as access to food and improved education, water and sanitation, also improved in the last five years. Inequality, measured by the Gini index, decreased from 37 in 2017 to 28 in 2022, showcasing the growth has been pro-poor.

[3] The government provided temporary income support to the most vulnerable up to September 2022, targeting the severely affected by the COVID-19 pandemic. The government extended temporary income support through the Druk Gyalpo's Relief Kidu (DGRK) until September 2022.[1] Results from the COVID-19 High-Frequency Monitoring Survey suggest that social assistance coverage declined slightly from 20 percent of households receiving any form of assistance in September 2020 (first round of the survey) to about 17 percent in April 2021. Encouragingly, coverage increased for groups that were more adversely affected by the pandemic, including service sector workers and workers who lost jobs. Temporary income support from the DGRK remained by far the most dominant form of assistance (78 percent).

Despite this progress, vulnerability to shocks and spatial inequalities remain a significant challenge. Vulnerability to falling back into poverty or experiencing a lowering of welfare conditions as a result of climate-related hazards affects large segments of the population and at least 60 percent of the poor. The poverty rate is as high as 41 percent in Zhemgang district and as low as 1.5 percent in Thimphu district. With the Gini coefficient standing at 0.29 in 2022, inequality in Bhutan is lower than the regional average, but spatial inequality remains an issue with a Gini as high as 0.32 in Zhemgang district and as low as 0.24 in Punakha, Sarpang and Thimphu districts.

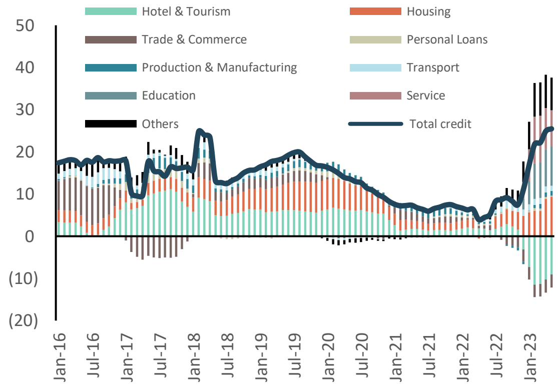
3. Monetary Policy and Financial Sector

Monetary policy was tightened, but broad money growth has been moderate. Monetary policy is anchored by the exchange rate peg to the INR, which limits RMA's ability to use monetary policy for macroeconomic adjustments. The RMA does not have an explicit inflation target. It uses the cash reserve ratio (CRR) and the statutory liquidity ratio (SLR) to manage liquidity in the financial system and intervenes in the foreign exchange markets to maintain the peg. The reserves holding increased by 25.9 percent in FY22/23 due to increase in the CRR by one percentage points in October 2022 and a rise in the deposit base. The liquidity in the banking sector has been on a declining trend in the recent years, primarily due to lower foreign exchange inflows related to the grants and aid. The broad money growth remained moderate at 9.8 percent in FY22/23, supported by growth in demand deposits.

The credit flow to the private sector expanded in FY22/23, continuing the trend initiated in the previous fiscal year (Figure 9). Private sector credit accelerated from 10.8 percent in June 2022 to 19.3 percent in June 2023, almost reaching the pre-COVID growth rate of 20.5 percent. In overall portfolio, housing loans constituted the largest part (29.8 percent) followed by hotel and tourism (12.7 percent), production and manufacturing (10.1 percent), trade and commerce (8.1 percent) and education loans (8.0 percent), as of November 2023. The surge in education loan is attributable to the high outmigration in Bhutan, as many Bhutanese left the country with student visa. Despite the rise in private sector credit, access to finance is considered a major obstacle by most entrepreneurs to conduct business. The government is exploring the possibility of allowing banks to engage in External Commercial Borrowing to facilitate access to finance.

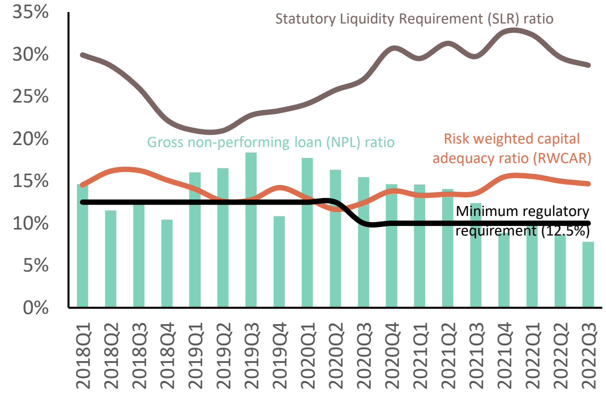
Financial sector soundness indicators show mixed performance (Figure 10). The overall financial sector non-performing loans (NPL) ratio declined from 8.8 percent in November 2022 to 7.7 percent in November 2023, indicating improvement in asset quality. However, the NPL ratio of the Non-Bank Financial Institutions (NBFIs) remained elevated at 17.4 percent. The risk weighted capital adequacy ratio (CAR) for the overall financial sector increased marginally to reach 15.9 percent in November 2023, driven by an increase in CAR in NBFIs. The profitability, in terms of Return on Assets (ROA), showed marginal improvement to 2 percent in November 2023, compared to 1.9 percent in June 2022.

Figure 9 Credit growth and sectoral contribution (y-o-y growth, percent, 3-month moving average)



Source: RMA.

Figure 10 Financial sector soundness indicators (percent)



Source: RMA.

4. External Sector

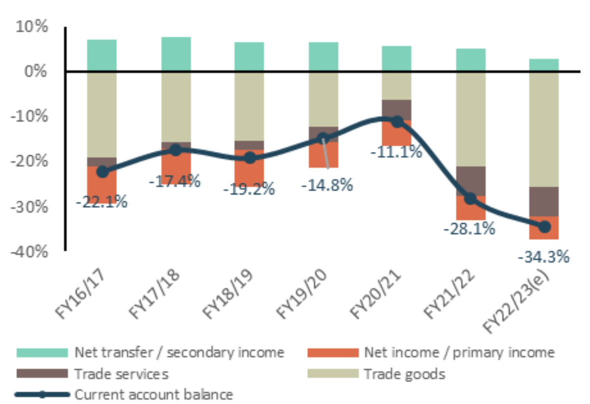
The CAD has remained elevated and gross international reserves declined (Table 1). Though exports were supported by higher tourism receipts (albeit from a low base given near-zero tourism receipts in FY21/22), hydropower exports declined due to increased domestic consumption, reflecting the higher electricity needs for energy-intensive crypto mining operations. Furthermore, due to crypto mining related IT equipment imports the CAD widened to 34.3 percent of GDP in FY22/23 (Figure 11). Services imports also rose due to increased educational travel related service payments and spike in the Annual Travel Scheme (ATS). As a result, gross international reserves have declined further from US$833 million in June 2022 to US$574 million in June 2023 (Figure 14). Provisional estimate for the first quarter of FY23/24 indicate that the CAD has narrowed by 35.5 percent, driven by increase in services exports.

The sharp decline in reserves is partly due to the crypto mining investments. The state holding company Druk Holding and Investments (DHI) invested US$539 million (21 percent of FY21/22 GDP) in cryptocurrency mining operations over FY21/22 and FY22/23, financed by loans from the Royal Monetary Authority (RMA), to accelerate the country's digital transformation and diversify the economy. The proceeds of the bonds were used to import IT equipment for cryptocurrency mining operations and related goods (Figure 12). This resulted in a significant decline of international reserves in FY21/22 and a widening of the CAD due to imports of IT equipment and related goods for crypto mining. To reflect the drawdown on the reserves for the loan, international reserves were retroactively adjusted to US$970 million for December 2021, from US$1.437 billion. DHI is required to repay US$224 million in FY23/24 and US$315 million in FY24/25 to RMA, according to the loan repayment schedule. The recent increase in cryptocurrency values has helped the DHI to facilitate timely repayments so far.

To reduce pressure on international reserves, the government extended several administrative measures in 2023. In mid-2022, the government extended two INR standby credit facilities (SCF) with the Government of India (GoI) and introduced administrative measures to restrict the import of vehicles and a foreign exchange quota for international travel. In mid-2023, the RMA extended the moratorium on vehicles (until February 2024) and imposed a ban on commercial housing and hotel construction loans (until end-December 2023) in response to the declining international reserves and the high credit concentration and non-performing loans in these sectors. Additionally, the RMA extended and enhanced the incentives scheme on inward remittance from 2 percent to 10 percent.

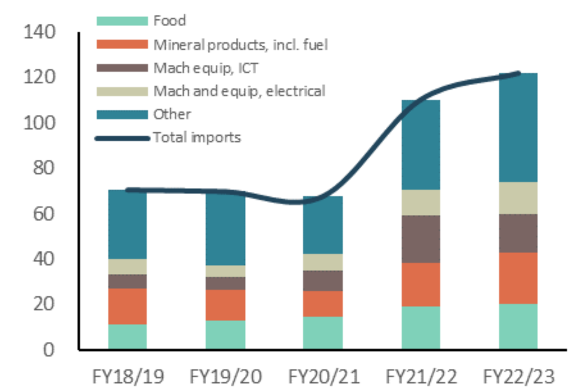
Trade deficit with India increased. In FY22/23, the trade deficit with India, Bhutan's predominant trading partner, increased by 60.3 percent (y-o-y). This reflects a 16.5 percent increase in imports and a 7 percent fall in exports. The fall in exports was due to decrease in hydropower exports by 13.2 percent. The performance of the Ngultrum in the international markets is intricately tied to the INR's performance on the global stage. Over the past two years, the INR has experienced a considerable volatility and has undergone a significant depreciation against the USD. A significant depreciation of INR mirrors the continuous appreciation of the US Dollar in response to the aggressive tightening of monetary policy by the US Federal Reserves and the surge in the US Treasury yields (RMA Annual Report 2022-23).

Figure 11 Current account and components (percent of GDP)



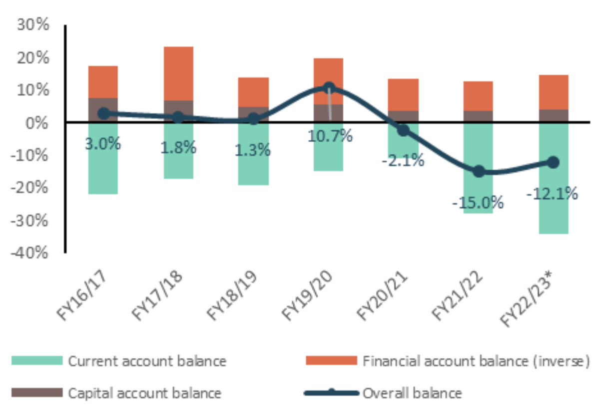
Source: RMA.

Figure 12 Goods import (BTN billion)



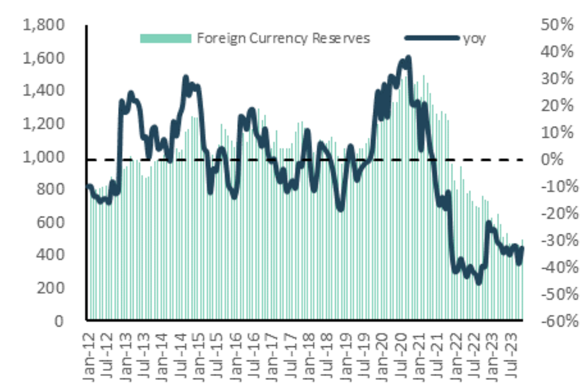
Source: MoF.

Figure 13 Balance of payments (percent GDP)



Source: MoF.

Figure 14 Gross international reserves (in million US$ and y-o-y growth)



Source: RMA.

Table 1 External accounts (percent of GDP)

	FY17/18 (act)	FY18/19 (act)	FY19/20 (act)	FY20/21 (act)	FY21/22 (act)	FY22/23 (est)
Current account balance	**(17.4)**	**(19.2)**	**(14.8)**	**(11.1)**	**(28.1)**	**(34.3)**
Goods balance	**(15.7)**	**(15.3)**	**(12.1)**	**(6.4)**	**(21.1)**	**(25.6)**
Exports	22.7	23.3	25.0	27.5	26.8	23.5
Hydropower exports	7.0	5.9	8.1	14.6	11.3	9.2
Non-hydropower exports	15.8	17.4	17.0	12.8	15.4	14.3
Imports	38.5	38.6	37.1	33.9	47.9	49.1
Services balance	**(1.3)**	**(1.9)**	**(3.5)**	**(4.4)**	**(6.5)**	**(18.0)**
Exports	7.2	6.4	5.1	0.8	0.8	4.9
Imports	8.5	8.4	8.6	5.2	7.3	22.9
Primary balance	(8.0)	(8.4)	(5.7)	(5.8)	(5.5)	-
Secondary income	7.6	6.5	6.6	5.6	5.1	9.2

Source: MoF and WB staff estimates.

5. Fiscal Sector and Debt Sustainability

Revenues are estimated to have increased marginally in FY22/23 as a share of GDP (Figure 17). The Corporate Income Tax (CIT), Sales Tax, and Royalty were the highest contributors to the total tax revenue comprising 33.3 percent, 29.1 percent, and 21.1 percent, respectively. An increase in indirect taxes was attributed to an increase in taxes on international trade and transactions. Increase in the domestic non-hydro revenues reflects the gradual recovery of economic activity in the industry and services sectors.

However, total expenditure as a share of GDP decline to 29.3 percent from 32.1 percent (Figure 18), driven by both capital and current expenditures. As the 12th FYP activities were frontloaded in FY20/21 to boost economic activity and support the recovery from the pandemic, capital expenditure was lower in FY22/23, which was the last year in the 12th FYP. The government also rationalized primary recurrent expenditure, including official travel, workshops, office equipment and vehicles, which resulted in a decline in non-wage recurrent expenditure. Among the major components of current expenditure, pay and allowances continue to remain the largest share at 48.7 percent followed by interest payments at 11.4 percent. The high attrition rate of the public servants has led to the increase in the retirement and Provident Fund and Pension (RMA Annual Report 2023).

As a result, the fiscal deficit declined significantly from 7.8 percent of GDP in FY21/22 to 4.7 percent of GDP in FY22/23 (Figure 19 and Table 4). The fiscal deficit was financed in equal parts by external borrowing from multilateral and bilateral partners on concessional terms and domestic borrowing.[4] External concessional borrowing has recently not been adequate to meet the government's increasing financing needs. The government has resorted to borrowing from

[4] Budget support in FY22/23 includes US$37.4 million from ADB, and US$50 million from JICA.

the domestic market, mainly through issuance of treasury bills and longer-term treasury bonds, use of advances from the central bank, and availing of overdraft facilities from commercial banks.

Box 1 Bhutan Public Expenditure Review

The World Bank has recently completed a report titled Bhutan Public Expenditure Review (PER). PER is a core analytical report produced by the World Bank for its member countries. A summary of the Bhutan PER is outlined below:

- ***Macro-Fiscal Context:*** Bhutan has had relative success in maintaining fiscal sustainability. However, in recent years it has experienced challenges due to the widening fiscal deficit and rising public debt. Bhutan's procyclical fiscal policy stance, dependence on the hydropower sector, and contingent liabilities from a large state enterprise sector pose fiscal risks. To maintain fiscal sustainability, it would be important strengthen domestic resource mobilization, particularly from non-hydro sources, and carry out fiscal consolidation in the medium term.
- ***Enhancing Domestic Resource Mobilization***: Bhutan's revenue as a percentage of GDP has fluctuated in the last decade but remained relatively high compared to countries with similar income level due to tax and non-tax revenues generated by the hydropower sector. External grants, another important source of financing, have been declining, and are expected to decline further following Bhutan's LDC graduation. Direct taxes from the non-hydropower sectors have remained stagnant. Moreover, most of the small and medium enterprises are out of the tax net. Although overall tax policies are progressive, tax incentives to businesses are regressive in nature, narrowing the tax base further. Tax collection is also constrained by an outdated tax administration.
- ***Striving for productive and efficient public expenditure***: Bhutan's government spending exhibits volatility and strong procyclical tendencies. Bhutan's capital expenditures as a share of GDP are among the highest globally, largely funded by external grants. Expenditures on salary and allowances consume a significant portion of the current budget. Notably, Bhutan's commitment to education and healthcare remains robust, supporting relatively successful service delivery despite geographical challenges. However, there are rooms to improve efficiency of spending.
- ***Turning State Enterprises into a Development Asset***: State enterprises in Bhutan contribute significantly to budget revenues and job creation but face profitability and performance challenges. Main fiscal risks include heavy reliance on volatile hydropower revenues, subsidies for rural power provision, weak financial performance in some state enterprises, and potential distress in the financial sector dominated by state-owned institutions. While Bhutan has enhanced its legal and regulatory framework for state enterprises management, key policy gaps persist, including ownership and dividend policies. Challenges remain in investment management, corporate governance, and financial reporting quality. Given the challenges, the Government is exploring the potential to sell some SEs to the private sector.

The report includes several policy recommendations, including: (i) implement the Goods and Sales Tax;(ii) introduce capital gains tax on sale of immovable properties; (iii) establish a large taxpayers unit; (iv) operationalize Bhutan Economic Stabilization Fund (BESF); (v) conduct fiscal consolidation in the medium term; (vi) improve spending efficiency (vii) conduct a comprehensive assessment of fiscal risks in the annual budget report, including an estimate of all state enterprise related liabilities; (viii) establish an action plan to restore loss-making state enterprises to profitability.

The Sixth Pay Commission Report proposed a significant increase in pay and allowances for the government employees. Effective from July 2023, a significant salary boost is anticipated, ranging from 55 to 74 percent, depending on the job grade. The pay and allowances of employees at three higher education institutions, which were excluded from previous pay commissions, are now incorporated into the new pay commission structure. The latest pay commission report underscores two primary objectives: i) ensuring a reasonable standard of living for public servants, and ii) fostering motivation and retention of skilled individuals within the public sector. The annual increase in public expenditure due to the new pay scale is expected to be around BTN 6000 million, which is about 9 percent of total primary expenditure of FY21/22.

Box 2 Features of the FY23/24 budget

The FY23/24 budget was presented to the parliament in June 2023 which aimed at building stronger institutions through strategic reforms while ensuring a sustainable fiscal path and smooth transition. The medium-term outlook is based on a gradual fiscal consolidation. While the fiscal deficit is expected to remain elevated at 9.7 percent of GDP in FY23/24, it is expected to be contained within 5 percent of GDP within next 5 years.

The total estimated resource for FY23/24 is BTN 53513.2 million, 12.4 percent lower than the FY22/23 revised estimate. Domestic revenue is expected to contribute 86.4 percent of total resources, which includes BDT 4000 million from the DHI to meet the salary payment under the Sixth Pay Commission Report (Figure 15). Grants are expected to decline by 66.7 percent compared to the revised FY22/23 budget. Since the 13th Five Year Plan is under formulation and commitment from the development partners are yet to be confirmed, the grants estimate for the FY 23/24 is lower and includes only those that have been committed to be disbursed. The projected growth in higher tax revenue is expected to come from corporate tax from the Druk Green Power Corporation (DGPC) with the corporatization of the Mangdechhu hydropower project, property tax, and royalty.

Figure 15 Sources of Income

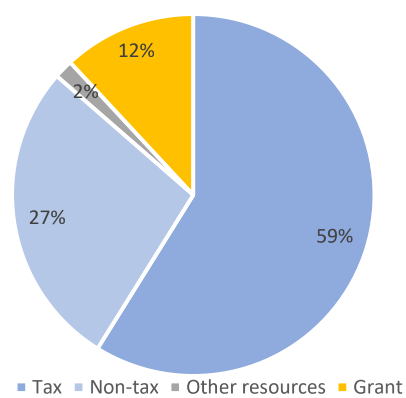


Figure 16 Components of total expenditure

Total expenditure is estimated at BTN 74861.6 million, 2.8 percent lower than the revised FY22/23 budget. Out of the total expenditure, about 39 percent is assigned to salary and benefits (Figure 16). Allocation to salary and benefits rose by 27.3 percent compared previous budget due to the implementation of the Pay Structure Reform Act of Bhutan 2022 (see Table 1). Capital expenditure makes about 40 percent of total expenditure. Similar to previous years, given that the estimated domestic resources are not adequate to cover the recurrent expenses, the sources of financing for the capital budget are through grants (27 percent) and from deficit financing that is planned to be mobilized from domestic market and concessional external borrowings (73 percent). The budget for FY23/24 is aimed at ensuring completion of on-going activities and continuity of critical public service delivery.

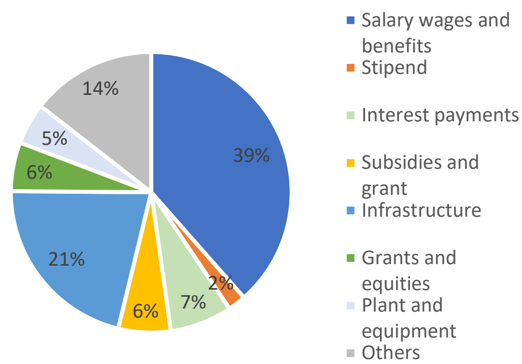


Table 2 Increase in the allocation of major expenditure components

	Allocation for FY22/23	Allocation for FY23/24	% change from FY22/23
Salary wages and benefits	22934.7	29196.0	27.3
Interest payments	3583.2	5384.6	50.3
Subsidies and grants	2496.6	4509.0	80.6
Infrastructure	25772.9	15977.1	-38.0
Plant and equipment	2308.0	3576.5	55.0

Share of social service and economic and public services expenditure in total budget declined for FY23/24. Within social services, though share of education expenditure increased marginally, share of health expenditure declined. Most of the education expenditure would be driven by spending on undergraduate scholarship and improving access to the quality Early Childhood Care and Development. Health spending would prioritize procurement of medical equipment and construction of different hospitals. Share of expenditure on general public services and debt service payments on total expenditure has increased by 2.4 and 5.8 percentage points, respectively (Table 3).

Table 3 Sectoral allocation in the FY23/24 budget

Sectors	Share (%) in total allocation	Pp difference from previous year
I. Social Services	**28.8**	**-0.4**
Health	11.6	-1.3
Education	17.2	0.9
II. Economic and Public Services	**26.7**	**-6.5**

Renewable Natural Resources	8	-0.6
Mining & Manufacturing		
Industries	3.2	-0.6
Roads/Transport	8	-3
Housing & Community	3.7	-2
Communications and Technology	2.1	-0.5
Energy	1.7	0.2
III. Religion & Cultural Services	**1.7**	**-0.5**
IV. Law and Order Services	**3.1**	**-0.8**
V. General Public Services	**21**	**2.4**
VI. National Debt Services	**18.8**	**5.8**
Total	**100**	**0**

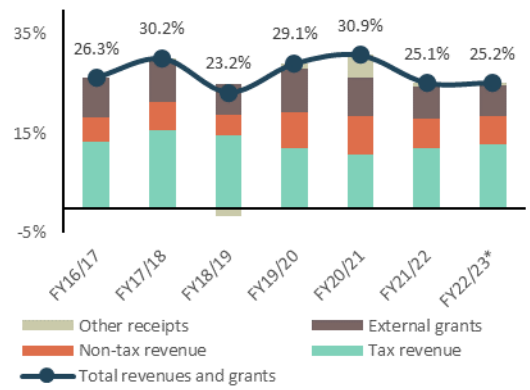
Total PPG debt stood at 116.5 percent of GDP in FY22/23 (Figure 20). This reflects an increase in non-hydropower debt due to higher financing needs and also an increase in hydropower debt due to the disbursement for the ongoing hydropower projects. About 88 percent of the PPG debt is external and owed to official bilateral or multilateral creditors, with the GoI the largest creditor, followed by the Asian Development Bank (ADB) and IDA. External PPG debt amounted to 118.3 percent of GDP in FY22/23, of which hydropower debt accounted for about 69 percent. Domestic debt was mostly in the form of treasury bills and 3- to 12-year treasury bonds.

Table 4. Fiscal accounts (percent of GDP)

	FY17/18 (act)	FY18/19 (act)	FY19/20 (act)	FY20/21 (act)	FY21/22 (act)	FY22/23 (est)
Resources	**30.2**	**23.2**	**29.1**	**30.9**	**25.1**	**25.2**
Tax revenue	15.7	14.7	12.2	10.7	12.0	12.8
Non-tax revenue	5.7	4.1	7.2	7.9	6.1	5.6
o/w hydropower profit transfers	0.0	0.0	1.9	3.8	2.0	1.9
Other receipts 1/	0.2	(1.7)	1.0	4.6	0.8	0.5
Grants	8.6	6.1	8.8	7.7	6.3	6.3
Expenditure	**31.7**	**24.2**	**30.9**	**36.6**	**32.1**	**29.3**
Current expenditure	15.9	15.0	19.0	22.5	15.9	15.4
o/w National Resilience Fund 2/	0.0	0.0	1.3	6.0	0.0	0.0
Capital Expenditrue	16.7	8.8	11.8	14.3	16.1	14.4
Advance/suspense (net)	(0.9)	0.4	0.2	(0.1)	0.1	0.2
Fiscal balance	**(1.5)**	**(1.1)**	**(1.8)**	**(5.8)**	**(7.0)**	**(4.1)**
Primary balance	(0.3)	(0.2)	(1.4)	(4.8)	(5.6)	(2.4)
Financing (net)	**1.5**	**1.1**	**1.8**	**5.8**	**7.0**	**4.1**
Net lending 3/	1.2	0.5	0.5	0.4	1.7	2.1
External borrowing (net) 4/	(0.1)	0.6	1.9	0.8	1.9	1.0
Domestic borrowing (net)	0.3	0.2	(0.5)	4.6	3.4	1.0

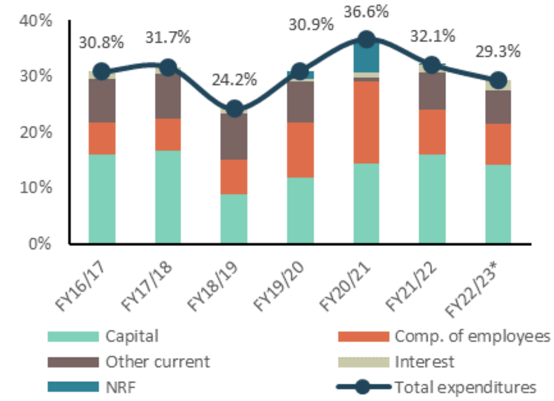
1/ Other receipts include the redemption of T-Bills and overall transactions from cash balances. This line item has been negative in some years, driven by adjustment for prior year's advances. In FY19/20 and FY20/21, other receipts cover transfers from the NRF to cover COVID-19 relief measures.
2/ Includes temporary income support provided to individuals and loan interest payment support to borrowers (DGRK) financed by the NRF.
3/ Includes principal repayments from SEs (for central government loans that are on-lent to SEs), minus on-lending to SEs
4/ Includes central government loans, and central government loans that are on-lent to SEs
Source: MoF and WB staff estimates.

Figure 17 Revenue components (percent of GDP)



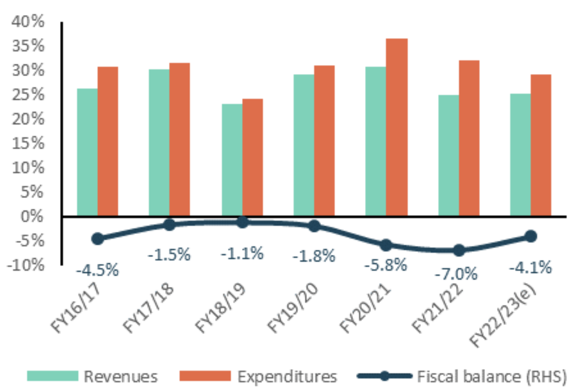
Source: MoF. Note: In FY19/20 and FY20/21, other receipts cover transfers from the NRF to cover COVID-19 relief measures.

Figure 18 Expenditure components (percent of GDP)



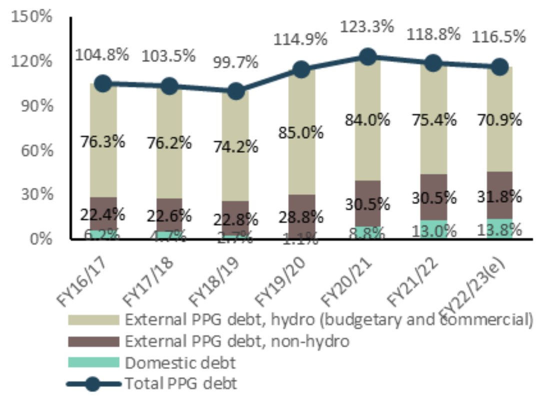
Source: MoF. Note: NRF expenses in FY19/20 and FY20/21 include COVID-19 relief measures in the form of a temporary income support provided to individuals and loan interest payment support to borrowers. Starting from FY21/22, COVID-19 relief measures were financed by the King and Sungchob Fund outside of the budget.

Figure 19 Fiscal accounts components (percent of GDP)



Source: MoF.

Figure 20 Public debt (percent of GDP)



Source: MoF.

B. OUTLOOK AND MEDIUM-TERM PROSPECTS

1. Medium-term Outlook

The economy is projected to grow by 4.9 percent in FY23/24 (Table 5). Growth is expected to be supported by the service sector, including higher growth in tourism-related services, and the industry sector due to a gradual increase in mining (mineral products) and manufacturing activities (base metals). New incentives for longer-staying international tourists are expected to support tourism in FY23/24, however total arrivals are expected to remain below pre-COVID levels.[5] On the demand side, growth is supported by services exports and consumption, reflecting higher government spending. Medium term growth is expected to be supported by a robust growth in exports, construction, and services sectors. The commissioning of the Puna II hydropower plant will support growth, adding 1,020 MW to the current hydro generation capacity of 2,300 MW.

Inflation is projected to remain elevated in the short term due to extended global supply disruptions resulting from Russia's invasion of Ukraine and tensions in the Middle East. For Bhutan, imported consumer goods and services carry 55 percent weight in the CPI basket, of which food products account for 24 percent. In the medium term, inflation is expected to moderate and be in line with inflation in India, given the Bhutanese Ngultrum's peg to the INR.

The fiscal deficit is expected to increase due to a decline in revenues and a major salary increase to address significant staff attritions. The deficit is projected to increase to 5.0 percent of GDP in FY23/24 from 4.7 percent in FY22/23. Current expenditure is expected to increase due to a major salary hike for public servants between 55 and 74 percent amounting to 2.8 percent of GDP.[6] The salary increases are expected to be partly financed by proceeds from DHI's crypto mining operations. However, total expenditures are expected to remain moderate because of lower capital expenditures in the first year of the 13th FYP given that capital spending is typically lower in the first two years of the FYP. The increase in tax collection from higher royalties from tourism and hydropower will be offset by lower one-off profits from hydropower projects and external grants.

The fiscal deficit is expected to decline beyond FY24/25 driven by fiscal consolidation and an increase in hydropower revenues. Capital expenditure and primary non-wage recurrent expenditure is expected to moderate in the medium-term, reflecting a normalization in spending after the COVID-19 pandemic and the election year in FY23/24. Domestic revenues are expected to reach 24.1 percent of GDP in FY25/26, reflecting higher hydro revenues in the form of one-off profits and royalties from the commissioning of the Puna II hydropower plant. However, increase in hydropower revenues is expected to be partly offset by a decline in overseas development assistance (ODA) following the LDC graduation in 2023.[7] The government has initiated several reforms to improve public spending efficiencies and increase domestic revenue mobilization through improved tax policy and administrative reforms.[8] However, the impact of these reforms on revenues is difficult to estimate and therefore the macroeconomic framework conservatively assumes minimal impact over the medium term.

Debt is expected to remain sustainable. PPG debt is projected to remain elevated as a share of GDP. Hydro debt is expected to decline (as a share of GDP) due to debt repayments, but non-hydro debt is expected to increase in the short term, reflecting the high fiscal deficit, before

[5] In June 2023, the government lowered fees for international tourists that stay longer than four days.

[6] The increase is an attempt to curb the high attrition rate of public servants. Voluntary resignations in the Royal Civil Service increased from an annual average of 441 between FY14/15 and FY20/21 to 1,023 in FY21/22 and 1,985 in the first eight months of FY22/23. Royal Civil Service Commission Annual Reports and https://kuenselonline.com/migration-of-bhutanese/

[7] ODA represents is approximately 30 percent of total grants in Bhutan

[8] Tax reforms include the implementation of the 2022 Property Tax Act, an ongoing review of direct and indirect tax policy, and measures to identify non-tax registrants and reduce compliance costs for taxpayers.

moderating in the medium term.[9] The 2022 joint IMF-World Bank Debt Sustainability Analysis (DSA), the most recent joint DSA, assesses the risks of debt distress to be moderate.[10] Although the significant stock of debt would normally point to a high risk of overall and external debt distress, the risk was assessed to be moderate given unique mitigating factors. First, most of the outstanding PPG debt is linked to hydropower project loans from the GoI, which are implemented under an intergovernmental agreement where the GoI covers financial and construction risks and commits to purchase all surplus electricity at a price reflecting cost plus a margin. Second, the debt dynamics are set to improve over the medium term, driven by a significant increase in electricity exports and a decline in imports associated with hydropower construction.

The CAD is projected to fall sharply as lumpy IT equipment imports fall, and to moderate further in the medium term supported by an increase in tourism and electricity exports. The expected improvement in the CAD in FY23/24 to 15.7 percent of GDP is driven by a lower trade deficit, led by a significant reduction in goods imports. This reflects the decline of lumpy imports of crypto IT equipment, which accounted for 6 percent GDP in 2022 (DHI also imported related goods to expand the electricity network).[11] The CAD is expected to moderate further in the medium term due to an increase in tourism exports from FY24/25, the on-streaming of the Puna II hydropower project in FY25/26, as well as a decline in imports following the completion of the hydropower projects. International reserves are expected to remain at US$516 million in FY23/24 (equivalent to 3.3 months of import coverage).

Table 5. Key macroeconomic Indicators

[9] While hydropower project loans are mostly on-lent to SOEs by the central government, external debt service payments are done by the MoF on behalf of the SOEs (through the national budget). SOEs reimburse the MoF from their revenues from hydropower exports to India.
[10] The next update is scheduled for 2024 as part of the IMF Article IV consultations.
[11] As per RGoB, DHI has used all the RMA loan proceeds and there will be no further imports of IT equipment in FY23/24.

	FY20/21 (act)	FY21/22 (act)	FY22/23 (est)	FY23/24 (proj)	FY24/25 (proj)	FY25/26 (proj)
Real Economy: annual percent change						
Real GDP growth, at constant factor price	(3.3)	4.8	4.6	4.9	5.7	6.0
Agriculture	2.7	0.1	0.4	1.7	1.6	1.7
Industry	(5.9)	4.8	5.6	5.0	9.1	9.6
Services	(1.2)	6.1	5.0	5.8	4.6	4.7
Real GDP growth, at constant market price	(3.3)	4.8	4.6	4.9	5.7	6.0
Private Consumption	0.3	1.5	2.9	2.0	2.1	2.2
Government Consumption	5.4	1.9	(1.2)	0.5	0.9	1.4
Gross Fixed Capital Investment	(3.4)	25.7	13.3	(0.5)	0.4	3.2
Exports, good and services	(10.4)	(3.6)	3.7	7.7	9.3	9.7
Imports, goods and services	(0.5)	13.2	8.9	(4.0)	(3.9)	(1.0)
GDP deflator	6.7	6.7	5.2	5.3	5.5	4.4
CPI inflation (year-average)	8.2	5.3	4.6	4.9	4.1	4.0
Fiscal Account: percent of GDP						
Overall balance 1/	(5.8)	(7.0)	(4.1)	(5.0)	(3.5)	(2.2)
Primary balance	(4.8)	(5.6)	(2.4)	(3.8)	(2.0)	(0.3)
Total PPG debt 2/	123.3	118.8	116.5	110.9	103.4	112.0
External PPG debt	114.4	105.8	102.7	95.3	87.5	95.9
Hydropower	84.0	75.4	70.9	64.9	57.4	66.9
Non-hydropower	30.5	30.5	31.8	30.4	30.1	29.0
o/w Central bank						
Domestic PPG debt	8.8	13.0	13.8	15.6	15.9	16.1
Balance of Payments: percent of GDP						
Current account balance	(11.1)	(28.1)	(34.3)	(15.7)	(9.7)	(9.6)
Trade balance (goods and services)	(10.9)	(27.7)	(43.5)	(23.0)	(15.0)	(14.2)
Goods exports	27.5	26.8	23.5	30.1	30.5	23.4
Hydropower	14.6	11.3	9.2	9.8	8.2	10.2
Non-hydropower	12.8	15.4	14.3	20.3	22.3	13.2
Goods imports	33.9	47.9	49.1	38.5	33.2	27.6
Gross international reserves (USD millions) 3/	1318	824	579	516	544	525
Gross international reserves (months of goods and services imports)	15.6	6.5	3.3	3.3	3.6	3.5
Gross international reserves (months of prospective goods and services imports)	9.9	4.6	3.8	3.3	3.6	3.5

1/ Includes an estimated amount for FY21/22 and FY22/23 for temporary income support provided to individuals and loan interest payment support to borrowers (DGRK) financed by the NRF.
2/ PPG debt, including central government debt, central government loans that are on-lent to SEs, SE debt (direct debt contracted by SEs, not routing trough the budget) and Central Bank debt (loan/credit facilities for BOP support purposes).
3/ The RMA revised gross international reserves retrospectively in July 2022, which resulted in lower international reserves from September 2020 to December 2021. With the revision, international reserves stood at US$970 million in December 2021, compared to US$1.4 billion in the old series.
Source: MoF, WB staff estimates

2. Risks, Challenges, and Opportunities

Downside risks to the economy persist. Domestic risks include delays in hydropower projects, which could affect fiscal and external balances. Delayed fiscal consolidation and the materialization of financial sector contingent liabilities could further erode buffers. External risks include rising and volatile commodity prices due to geopolitical tensions, which could exert further pressure on the external balance and international reserves. Lower than expected returns from crypto operations and continued immigration of the educated workforce could also weigh on the economy in the medium term.

It would be important to ensure macro-fiscal sustainability in the medium to long term. Although macro-fiscal sustainability has been maintained over the past two decades, supported by large hydro revenues and external grants, spending to fund the COVID-19 relief measures for individuals and businesses coupled with subdued revenue performance have resulted in high fiscal deficits and non-hydro public debt since FY20/21, with limited fiscal space to absorb additional shocks. Vulnerabilities in the financial sector with high levels of non-performing loan (NPL) have increased fiscal risks, given that about 60 percent of assets of the financial sector are controlled by the public sector. The government has outlined ambitious reforms to support economic diversification and green and inclusive development, including through the upcoming Thirteen FYP. However, limited fiscal space and high debt levels limit the government's ability to support the economic recovery during global economic uncertainties. Based on a World Bank analysis, absence of fiscal consolidation and delayed implementation of the hydropower projects could make the macro situation unsustainable in the medium to long term. In this context, it is important to accelerate reforms to enhance domestic resource mobilization and improve spending efficiency to restore fiscal space and sustain public debt.

Supporting economic diversification, higher agriculture productivity, and better access to finance will help promote economic growth and mitigate macroeconomic risks.[12] The heavy dependence of the Bhutan economy and government revenues on the hydropower sector raised concerns of a Dutch Diseases effect, resulting in a loss of competitiveness in non-hydro sectors. Proper management of hydropower revenues in stimulating economic diversification ameliorates such adverse effects. Besides that, agriculture sector is the biggest employer in Bhutan, but its productivity growth has been lacking behind peer countries. Policies to encourage higher value-added in the agriculture sector will not only stimulate economic growth but improve the living standards of the agricultural households in the country. Lastly, access to finance in Bhutan has been traditionally limited to large corporations with collaterals. Improving access to finance for the private sector, especially the smaller businesses have the potential to support the growth of private businesses and employment opportunities among them.

Bhutan's long term economic prospect will depend on effective implementation of its plans. The government's strategic support of the hydropower sector involves large fixed-capital investments over a long-term horizon. The government has also placed big bets on several national initiatives, such as the investment in cryptocurrency mining to accelerate the country's digital transformation and generate additional revenues, and the government's plan to establish a Mindfulness City in Gelephu near the southern border with India. These transformative projects can potentially bring considerable rewards, but the risks can also be high given large financing requirements that could affect Bhutan's macroeconomic fundamentals and therefore must be carefully weighed alongside the rewards.

Bhutan also needs to address its labor market challenges to foster sustainable growth. The lack of economic diversification, promotion of private sector activity and limited capacity of the labor market to absorb the Bhutanese youth, poses risks to the long-term sustainability of growth and

[12] This and following paragraph drawn from the forthcoming Bhutan Country Economic Memorandum (CEM) by the World Bank

job creation. GDP growth has been largely driven by the publicly led hydropower sector while structural transformation has been slow. The capital-intensive nature of the hydropower sector limited employment opportunities—the sector employed less than 1 percent of the labor force. Private sector development remains limited, and Bhutan suffers from weak productivity gains. The special section of this BDU will discuss the most pressing labor market challenges in Bhutan and ways to mitigate them. The Special Section further discuss Bhutan's labor market and job creation challenges.

C. SPECIAL SECTION: Labor Market and Jobs in Bhutan

The Royal Government of Bhutan (RGoB) has committed to advancing reforms, which focuses on creating gainful employment and enhancing private sector diversification. However, recent shocks from the COVID-19 pandemic and global macroeconomic volatilities disrupted these efforts. The recovery could be further complicated by the country's pressing structural challenges related to a lack of economic diversification away from the hydropower- led growth model, vulnerabilities to shocks, and weak productivity gains. Under this context, this special focus section examines the labor market in Bhutan with the objective of identifying the most pressing challenges. This section is a brief summary of key findings of the 2024 Bhutan Labor Market Assessment Report by the World Bank[13] that analyzes data from three sources: (1) the Bhutan Labor Force Survey (BLFS), 2013–22; (2) the 2022 Bhutan Establishment Survey; and (3) administrative program–level data from the Ministry of Education and Skills Development (MoESD) and the Ministry of Industry, Commerce, and Employment (MoICE).

Insights into Bhutan's Labor Market: Profile and Key Challenges

Bhutan's labor remains predominantly employed in the low productivity sectors. Workers face many challenges, including limited inclusion of women in meaningful employment and persistence of low-productivity agricultural employment. Employment quality outside of the public sector remains weak, leading to public sector queuing, rising unemployment among urban workers, and a record number of Bhutanese migrating abroad.

Limited productivity gains have hindered structural transformation, and labor remains predominantly employed in the low productivity agricultural and public sectors. The share of agriculture in GDP has significantly declined over the past two decades, dropping from 25 percent of GDP in 2000 to 12 percent in 2021, the share of services has increased from 37 to 50 percent. The contribution of the non-hydro industry sector, excluding electricity, has remained relatively stable at about 25 percent before the COVID-19 pandemic (Figure 21). Despite the decreasing share of agriculture in value added, the labor force continues to be largely confined to

[13] For the publication, please refer to Alaref, Jumana; Martinoty, Laurine; Viollaz, Mariana; Bartl, Esther; Leite, Phillippe; Etang Ndip, Alvin. 2024. Bhutan Labor Market Assessment Report. Washington, DC: World Bank. Available at: https://openknowledge.worldbank.org/entities/publication/4250ebf8-df88-4f3b-9cc6-fc4535551671

the agricultural sector. In 2022, the labor market was mostly dominated by low-productivity agricultural employment (40 percent), followed by the public sector (25 percent, including education and health). Although more productive sectors like electricity, transport and communication, financial intermediation, and mining, have seen an increase in their share of total employment between 2013 and 2022, they still have a relatively small presence in terms of employment (Figure 22). Sectors like construction have grown in size but have lower productivity levels compared to smaller and slowly growing sectors.

Figure 21 Sector shares in GDP, constant 2000 prices, 1980-2021

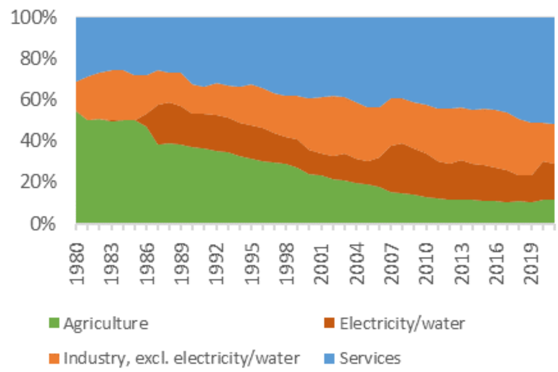
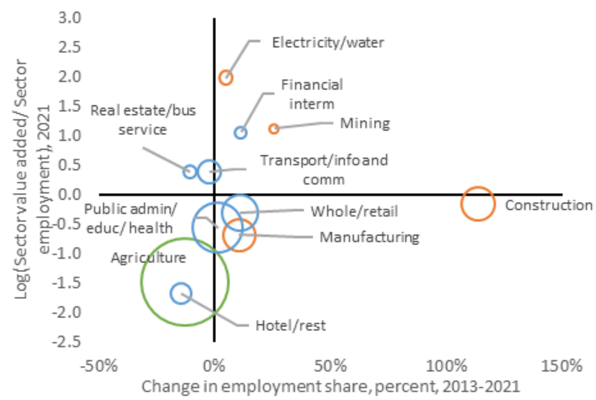


Figure 22 Change in sectoral productivity and employment shares, 2013-2021



Source for Figure 1: NSB and staff calculations. *Source for Figure 2*: Alaref et al. (2024). Note: The circle size in the right hand graph reflects sector employment in 2013. Productivity is measured as the sector-level value added per worker in 2022.Data is based on 2022 National Accounts Statistics (NAS) and 2013-2021 LFS.

Employment quality remained weak. An assessment of job quality through the lens of hours worked finds that overwork (working more than 48 hours a week) is prevalent and affects 63 percent of the workforce. Overwork is concentrated in certain economic sectors where vulnerable types of employment (such as self-employed and family workers) tend to dominate. These sectors include construction, wholesale and retail trade, transportation, and accommodation and food services. A look at employment quality through the lens of the benefits attached to a job reveals that one out of three salaried employees have no written contract from their employer, accounting for over 11 percent of workers in Bhutan (and 23 percent of workers in urban areas). Manufacturing, construction, wholesale and retail trade, and accommodation and food services (where overwork is more prevalent) account for 55 percent of nonwritten contracts.

There is limited inclusion of women in meaningful employment. Young women (ages 15–24) invest less in higher education than men, and they have a 1.5 times higher risk of being not in education, employment, or training (NEET), notably to fulfill household responsibilities. The labor force participation of women of prime working age is strongly correlated with their marital status, the presence of young children, as well as labor force participation of other women in their family and community. They tend to work in low-productivity sectors such as agriculture, manufacturing, and services or as self-employed or family workers, and they have limited access to private employment or public sector jobs. Although women's labor force participation increased substantially during the pandemic, it fell in 2022 back to its pre-pandemic levels at 53 percent, which could be indicative of a discouragement effect.

With limited opportunities outside the public sector, unemployment and emigration rose among the educated workforces. Public sector employment grew to absorb educated and urban workers, comprising 25 percent of total employment. Men and high-skilled workers in urban areas dominate public sector employment, while female, low-skilled, and rural workers are more likely to remain employed in agriculture as self-employed or family workers, with limited options for upward mobility. Although there is no evidence that the unemployed have unrealistic wage expectations, the majority prefer public sector jobs over private sector ones. In response to the limited attractive options for the fast-growing cohorts of educated workers outside of the public sector, the rise of unemployment in urban areas that began in 2019 continued in 2022. In addition, a large number of Bhutanese workers have migrated since 2022 or have plans to migrate. The average number of those migrating increased significantly to more than 5,000 a month in early 2023, compared with less than 500, on average, one month prior to the pandemic. One out of 10 not in education, employment, or training (NEET) individuals plans to migrate abroad.

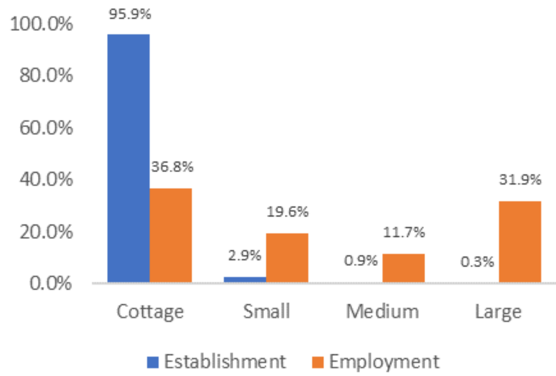
Since 2013, the size of the working-age population has fallen, but the demographic dividend has remained the same. Although the size of the working-age population has been decreasing since 2013, the demographic dividend—that is, the share of the working-age population relative to younger or older dependents—remained stable over the years. Over the years, the skill level of working-age men and women has increased rapidly, faster in urban areas than in rural areas. However, women, youth, and educated workers have employment rates below the national average, highlighting a high degree of underutilization of their human capital in the labor market.

Insights into Firms and Anticipated Labor Needs

The private sector in Bhutan faces the twin challenges of accelerating job creation in productive sectors that can absorb the increasingly educated workforce, while also improving the allocation of labor to fill existing vacancies in low and semi-skilled positions.

The private sector in Bhutan is largely comprised of low-productivity microenterprises, lacking dynamism, diversification, and productive job opportunities. In 2022, only 2.7 percent of firms were new, indicating a lack of entrepreneurial activity and over 95 percent of firms employed less than five people (Figure 23). These very small firms tend to remain small, likely due to restrictions on growth, and inefficient firms are not exiting the market. Between 2018 and 2022, firms became older and smaller, with the share of long-established firms increasing from 24 percent to 26 percent, and the share of cottage firms rising from 89 percent to 96 percent. Furthermore, most firms (nearly 97 percent) are owned as individual proprietorships. In terms of employment, the average number of workers hired by firms decreased from 1.1 in 2019 to 0.7 in 2020 and 2021, indicating a decline in job opportunities within the private sector. Additionally, there is a lack of diversification in terms of economic activity, with the wholesale and retail trade, and accommodation and food services sectors accounting for nearly 80 percent of firms. These sectors typically have low labor productivity and employ low-skilled workers.

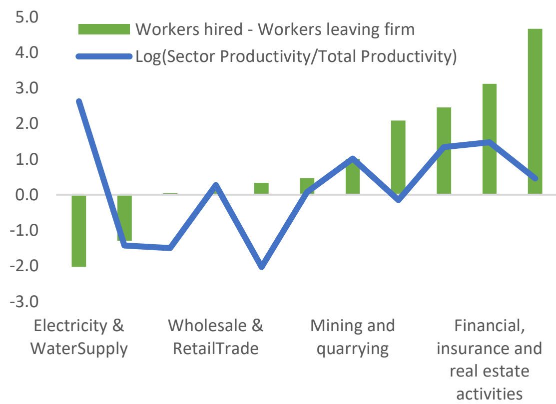
Figure 23 Establishment size and employment share, 2022



Source: Alaref et al. (2024), based on 2022 ES.
Note: Cottage firms have fewer than five employees; small firms between five and 19 employees; medium firms between
20 and 99 employees; and large firms 100 employees or more.

Job creation is prevalent in the more productive sectors, which tend to hire more skilled workers. In 2021, the relatively more productive sectors hired more workers, while the least productive ones hired fewer (Figure 24). A comparison of net job creation rates by economic sector and sectoral labor productivity in 2021—measured as GDP per worker—reveals that some of the sectors with the highest job creation rates in 2021 were also among the most productive: financial, insurance, and real estate activities; transportation, storage, and communications; and mining and quarrying. On the other hand, the three sectors with low net job creation rates exhibited lower levels of labor productivity: agriculture, forestry, and fishing; hotels and restaurants; and wholesale and retail trade. The two exceptions were the electricity and water supply sector, which exhibited a negative job creation rate in 2021 despite its above-average labor productivity, and the construction sector, which created the most jobs despite its lower productivity when compared with the other sectors, such as transportation, storage, and communication, and mining and quarrying. Over a longer period, from 2013 to 2021 (Figure 2), the share of more productive sectors in total employment has increased, while less productive sectors have declined.

Figure 24 Labor productivity and net job creation rate in 2021

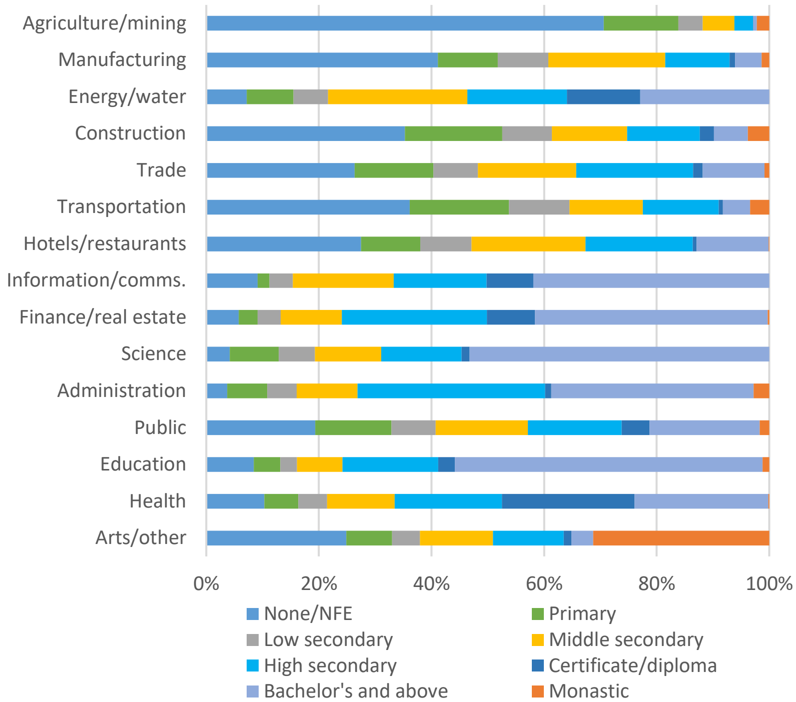


Source: Alaref et al. (2024), based on 2022 ES and 2022 NAS.

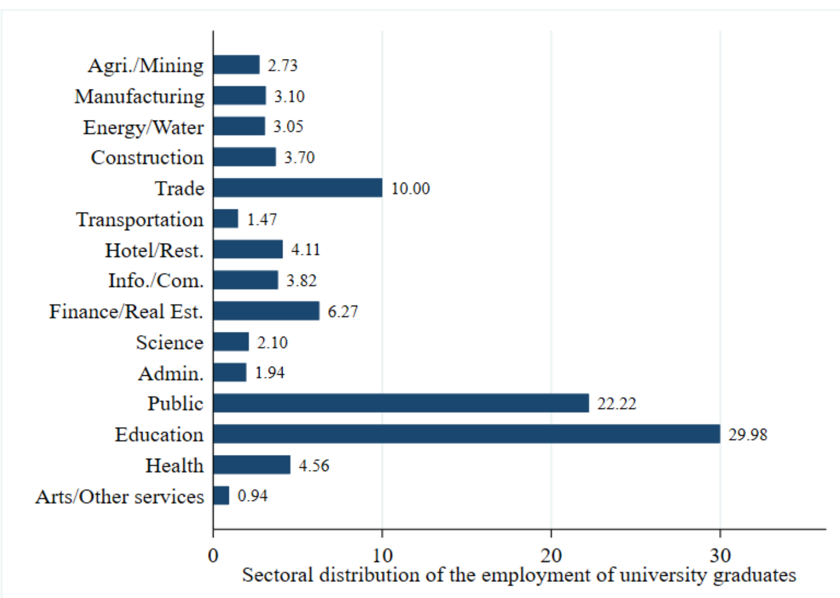
Yet, these sectors remain very small and are unlikely to absorb the rising number of high-skilled workers on their own. Compared with the historically large sectors, small but faster-growing sectors hire workers with very different education levels, and many of them hire a substantial share of workers with a tertiary diploma (Figure 25, panel a). In 2022, the main providers of high-skilled jobs for university graduates were the education and public administration and defense sectors, which is in line with earlier finding that the public sector remains the main employer (Figure 25, panel b). More than one in 10 university graduates worked in a small job-creating sector: 6 percent in financial, insurance, and real estate activities; 4 percent in information and communication; and 2 percent in professional, scientific, and technical services. However, these sectors remain small and unable to absorb the increasing supply of high-skilled jobseekers. Financial, insurance, and real estate sectors made up 0.2 percent of firms and 2 percent of employment in 2022, and the information and communication sector made up 0.5 percent of firms and 1 percent of employment. Current trends in education and labor demand prospects suggest that the oversupply of high-skilled jobseekers (and the high unemployment in this group) is likely to grow over time and will require the appropriate policies to improve productivity and job creation in high value-added industries in the private sector.

Figure 25 Education and sectoral employment, 2022

(a) Share of each education level by sector



(b) Share of each sector in employment of high skilled



Source: Alaref et al. (2024) based on 2022 LFS.

Higher-order skills related to the use of digital technologies are rarely utilized by firms. In 2022, 89 percent of firms reported using e-payment. As for other digital technologies, the percentage of firms that use them is low, ranging from 19 percent for social media to 0.6 percent for outsourced data centers. When disaggregated by economic sector, the data reveal that the use of e-payment is high in all of them. Firm websites are used widely in the education sector (55 percent of firms) and financial services (44 percent). These two sectors stand out as those with the highest usage of social media (89 percent of firms in the education sector and 91 percent in financial services). Over 50 percent of firms in the construction, education, mining, and financial services sectors use accounting systems.

Future vacancies in the private sector will be concentrated mostly in occupation categories requiring low to medium levels of education and some specific technical skills. About one-third (29 percent) of firms expect to have new vacancies in the next one or two years, mainly in services and sales (Table 6). The distribution of new vacancies by occupation indicates that these firms will mainly need personal services workers and sales workers, in addition to some workers with some specific technical skills.[14] When looking at the education level that firms expect to demand in the future, mid-level education stands out. The expected labor demand for workers with a primary or secondary level of education is 42 percent of the total. The expected demand for workers with no education is also high, reaching 27 percent of the total. The remaining share is certificate level (17 percent), diploma (5 percent), bachelor's degree (8 percent), and master's degree and above (0.6 percent).

Table 6 Distribution of expected vacancies for the next one or two years by occupation

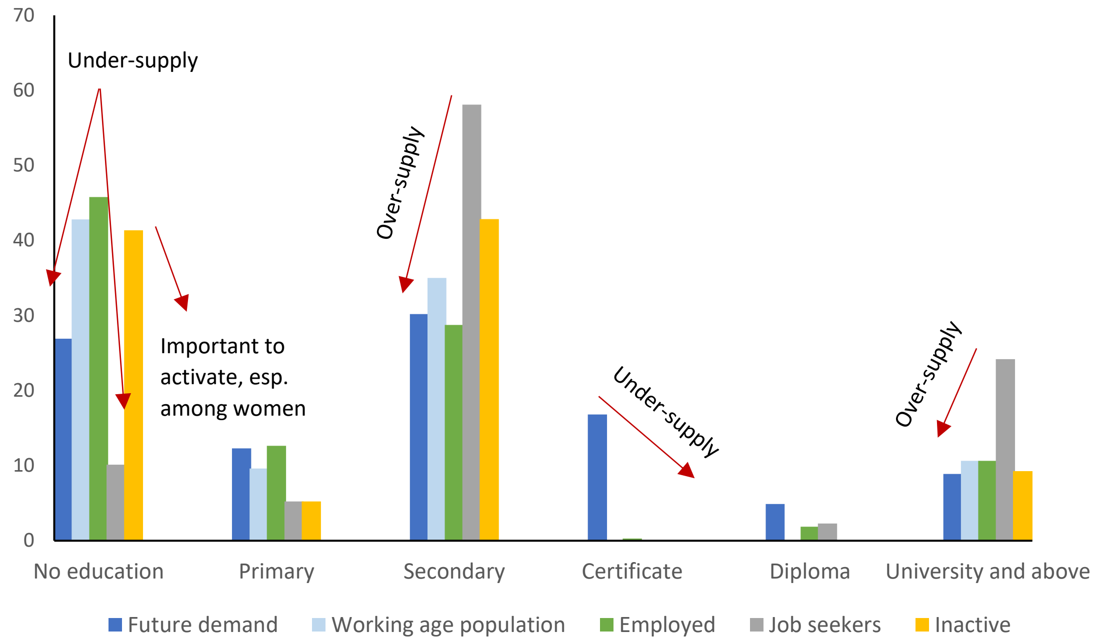
[14] These include building and related trades workers; food preparation assistants; laborers in mining, construction, manufacturing, and transportation; and food processing, woodworking, garment, and other craft and related trades workers.

Managers	Chief Executives, Senior Officials and Legislators	1.6
	Administrative and Commercial Managers	1.3
	Production and Specialized Services Managers	0.3
	Hospitality, Retail and Other Services Managers	0.4
Professionals	Science and Engineering Professionals	1.6
	Health Professionals	0.2
	Teaching Professionals	0.9
	Business and Administration Professionals	2.3
	Information and Communications Technology Professionals	0.4
	Legal, Social and Cultural Professionals	1.1
Technicians and Associate Professionals	Science and Engineering Associate Professionals	2.1
	Health Associate Professionals	0.3
	Business and Administration Associate Professionals	0.7
	Legal, Social, Cultural and Related Associate Professionals	3.2
	Information and Communications Technicians	0.6
Clerical Support Workers	General and Keyboard Clerks	1.0
	Customer Services Clerks	1.1
	Numerical and Material Recording Clerks	4.0
	Other Clerical Support Workers	0.0
Services and Sales Workers	Personal Service Workers	23.3
	Sales Workers	20.3
	Personal Care Workers	0.0
	Protective Services Workers	0.3
Forestry Workers	Market-oriented Skilled Agricultural Workers	0.6
Craft and Related Trades Workers	Building and Related Trades Workers (excluding Electricians)	6.9
	Metal, Machinery and Related Trades Workers	3.1
	Handicraft and Printing Workers	0.9
	Electrical and Electronics Trades Workers	2.3
	Food Processing, Woodworking, Garment and Other Craft and Related Trades Workers	4.5
Plant and Machine Operators and Assemblers	Stationary Plant and Machine Operators	1.0
	Assemblers	0.1
	Drivers and Mobile Plant Operators	2.9
Elementary Occupations	Cleaners and Helpers	0.4
	Agricultural, Forestry and Fishery Labourers	0.3
	Labourers in Mining, Construction, Manufacturing and Transport	4.6
	Food Preparation Assistants	5.0
	Refuse Workers and Other Elementary Workers	0.4

Source: Alaref et al. (2024) based on 2022 ES.

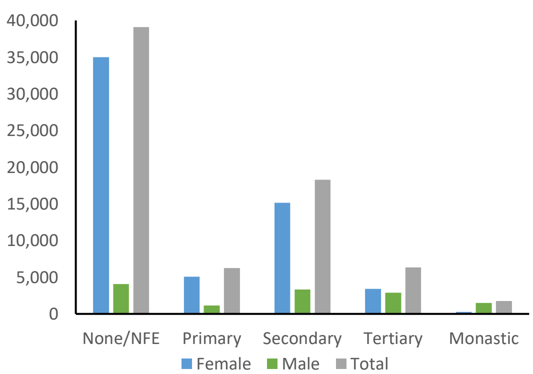
This demand will not match the profile of the current job-seekers. A comparison of the distribution of the expected labor demand by education and the distribution of current job-seekers points to a potential mismatch between labor demand and supply. Figure 26 reveals a shortage of job-seekers with low levels of education and with some specific technical skills (gained through certificates or diplomas) to fill positions mainly in services and sales and craft and related trades. This finding can be attributed in part to the high share of the working-age population with low education levels who remain outside the labor force, especially women (Figure 27). This finding points to the need to improve Bhutan's activation policies to increase the attractiveness and accessibility of the available low-skilled positions, targeting the unemployed and the inactive, especially women in urban areas. Figure 26 displays graphically the oversupply of secondary- and tertiary-educated job-seekers able to fill the current and expected labor demand for workers who fall outside of these education categories.

Figure 26 Comparison between expected labor demand and the current labor force and inactive population, by education



Source: Alaref et al. (2024) based on 2022 Establishment Survey and the 2022 Bhutan Labor Force Survey.

Figure 27 Number of inactive (ages 25-64), by education



Source: Alaref et al. (2024) based on the 2022 Bhutan Labor Force Survey.

Firms do not employ a high share of foreign workers to fill in labor shortages. Given the observed skill mismatches in the labor market, approximately one-third of firms in Bhutan faced hiring difficulties in
2022. Although worker shortages in the domestic labor market could lead firms to hire low-skilled foreign workers from neighboring countries, only a few firms in Bhutan hire foreign workers, and the percentage of firms doing so has declined substantially over time. According to the 2022 ES, 7 percent of firms hired at least one foreign worker in 2022, a lower share than in 2017 when 9 percent hired workers from abroad, according to the Economic Census. The percentage of foreign workers in all firms is 3 percent, but this share rises to 42 percent when conditioning on firms hiring at least one. Craft and related trades have a higher presence of foreign workers—47

percent (Figure 28). Most foreign workers in this occupation category are from India and work in the construction sector. Other than the lack of skilled domestic workers (as reported by 31 percent of firms), the main reasons by firms to hire foreign workers include better workmanship (20 percent) and better work attitudes (19 percent).

Figure 28 Distribution of foreign workers by occupation

Source: Alaref et al. (2024), based on 2022 ES.

Labor shortages and hiring difficulties negatively affect firm performance. Sixty percent of firms indicated that worker shortages have a strong impact on the workload of the existing staff; 47 percent found that they have a high impact on the loss of productivity; and 40 percent pointed to their impact on the loss of profits or sales (Table 7). Worker shortages also have a high impact on a firm's ability to grow and diversify (40 percent of firms) and can lead to loss of markets (38 percent), lower-quality output (29 percent), and firm closure (25 percent). Retaining workers is less of a problem for firms than hiring.

Table 7 Impact of worker shortages on firm performance

	High impact	Moderate impact	Low impact
Loss of productivity	45.7	44.4	9.9
Loss of markets	37.8	50.6	11.6
Inability to grow and diversify establishment	39.1	49.4	11.4
Higher workload for existing staff	60.5	33.0	6.5
Establishment closure/shutting down	24.7	32.8	42.5
Lower quality output	28.6	44.4	27.1
Decrease in profit/revenue	40.3	43.8	16.0

Source: Alaref et al. (2024), based on 2022 ES.

The private sector does not have links to training institutes to address labor shortages. The majority of firms do not have links to public providers of training, which highlights the disconnect between training programs and labor demand in Bhutan. Between 79 and 91 percent of firms indicated they do not have any connections with public or private colleges in the country, public technical or vocational institutions, private training institutes, government entities, private sector associations, or external training and education institutes (Table 8). This lack of linkages could explain the high percentages of firms planning to provide in-house training (40 percent) or planning to resort to on-the-job learning (56 percent). Fifty-seven percent of firms have provided in-house training in the past—a surprising finding given the myriad of technical and vocational education and training (TVET) programs available and administered by the Ministry of Education and Skills Development. Firms also understand the value of training because past training has successfully improved workers' abilities and skills.

Table 8 Level of connection with potential partners for providing training

	Public or private colleges in the country	Public technical or vocational institutes	Private training institutes	Government sector body	Private sector association/Body	External training and education institutes
No linkage at all	91.2	91.2	91.2	79.4	86.3	90.3
Poor linkage	2.1	2.0	2.7	8.0	4.0	2.7
Moderate linkage	1.8	1.5	1.6	7.7	4.2	2.0
Strong linkage	0.7	0.9	0.5	2.5	1.5	0.8
Not relevant	3.6	3.7	3.5	2.0	3.5	3.7
Plan to establish linkage in the future	0.5	0.8	0.6	0.4	0.5	0.5

Source: Alaref et al. (2024), based on 2022 ES.

Notes: Percentage of firms answering Yes to each type of training.

Training needs from employees' perspectives match those reported by firms (Table 9), yet the number of workers trained has declined over time. In 2022, 72 percent of workers indicated that short-term training was critical for their current occupation, and 69 percent of firms said they had training needs at this level. Seventeen percent of workers reported that the level of training needed for their occupation was a diploma, bachelor's, master's, or PhD degree; 9 percent reported in-house training; and 2 percent reported online training. The number of workers trained has declined over time, likely because of funding constraints. The average number of workers trained in 2019 was 9.1, but that number declined to 8.9 in 2020 and to 5.6 in 2021.

Table 9 Training critical for the current occupation and funding plans according to employees

Level	
Master's/PhD	3.8
Diploma	10.8
Short-term training	71.9
Online learning	2.1
In-house training	9.0
Bachelor's	2.3
Plan to fund	
Self	8.1
My organization	40.2
Office project	1.4
Donor scholarship	13.8
No funding	36.5

Source: Alaref et al. (2024), based on 2022 ES.

Policies and regulations related to the business climate are considered a major constraint to business management and growth than labor-related regulations. Among business climate factors, access to markets, finance, and raw materials or goods were considered to be major or very severe constraints to business management (Table 10). According to the 2017 Investment Climate Assessment, fewer Bhutanese firms had a loan or a line of credit in 2015 (47 percent) than in 2009 (59 percent). The decline likely stemmed from lack of credit information and from a complex, unpredictable, and ineffective restructuring and insolvency regime, despite the fact that the government had reduced the amount of collateral required for a loan.

Table 10 Constraints in the management of firms

	No constraint	Minor constraint	Moderate constraint	Major constraint	Very severe constraint
Business Climate Factors					
Internet access and connectivity	7.8	12.1	10.8	11.6	11.7
Customs and Trade Regulations	9.0	10.5	8.6	7.5	7.1
Business Licensing and Operations Permits	10.0	8.3	6.4	4.8	10.5
Access to Finance	8.0	10.6	10.7	14.9	10.3
Access to Raw materials/goods	7.4	12.0	11.8	15.1	12.6
Access to Market	6.1	12.2	17.4	19.2	18.7
Policy Uncertainty	9.0	9.6	9.4	7.4	11.3
Corruption, crime, theft and disorder	11.4	5.6	3.3	3.4	2.8
Labour Factors					
Stringent labour law and regulation	10.9	5.8	6.4	3.3	4.9
High workers turnover	10.9	5.3	4.9	7.3	5.1
Overall market wage level	9.6	8.0	10.3	5.5	4.9

Source: Alaref et al. (2024), based on 2022 ES.

The severity of these factors varies by firm size. Disaggregation by firm size shows that in 2022 labor-related regulations were a bigger constraint for larger firms because they are more likely than cottage firms to comply with them. On the contrary, investment climate factors, including access to finance, markets, and raw materials were more binding for smaller firms. The overall findings on the investment climate and labor-related regulations are in line with the existing literature on barriers to doing business in Bhutan. Firms in Bhutan are burdened with administrative hurdles, including unclear and multiple licensing procedures and lack of information on licensing requirements. Also, private sector activity may be hampered by competition policy that encourages the dominance of SoEs in key economic sectors and may be crowding out private sector investment.

Employment Support Program and Delivery System

Bhutan's employment support programs and delivery systems face gaps in addressing some of the challenges related to the activation of women, limited job-relevant skills, and the difficulties firms face in accessing trained labor.

There is a strong case for targeted employment support programs that improve the skills of vulnerable groups and support both workers and firms in Bhutan. Employment support programs are needed to help reduce the extensive skill mismatches in the labor market discussed earlier. As of 2019, 0.1 percent of the country's gross domestic product (GDP) was spent on skills development and training, with only Singapore spending more, 0.3 percent. Although Bhutan has improved its employment programs and policies over the last few years, significant gaps remain. Bhutan's employment support programs and delivery system consist mainly of Active Labor Market Programs (ALMPs), technical and vocational education and training (TVET) courses, Employment Services Centers (ESCs), and a Labor Market Information system (LMIS).

- ALMPs in Bhutan are small, fragmented, and not specifically focused on the activation of women. ALMPs primarily serve vulnerable youth, offering labor market training to enhance skills, but lack comprehensive coverage and gender sensitivity. Programs like Youth Employment Livelihood Program (YELP), Skills Development Flagship Program, and others focus on employability, with YELP being the largest and only one offering wage subsidies. However, these programs have limited regional reach, small participant numbers, and no clear plans for scaling up. They also fail to establish strong links with employers, lack demand-driven training, and do not provide soft skills training, which diminishes their effectiveness in the labor market. Additionally, there is a lack of rigorous evaluation, data transparency, and systematic tracking of graduates' outcomes, which hinders the assessment of their impact and relevance. Efforts to improve data collection are underway, but the fragmentation and lack of coordination across different ministries' ALMPs further limit their overall impact.
- The public TVET system is well established, but it remains too small to meet labor demand and is not sufficiently linked to employers. Bhutan's TVET system supports ALMPs by offering vocational training to young job-seekers, with improved quality and student satisfaction in recent years. The system has enabled occupational mobility, particularly for those from agricultural and uneducated family backgrounds. However, despite these improvements, the number of TVET graduates remains low and does not meet private sector demands, with a decline in graduates and a gender imbalance emerging. The TVET system lacks demand-driven programs and strong employer links, resulting in high unemployment rates among graduates and a mismatch between the skills provided and future job market needs. Geographical distance from employment opportunities and a concentration of private training providers in Thimphu also limit the system's inclusiveness and its ability to address rural unemployment.
- ESCs are not empowered enough to play a pivotal role in job placement and matching. There has been an 18 percent increase in job-seeker visits year over year. Despite this, ESCs face challenges due to a lack of trained, dedicated staff, with only Thimphu's ESC having permanent staff and others relying on interns, leading to limited service provision. Data on ESC operations and effectiveness is insufficient, as there is no systematic collection or monitoring and evaluation system in place. Furthermore, most ESCs are situated in government buildings with inadequate resources and are subject to formal dress codes and restricted hours, which hampers their ability to provide comprehensive services such as counseling.
- Bhutan has a new LMIS, but it is still in its early stages and needs further development. An LMIS aims to provide stakeholders with updated and easily accessible labor market

information to make informed career and training decisions. Although the LMIS is in the early stages and managed by the Data Science Project under the Royal Office for Media, there are uncertainties regarding data sharing with ministries and whether new data collection is mandated. Current gaps include the absence of earnings data and unclear data sources and methodologies, which may confuse the general audience. Future integration with the Bhutan Labor Market Information System (BLMIS) job matching and training portal could enhance the system's utility for students, employers, and job-seekers.

Addressing Bhutan's labor market challenges requires pursuing vertical growth policies that are sector-specific to support private sector development and job creation. In parallel, horizontal reforms that improve the business environment, strengthen human capital accumulation, and increase the effectiveness of employment support programs are needed. Table 11 below summarizes the policy directions suggested to address Bhutan's the labor market challenges.

Table 11 Policy directions to address challenges in the labor market

Challenge	Underlying constraint	Suggested policy direction
Limited productivity and job creation in the private sector, which partly explain the speed and scale of recent outmigration	Bhutan's hydropower-led growth model has had negative implications for the development of productive sectors outside of agriculture and the public sector.	Pursue a vertical approach to promoting the growth of promising job-rich sectors. At the same time, implement horizontal reforms across all sectors to improve the productivity of small firms and support their growth. These reforms include (1) strengthening entrepreneurship by facilitating access to finance, mentorship, and links to supply chains and markets; (2) governance reforms related to the investment climate, foreign direct investment, and the efficiency of state-owned enterprises; and (3) labor market reforms to promote flexible labor regulations that can support worker mobility and firms' access to labor, as well as a functional labor market information system (LMIS) that can regularly identify skills in the labor market and support hiring needs for start-ups.
Limited human capital accumulation	The productivity of Bhutan's workforce is undermined by low levels of human capital that stem in part from unequal and inadequate access to quality foundational human capital services, especially for disadvantaged families in rural areas.	Targeted government resources are needed to ramp up investments in early childhood education, nutrition, and development. Low-income young mothers benefiting from employment support could be linked to other human capital programs to strengthen maternal and infant health.

Limited human capital utilization	The productivity of agri-cultural workers is low. In urban areas, there is a suboptimal allocation of labor to meet employers' hiring needs.	In rural areas, the provision of coordinated economic inclusion services could support improvements in agricultural productivity. In urban areas, the following efforts are needed to strengthen employment support programs: (1) reorient the technical and vocational education and training sector to improve the links with the private sector; (2) allocate the appropriate resources to improve the capacity of employment services centers to establish relationships with local employers, engage in vacancy collection, and provide services such as on-the- job assistance, counseling, and mobility support for low-skilled workers; (3) implement programs to bridge the gap between labor supply and demand, such as on-the-job training; and (4) enhance the capacity of the existing LMIS to reduce data gaps and better understand the profiles of workers and how they align with the skills and occupations demanded by the private sector, thereby reducing skill mismatches.

Source: Alaref et al. (2024)