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Bhutan in 2018: Economic and Geopolitical Adjustments for Long Term Prosperity¹

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Bhutan will continue to face economic difficulties in 2018. This is largely due to the impact of economic reforms in India such as the implementation of the Goods and Services Tax. However, the large scale hydroelectric power projects in Bhutan will strengthen its ongoing economic integration with India. On the foreign policy front, there will be issues, from time to time, between India and China. Bhutan will, therefore, need to perform a balancing act between its two large neighbours to ensure that its own foreign policy priorities are not compromised. That would be a tough act!

¹ The Institute of South Asian Studies (ISAS) at the National University of Singapore (NUS) has undertaken a prognosis of the eight South Asian countries in 2018. This is both opportune and relevant, given significant developments in the region. Although it requires some crystal ball-gazing, such prognosis is important in providing an understanding of the outlook for each country. This paper is part of a series of nine papers on key development in the eight South Asian countries, namely, Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka, this year.

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Bhutan's Economy

In 2017, Bhutan's real gross domestic growth (GDP) growth rate was 5.9 per cent. According to projections by the International Monetary Fund, its real GDP is expected to grow by 11.2 per cent in 2018.³ Bhutan's major trading partner is India, and overwhelmingly so. In 2015, India's share in the total trade of Bhutan was 80.50 per cent. This increased to 82.91 per cent in 2016 and the trend is expected to continue.⁴ India is worried about increasing Chinese foray into its neighbourhood, and it is trying to hold on to and consolidate its primary position in its economic partnership with Bhutan.⁵ Bangladesh is Bhutan's second biggest trading partner at 4.13 per cent in Bhutan's total foreign trade. It is also increasing its economic interactions with Bhutan, marked by the visit of Bangladesh's Prime Minister, Sheikh Hasina, to Bhutan in April 2017.

Bhutan will be negotiating a major transit agreement, which will facilitate its connectivity to its second largest market, Bangladesh. It will also increase the connectivity among India Bhutan and Bangladesh. The first Joint Working Group on Transit Agreement and its related protocol between the Bhutanese and Bangladesh government was held in Dhaka, Bangladesh, on 30 November 2017. The agreement, once finalised, will enable Bhutan to use Mongla and Chittagong port for international trade.⁶

According to the latest Ease of Doing Business Ranking in 2017, Bhutan is the most business-friendly country in South Asia, at the 75th position in the ranking. This is despite the fact that, due to concerns in protecting its environment and traditions, Bhutan carefully considers individual projects based on their impact on its tradition and culture.

³ World Economic Outlook, October 2017, <https://www.imf.org/en/Publications/WEO/Issues/2017/09/19/world-economic-outlook-october-2017>, Accessed on 5 January 2018.

⁴ Ministry of Economic Affairs, Bhutan, <http://www.moea.gov.bt/wp-content/uploads/2017/07/Trade-Statistics-2016.pdf>. Accessed on 5 January 2018.

⁵ India can't allow its neighbours to drift away to China: Gen Bipin Rawat, Times of India, 12 January 2018. <https://timesofindia.indiatimes.com/india/india-cant-allow-its-neighbours-to-drift-away-to-china-gen-bipin-rawat/articleshow/62476264.cms>. Accessed on 12 January 2018.

⁶ Joint Working Group on Transit Agreement between Bhutan and Bangladesh, 6 December 2017. Latest News, <http://www.moea.gov.bt/?p=3692>. Accessed on 5 January 2018.

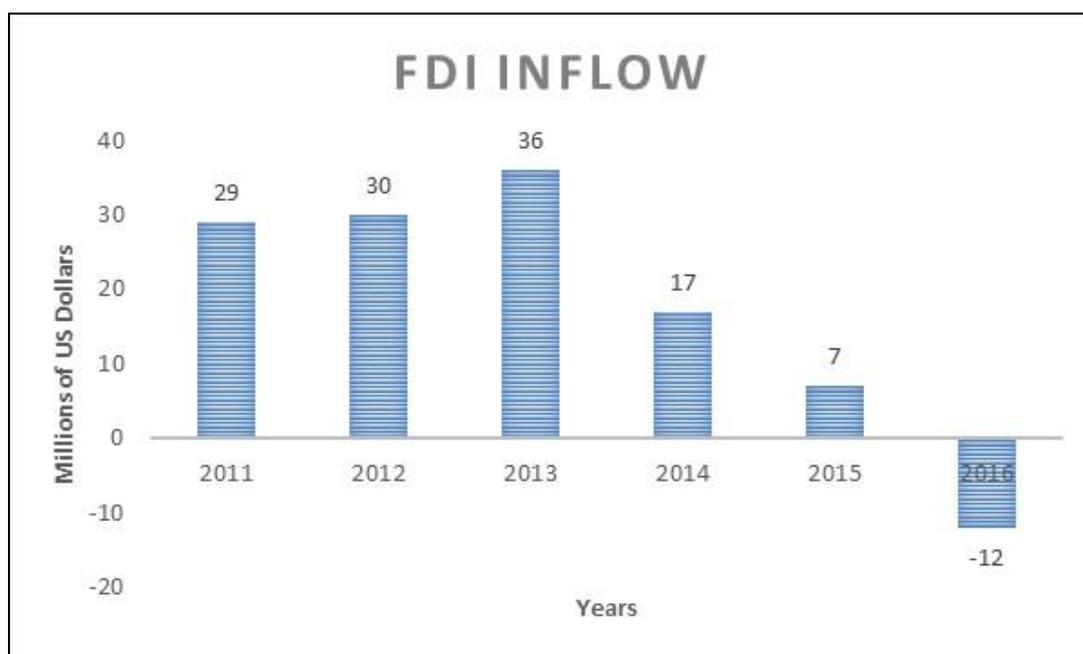
Table 1: Ease of Doing Business Ranking, 2017

Economy	Ease of Doing Business Rank
Bhutan	75
India	100
Nepal	105
Sri Lanka	111
Maldives	136
Pakistan	147
Bangladesh	177
Afghanistan	183

Source: <http://www.doingbusiness.org/rankings?region=south-asia>. Accessed on 4 January 2018.

In spite of the fact that Bhutan is business-friendly country, it witnessed a negative foreign direct investment (FDI) inflow of US\$12 million (\$15.8 million) in 2016. This was due to divestment being higher in Bhutan than the FDI inflow.

Table 2: Bhutan's FDI Flows



Source: http://unctad.org/en/PublicationsLibrary/wir2017_en.pdf.

Indian GST Pressures

The implementation of the Goods and Services Tax (GST) by India in 2017 hit the Bhutanese economy hard. It led to a decrease in the competitive edge of Bhutan's export-oriented industries. Bhutanese enterprises such as Dungsam Cement Corporation Limited (DCCL) and Ice Beverages, for example, have experienced a huge decrease in production following the implementation of the GST. In the case Ice Beverages, the effective tax rate after the GST was implemented is around 40 percent as compared to 14 percent in the previous regime. This is in view of the fact that, in addition to the 28 per cent GST, there is a cess of 12 percent. In the case of DCCL, although there is some level-playing field on the tax front, subsidies and refund on the Central GST are extended to its competitors in the Northeastern States in India. As a result, DCCL has become less competitive when compared to Indian manufacturers.”⁷

The Hydropower Sector

Bhutan's major export item is hydropower – it is the main pillar of the Bhutanese economy. Following domestic consumption, Bhutan exports most of its hydropower to India. By financially assisting, building and being a consumer of Bhutan's hydropower, India has been able to successfully integrate Bhutan's energy sector into its energy sector. Three major hydropower projects – Punatsangchu I (1,200 MW), Punatsangchu II (1,020 MW) and Mangdechu (720 MW) – are under construction. Magdechu is scheduled to be completed in 2018. The other two projects have been delayed but are expected to be completed before 2022. The foundation stone for the first joint venture hydropower project between India and Bhutan – the Kholongchu project – was laid by India's Prime Minister Narendra Modi during his visit to Bhutan in June 2014.⁸

The implementation of these projects will further integrate Bhutanese economy into the Indian economy. India's billions of dollars' worth hydropower project investment in Bhutan

⁷ “Govt. working with Indian counterparts on GST”, *Kuenselonline*, 8 January 2018, <http://www.kuenselonline.com/govt-working-with-indian-counterparts-on-gst/>. Accessed on 6 January 2018.

⁸ “Ongoing Hydropower Projects”, Embassy of India Thimphu, Bhutan. <https://www.indianembassythimphu.bt/pages.php?id=36>. Accessed on 5 January 2018.

has geopolitical and strategic implications – the levers of Bhutanese economy will be in Indian hands for the foreseeable future.

In summary, in 2018, the Bhutanese economy will find itself in an adjustment mode as it responds to economic reforms carried out in India in the form of demonetisation and the implementation of the GST. However, India's preferential economic policies would help to mitigate Bhutan's economic situation.

The Geopolitical Environment

Bhutan is rarely mentioned in the global news media. Whenever there is a report on Bhutan, it is normally on its exotic location, its special laws and regulations to protect its cultural heritage, its young royal family, and its ingenious Happiness Index to measure the well-being of its population. However, 2017 was an exception in this respect. Bhutan grabbed the global media attention, in particular the Asian media, because of the border standoff between Indian armed forces and the Chinese military in the territory claimed by Bhutan called Doklam.

The India-China standoff showed the difficulty faced by a small country geographically sandwiched between two competing big powers. While the standoff is said to have been resolved, it has presented a number of concerns for Bhutan. The issue may continue to test Bhutan's diplomatic energies in the coming years. It has the ominous task of performing a balancing act between India and China.

Bhutan is yet to have formal diplomatic relations with Beijing and its boundaries are not demarcated with China. The latter's connectivity projects in the neighbourhood are likely to put more pressure on Bhutan on having formal diplomatic relations with China. Also, China's increasing capabilities and its willingness to act decisively in the region could lead to Bhutan rethinking its relations with China.

Lessons from Nepal

In 2018, Bhutan could do well to closely watch Nepal's relationship with China. If China successfully assists Nepal to develop its economy despite India's protestations and interferences in Nepalese politics to restrict the Chinese influence, it could be a signal for Bhutan that China is determined to increase its influence in the South Asian region. The importance of understanding the diplomatic situation in the region is essential for Bhutan's survival. In 2015, the Bhutanese concluded, following the unofficial Indian fuel blockade of Nepal, that, while the Chinese influence in the region has grown, it was not sufficient to the Indian dominance in the region.

According to Tenzing Lamsang, Editor of *The Bhutanese*, a private newspaper, "Bhutan, led by a practical and able Monarchy, has historically been very good at drawing practical lessons from the diplomatic mistakes of its neighbours and taking necessary steps to avoid them. A lot of the current prosperity, peace and stability in Bhutan come from this unique quality, exemplified in His Majesty the Fourth Druk Gyalpo and now continued in His Majesty the King. Therefore, it is incumbent on ordinary Bhutanese citizens to better understand the diplomatic situation in our region. As unfortunate and avoidable as it is, the Nepal-India or India-Nepal clash gives us many important and even new lessons to learn."⁹

In Nepal, the leftist coalition won the national election in December 2017. The incoming Nepali government is perceived to be closer to China and this is viewed with apprehension both in India. Since 2015, China has increased its intensity of diplomatic initiatives with Nepal particularly in the name of the connectivity through the Road and Belt Initiative. China is currently Nepal's second largest trading partner and its largest investor. It is planning to further increase its investments in the country. During an investment summit in Nepal in 2017, foreign and domestic investors signed letters of intent to invest US\$13.52 billion (S\$18.17 billion) in Nepal. Of these, the Chinese share was US\$8.3 billion (S\$11.16 billion).¹⁰

⁹ Tenzing Lamsang, "More lessons from the India-Nepal crisis", *The Bhutanese*, 31 October 2015. <http://thebhutanese.bt/more-lessons-from-the-india-nepal-crisis/>. Accessed on 4 January 2018.

¹⁰ "Investors intend to pour \$13.52 b into Nepal", Kuvera Chalise and Ashim Neupane, *My Republica*, 4 March 2017. <http://www.myrepublica.com/news/15843/>. Accessed on 24 October 2017.

A pro-China tilt in Nepali politics is expected in 2018. Bhutan is expected to keenly observe how this would be handled by New Delhi. If China supports Nepal from possible pressures from India, then Bhutan could be tempted to explore the normalisation of diplomatic relations with China. However, having said that, even if Bhutan decides to test the waters, its overtures towards China will be gradual and with some form of approval from India. This is due to the fact that Bhutan is overwhelming dependent on India.

Conclusion

Bhutan may see a marginal downslide of its economy in 2018 and it will have to make adjustments in response to the changing regional economic landscape. However, in the long run, regional integration efforts will lay the groundwork for a stable economic growth for Bhutan.

In its foreign policy, its position is akin to the grass beneath two elephants – it will be trampled not only when the elephants fight, but also when they dance. It managed to come out relatively unscathed from the Doklam issue. The relationship between China and India will determine Bhutan’s diplomatic engagement with the two countries.

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