INDIA-BHUTAN ECONOMIC RELATIONS IN THE 1990s

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PARTHASARATHI BEHERA

SOUTH ASIAN STUDIES DIVISION
CENTRE FOR SOUTH, CENTRAL, SOUTH EAST ASIAN AND SOUTH WEST PACIFIC STUDIES
SCHOOL OF INTERNATIONAL STUDIES
JAWAHARLAL NEHRU UNIVERSITY
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जवाहरलाल नेहरू विश्वविद्यालय
JAWAHARLAL NEHRU UNIVERSITY
NEW DELHI-110067

South Asian Studies Division
Centre for South, Central, South East Asian
and South West Pacific Studies
School of International Studies

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CERTIFICATE

Certified that the dissertation entitled **"INDIA-BHUTAN ECONOMIC RELATIONS IN THE 1990s"** submitted by **PARTHASARATHI BEHERA** in partial fulfillment of the requirements for the award of the degree of **MASTER OF PHILOSOPHY** of this University is his own work and has not been submitted for any other degree to this University or any other University.

We recommend that this dissertation may be placed before the examiners for evaluation.

K. Warikoo

PROF. K. WARIKOO
(Chairperson)

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PROF. MAHENDRA P. LAMA
(Supervisor)

Dedicated to
My
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CONTENTS

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PREFACE

In a globalized world like today's, it is difficult, almost impossible for a country to remain isolated without hampering its progress, as no country is self-sufficient in itself. Every country is dependent on others and maintains some sort of relations, be it political, economic or socio-cultural, for their various interests.

Among all types of relations, countries are trying their best to maximize their economic relations with others. Though economic interests are given priority always, players in the international plane are emphasizing this explicitly now-a-days.

Economic relations are important for stability and integration in the world. This is because development is necessary for a country's progress and it has a bearing on the peace and stability among nations. But development can not take place without resources and technology. Many countries are unable to exploit their natural resources due to lack of resources and technical know-how. So, co-operation among the countries in this aspect is very much necessary. Economic relation can increase confidence among countries for a better political relation.

In this context, economic relations between India and Bhutan is an interesting subject to study. Bhutan is a land-locked country and it is sandwiched between two big countries-India and China. Bhutan also lacked the skilled manpower, infrastructure which are crucial for the development of a country. Therefore, Bhutan has to depend on external sources for moderrnization. Due to somewhat aggressive posture of China, Bhutan maintained economic relation with India. Various aspects of India-Bhutan economic relations are examined in this study.

The first chapter deals with some theoretical perspectives on economic relations. Economic contents of foreign policy and various instruments of economic relations like aid, investment, trade and transfer of technology are discussed in this chapter.

Second chapter discusses the profile of India-Bhutan economic relations from 1950 to 1989. Two critical elements in India-Bhutan economic relations i.e. aid and trade are discussed in this chapter. India initiated the planned development in Bhutan. This chapter includes India's contribution in the development process of Bhutan from First Five Year Plan (1961-66) to Sixth Five Year Plan (1987-92). Besides, the provisions of the treaties on trade and commerce signed between India and Bhutan are also examined.

Third chapter deals with the economic relations between these two countries in the 1990s. Bhutan's Sixth, Seventh and Eighth five year plans and India's contribution during these plan periods are discussed in this chapter. Major projects carried out by India and its role in the financial system of Bhutan are also included. Bhutan's trade relation with India, its composition and balance of trade in the 1990s are also studied in this chapter.

Fourth chapter contains the concluding observations.

Chapter-I

I

SOME THEORETICAL PERSPECTIVES ON ECONOMIC RELATIONS

We live today in an increasingly 'interderdependent' world and, perhaps someday, a 'world without borders.'[1] Global interdependence- the degree to which the quality of life within states is dependent on conditions in other states- lies at the heart of the external challenges states now face. As the range of global issues has expanded and the integration of national economies have created a globlized market, interdependence in a borderless world has reduced states ability to govern their affairs.[2]

Throughout modern history, states have competed with one another militarily for position and prominence in the hierarchy of international power. For more than three countries, world politics has been largely a record of preparing; waging and recovering from inter-state war. Military might was equated with prestige and influence, and military conquest became the means to economic as well as political preeminence. To some, the battlefield in world politics has shifted to economic issues. National destinies will be determined by commercial competition, not military conquest. The

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1 Lester R. Brown, *World Without Borders,* (New York: Random House, 1972)

2 Charles W. Kegley (Jr) and Eugene R. Wittkopf, *World Politics: Trends and Transformation,* (New York: Worth Publishers, 1999), p.15

apparent shift of priorities to the economic dimensions of world politics is certain to shape the distribution of global power.[3]

The end of the Cold War, and the collapse of the Soviet Union and other socialist states have altered the international economic environment. Barring isolated exceptions, 'statist' system, the various forms of socialism and the model of 'command economics' stand discredited. 'Market economy' has gained ascendancy around the world, virtually in every region, nations are engaged in market based reforms and 'liberalization' of economic policy. It is too simplistic to regard this as the triumph of capitalism, because the role of the state in creating the policy framework is universally accepted, as also the state's responsibility for checking the excesses of free market system, but the policy blend varies[4]

Economic Content in Foreign Policy

Around the world, there is acceptance of the fact that economics is central to foreign policy and that the promotion of a country's external interests means, first of all, the promotion of economic objectives.[5] But it is not very easy to conceptualise the content of the foreign economic policy of a country. The economic content of the foreign policy has been traditionally an important

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3 Ibid., p.16

4 Kishan S. Rana, "Promoting India's Economic Objectives Abroad: The Main Tasks Ahead" in Lalit Mansingh, et.al. (ed.), *Indian Foreign Policy: Agenda for the 21st Century, Vol.1* (New Delhi: Konark,1997), pp. 222-23.

5 Ibid., p.222

component of the foreign policies of the major powers. These foreign policies were often geared to achieve specific economic objectives. Equally economic policies of those countries were devised to attain specific political objectives.[6]

The level of economic and industrial development a state enjoys affects the foreign policy goals it can pursue. Generally, the more economically developed a state is, the more likely it is to play an active role in the global political economy. Rich states have interests that extended far beyond their borders and typically possess the means to pursue and protect them. Not coincidentally, states that enjoy industrial capabilities and extensive involvement in international trade also tend to be militarily powerful, in part because military might is a function of economic capabilities.[7]

Although economically advanced states are more active globally, this does not mean that their privileged circumstances dictate adventuresome policies. Rich states are often 'satisfied' ones that have much to lose from the onset of revolutionary change or global instability and that usually perceive the status quo as best serving their interests.[8] As a result they often forge international economic policies to protect and expand their envied position at the pinnacle of the global hierarchy. Levels of productivity and prosperity

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6 B. Bhattacharya, "Indian Foreign Economic Policy: Evolving Context and Task" in Mansingh, n.4, p.209.

7 Kegley and Wittkopf, n.2, pp.48-49.

8 View expressed by Arnold Wolfers, in *Discord and Collaboration*, (Baltimore: John Hopkins University Press, 1962) quoted in Kegley and Wittkopf, n.2, p.49.

also affect the foreign policies of the poor states at the bottom of the hierarchy. Some dependent states respond to their economic weakness by complying subserviently with the wishes of the rich on whom they depend.[9]

The requirements and pressures of the domestic trade and industry of a country, condition the economic content of its foreign policy. For Third World countries, dependence on rich nations is and has always been a stark fact of their economic lives. It is the principal reason for their heightened interest in promoting greater individual and collective self-reliance. At the same time, the developed countries of the world who once prided themselves on their apparent self-sufficiency are rapidly discovering that in an age of increasingly scarce natural and mineral resources they too are growing economically more dependent on the policies of certain groups of developing countries. All indications point to the fact that no nation or region is able to survive economically in complete isolation from others.[10]

Developing countries need external support for sustaining a high level of growth, to meet the basic needs and improve the well being of the people.[11] For them economic growth means:

i. Development of technical, professional, entrepreneurial and managerial skills.

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9 Kegley and Wittkopf, n.2, pp.49-50.

10 Michael P. Todaro, *Economic Development in the Third World* (London: Longman, 1977), p.399.

11 Rana, n.4, p.224.

ii. Increased productivity and out-put in industry and agriculture.

iii. Diversification of crops and industries to reduce dependence on one or a few mineral or agricultural exports and consequent vulnerability to world market price fluctuations and to reduce relative reliance on imported goods.

iv. Increased savings and investment to the point where self-financed investment plus foreign private investment permits output to grow faster than population.

v. Increased exports, to the point where export earnings plus foreign private earnings plus foreign private investment can finance sufficient imports for both consumption and investment.[12]

Developed western countries maintain economic relation with developing countries for various reasons. They import raw materials for their industries, cash crops like tea, cashew nuts, cocoa etc from developing countries. Besides, they are attracted by the gains from trade, strategic raw materials and investment income.[13]

Economic relation can increase confidence among countries for a better political relation. There are various instruments of economic relation such as aid, investment, foreign trade, transfer of technology etc.

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12 Joan M. Nelson, *Aid, Influence and Foreign Policy*, (New York: Macmillon, 1968), p.14.

13 S. Chandershekhar, *American Aid and India's Economic Development*, (New York: Fredrick A. Praeger, 1965), pp.50-53.

This chapter examines some of the major issues involved in various instruments of foreign economic relations.

Foreign Aid

The Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development (OECD) defines aid as resources transferred on concenssional financial terms with the promotion of the economic development and welfare of developing countries as the main declared objective.[14]

Foreign Aid meets two criteria: i) its objective should be non-commercial from the point of view of the donor and ii) it should be characterized by 'concenssional' terms, i.e. the interest rate and repayment period for barrowed capital should be softer (Less stringent) than commercial terms.[15] This definition can sometimes be inappropriate since it could include military aid, which is both non-commercial and concessional. Normally, however, military aid is excluded from international measurements of foreign aid flows.[16]

Forms and Contents of Foreign Aid

Foreign aid can be given either directly or through multilateral organization. It includes outright grants, long term loans; sometimes

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14 Peter Burnell, *Foreign Aid in a Changing World,* (Bucking Ham: Open University Press, 1997), p. 4.

15 Jagdish N. Bhagwati, "Amount and Sharing of Aid" in *Assisting Developing Countries: Problems of Debt, Burden-sharing, Jobs and Trade,* (New York: Praeger, 1972), pp.72-73.

16 Todaro, n.10, p.333.

sale of surplus products of donor country for local currency payments. Even transfer of technical know-how, training, improvement of managerial and administrative skill can be considered as a part of aid.

Resource transfer may take disguised forms such as granting of preferential tariffs by developed countries to Third World exports of manufactured goods. This permits LDCs to sell their industrial products in developed-country markets at higher prices than without such tariff reductions. There is consequently a net gain for LDCs and a net loss for developed countries which amounts to a real resource transfer to LDCs.[17]

Some scholars classify the various forms of foreign economic assistance as the following:

Capital Assistance: It supports creation, expansion and modernization of capital, that is, of the concrete physical means of production (factories, roads, ports power facilities, irrigation works, grain storage facilities) as well as physical facilities that are essential to an efficient economy but that make their contribution to production indirectly (communication facilities, school, potable water systems). Most capital assistance is provided for specific project.

Commodity assistance: It finances imports for an economy as a whole, to permit it to operate more fully and efficiently.

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17 Ibid., p. 332.

Technical assistance: It transfers skills and knowledge for industries and their proper management.[18]

Paula Hoy described the various types of aid and their purpose as presented in the following table.

Table1.1
Forms of Foreign Aid

Types of Aid	**Description/Purpose**	**Donor agency**
Project Aid	A grant or loan provided to a government agency or NGO, designated for a specific project or outcome	Bilateral and multilateral donors, NGOs
Program Aid	A policy based loan given to a recipient government to create certain economic conditions in that country or to support balance of payments	Bilateral and multilateral donors
Technological Assistance	Provides equipments and/or experts for a specific sector or outcome.	Bilateral and multi lateral donors, NGOs
Humanitarian Assistance	Provides grants, materials, food supplies to meet the immediate demands of victims of disasters	Bilateral and multi lateral donors, NGOs
Military Aid	To strengthen the military of recipient government	Bilateral donors

Source: Hoy, Paula, *Players and issues in International Aid,* (Connecticut: Kumarian Press, 1998), p.5

18 Nelson, n. 12, p. 211.

Need for Foreign Aid and Donor Motivations

Foreign aid is seen differently by donor and recipient countries. There are likely to be fundamental differences in attitudes and motivations between donor and recipient countries. Foreign aid is mainly meant for development in the recipient country. So it may be motivated by moral and humanitarian ground by the donor country. But it is not always correct to think that donor nations assist others without expecting some corresponding benefits (political, economic, military etc.) in return.[19] Very often donor countries give aid for their political, strategic and/or economic self-interest.

Economic Rationale

Many developing countries due to lack of capital face problem for their progress. So foreign aid plays a role in supplementing the domestic resources. Besides it fills the foreign-exchange gap of the recipient country. This is known as 'Two-gap' analysis.[20]

The relations between national-income analysis and balance-of-payment analysis can be expressed by the following equation –

$$(I+G) - (S+T) = (M-X)$$

Where: I = Gross investment

G = Government expenditure

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19 Todaro, n.10, p.337.

20 Two-gap analysis was formulated by Hollis Chenery and Michael Bruno, Development Alternatives in an Open Economy', *Economic Journal, 72* (1962) and Hollis B. Chenery and Alan H. Strout, 'Foreign Assistance and Economic Development', *American Economic Review,* September. 1966, pp. 680-733.

S = Gross saving

T = Taxes

M = Imports

X = Exports

From the above equation it is understood that when a country spends more on investment and government expenditure than it is earning from the resources through private savings and taxation, there will be a resource gap within the country and then imports will be greater than exports. Thus resource gap creates a foreign-exchange gap as foreign-exchange reserve is lowered for more import of goods and services.

Normally developing countries have low private savings and negative government savings (i.e., G > T). So, foreign aid is necessary for high domestic investment.[21]

As mentioned earlier, foreign aid not only includes capital inflow, but also technical know-how, it accelerates the process of development in the recipient country.

While providing aid, donor counties are not concerned only for the economic growth and development of the developing countries; they have their self economic interest also behind this. Some aid programs are tied aid, in which recipient country is bound to import some specific goods or services from the donor country or from a restricted choice of countries.[22] The rationale of tied aid are two:

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21 Gerald M. Meir, (ed.), *Leading Issues in Economic Development,* (New Delhi; Oxford, 1995), p. 215.

22 Sheila Page, *How Developing Countries Trade: The Institutional Constraints*, (London: Routledge, 1994), p. 83.

first, it reduces the net cost to the economy by minimizing the grant element and second, the government can secure the support of the industry and other interests by the carrot of the business potential of the aid.[23] So, it increases the donor country's trade volume. Besides, receiving country is not free to import according to it's choice, there by it may spend some extra amount for those goods or services. Donor countries also export their technology to the aid receiving country. So, providing aid also benefit the donors.

Political Grounds

Foreign aid is considered as an instrument of foreign policy in general and foreign economic-policy in particular. Some scholars are of the view that donor countries are motivated mainly by political reasons to provide aid.[24] Donor countries influence the policy and events in the recipient country. Even donor countries try to put the favourable regime in power in recipient countries. Some countries propagate their ideology and culture through aid.

Between 1961 and 1966 aid or the withholding of aid was used by America to influence the internal politics of other countries in the following manner:

i. Buy time for new regimes to consolidate their position and formulate programs of action.

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23 Bhattacharya, n.6, p. 211

24 Todaro, n. 10, p.337.

ii. Bolster government faced with acute financial crises, due either to special and temporary problems or to chronic conditions.
iii. Relieve politically threatening unemployment or counter other specific political threats.
iv. Attempt to influence the outcome of elections or to ensure that elections are held.
v. Register disapproval of military coups and encourage the early scheduling of elections.
vi. On rare occasions, to attempt to alter the composition of a government, outside the context of elections.[25]

Effects of Aid

Some problems arise while analysing the effectiveness of aid. These are mainly related to measurement of aid.

Firstly, as loans are to be repaid with interest (though interest rate is low), the benefit from it is less than it appear.

Secondly, the real value of aid is reduced when it is tied with some project or with import of goods and/or services from donor countries.

Thirdly, there is distinction between the nominal and real value of aid, especially during periods of rapid inflation.[26]

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25 Nelson, n. 12, p. 93.
26 Todaro, n.10, pp.334-35.

Though there are problems as mentioned above in calculation of foreign aid, it has helped in economic growth, development of infrastructure in the recipient countries.

But aid is criticized for increasing the gap in living standards between the rich and the poor in recipient counties, by some scholars, as it focuses on growth of the modern sector.

Still there are differences in motives and effects of aid which vary from country to country.

Foreign Investment

Foreign investment is basically the movement of capital from one country to another to earn return. It can be made broadly by two modes; i) investor investing capital in running a firm and ii) investor buying shares of a firm known as portfolio investment. In the first mode, investor has control over the management, while in the second type it does not have. World Trade organization (WTO) indicates that "Foreign Direct Investment (FDI) occurs when an investor based in one country (the home country) acquires an asset in another country (the host country) with the intent to manage that asset. The management dimension is what distinguishes FDI from portfolio investment in foreign stocks, bonds and other financial instruments.[27]

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27 Annual Report, Vol. 1, *Trade and Foreign Direct Investment*, World Trade Organization, Geneva, 1996, quoted in *Foreign Direct Investment, Development and the New Global Economic Order: A Policy Brief for the South*,(Geneva: South Centre,1997), p.27.

Second, FDI comprises three components: New equity from the Parent company in the home country to the subsidiary in the host country.

a) Reinvested profits of the subsidiary and

b) Long and short term net loans from the parent to the subsidiary.[28]

There is difference between statistical definition of FDI and the common sense usage of the term FDI. Thus FDI defined and measured according to IMF conventions does not necessarily mean that an actual act of investment as commonly understood has occurred, and an increase in measured FDI does not necessarily signify that an expenditure has been incurred to increase plant and machinery or stocks. Indeed from the point of view of the subsidiary in the host country, FDI defined in the manner described above is a source of capital funds but not a use of funds.

The reasons are: Firstly, recorded inflows of new equity or debt into the host country may be destined for the purpose of buying up an existing firm or merging with one. Though counted as FDI in the statistics, this does not necessarily represent any immediate addition to plant and machinery or stocks.

Secondly, the profits of subsidiary in a host country, whether these are repatriated or not, are notionally regarded as an outflow in

28 *Foreign Direct Investment, Development and the New Global Economic Order : A policy Brief for the South,* (Geneva: South Center, 1997), p.27

the current account of the host country's balance of payments. At the same time, that portion of undistributed profits (profits does not distributed to shareholders as dividends) which remain in the host country is regarded as an inflow of FDI from the home country to host country. It is recorded as a notional inflow on the capital account of the host country's balance of payments. However, a subsidiary in a host country may use the undistributed profits to buy financial assets or loan them to another enterprise for any use whatsoever. There will therefore have been no net addition to capital stock or inventories of the subsidiary or of the nation.[29] Normally MNCs are the key players in the field of investment. So, here while analyzing the role of investment, sometimes the activities of MNCs will also be discussed.

Determinants of FDI

Scholars have pointed out three major determinants of FDI. These are :

Ownership advantage:[30] Such advantages are thought to arise from economies of scale with respect to intangible assets such as skilled management capacity or original know how which may also be exploited to even greater advantage by investing abroad.

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29 Ibid., pp.28-29.

30 This theory was advocated by S.H. Hymer in *The International Operation of National Firms: A Study of Direct Foreign Investment* (Cambridge, MIT Press, 1960), quoted in n. 28, p.32.

Locational advantages:[31] These arise in part from the fact that, for many products, there is a production cycle involving several stages, with new technology first being produced and used in the home country and, once standardized, shifted abroad because either nearness to the final market or lower factor costs make this advantageous. However, even if one were to accept the characterization of technological stages in this theory, the theory does not explain why a firm has to establish its presence abroad rather than license its technology or products.

Internalization advantages:[32] It is an attempt to fill the gap in the locational advantage theories by calling attention to advantages which may accrue to a firm from 'internalization', i.e. engaging in foreign production itself, rather than sub-contracting or licensing it to a foreign firm. When 'transaction cost' involved in operating through the market mechanism are greater than those arising from carrying out activities within the firm, internalization, that is, establishing an overseas subsidiary will be preferred.

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31 It was pronounced by R.Vernon in the article "International Investment and International Trade in the Product Cycle", *Quarterly Journal of Economics*, 1983, pp.190-207, quoted in n.28, p.33.

32 This was attempted by P.J. Buckley and M.C. Casson in *the Future of Multinational Enterprises* (London: Macmillan, 1976) quoted in n.28, p.33.

Benefits of Foreign Investment

Foreign investment is seen as a way of filling in 'gaps' between the domestically available supplies of savings, foreign exchange, government revenue and skills, and the planned level of these resources necessary to achieve development targets by the traditional neo-classical analysts of economic growth.[33]

Like foreign aid, foreign investment also fills the resource gap between targeted investment and locally available savings in the host country. [34]

Foreign investment not only brings the capital to the recipient country, but also managerial ability, technical personnel, technological knowledge, administrative organization, and innovations in production and production techniques. This is desirable and productive to the recipient countries, as it fills the managerial gap and technological gap. Besides, this ensures that a project involving foreign investment will be adequately formulated and implemented. The pre-investment survey, act of investment and operation of the investment project are ensured in private foreign investment.[35]

Foreign investment has another significant contribution for developing countries. Besides raising the productivity of a given amount of labour, it allows a large labour force to be employed. So,

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33 Todaro, n. 10, p.328.

34 Ibid., p.329.

35 Meir, n.21, p.249.

foreign investment provides an alternative to labour migration from poor countries, who use to migrate due to lack of employment. The real wage of these labourers also increases who are employed in the advanced sector where foreign capital is invested.[36]

Domestic consumers are benefited from foreign investment as it makes available better quality and lower priced products sometimes.[37]

Foreign investment also helps in increasing domestic investment and industrialization in the recipient country. It happens when investment is done to develop a country's infrastructure, which attracts more investment later. When foreign investment in an industry makes its product cheaper, another industry that uses this products benefits from the lower prices. It helps in further industrialization.[38]

Negative Impact of Foreign investment

Nothing in this world is an unmixed blessing; everything has both positive and negative side. So, foreign investment has some negative effect in the recipient countries. Some issues are raised by the people of home country against investment in other countries. The most obvious economic problem for the home country involved in direct foreign investment is the loss of revenue from profit tax on the earning of their countries and know-how. There has been a view

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36 Ibid., p.248.

37 *Foreign Direct Investment....*, n. 28, p.37.

38 Meir, n. 21, p.249.

that these capital exports were diverting capital from their own country and hence from the welfare of the worker.[39]

Though initial impact of foreign investment is to improve the foreign exchange position of the recipient country, its long-run impact may be to reduce foreign exchange earnings by the overseas repatriation of profits, interest, royalties, management fees etc.[40] Foreign investment may have negative contribution to the GNP of host country by low payment of wages to labourers, low payment of royalties for natural resources.[41]

Foreign investment may cost host country in other way also. To encourage and attract foreign investors, government of the host country may have to provide special facilities, undertake public services, extend financial assistance or subsidized inputs. Those have a cost in absorbing governmental resources that could be used elsewhere.[42] Investors sometimes get more benefit from liberal tax concessions, disguised public subsides and tariff protection provided by the host government than they contribute to the public revenue in the form of corporate taxes.

Investing countries also reduces the scope of research and development (R&D) in recipient countries, as they do all the research work in their own countries. It further increases the brain-drain from

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39 Peter Drysdale,(ed.), *Direct Foreign Investment in Asia and Pacific*, (Canberra: Australian National University Press, 1972), pp. 6-7.

40 Todaro, n. 10, p.330.

41 H. C. Bos, et.al., *Private Foreign Investment in Developing Countries* (Dordrecht: D. Reidel Pub.,1974), pp.26-27

42 Meir, n.21, p.250.

developing countries to developed investing countries.[43] There may be social costs in the form of unemployment when FDI, which is relatively capital intensive causes the more labour intensive local firms to close down, and there is a net loss of jobs. An open market in FDI in the print and T.V media and in the entertainment fields also poses a risk of facilitating hegemony by west.[44]

Third World countries have commonly raised some objections against foreign investment, particularly against the activities of MNCs, which are discussed here.[45]

i) MNCs impact on development is very uneven and in many situations their activities reinforce dualistic economic structures and exacerbate income inequalities. They tend to promote the interests of small number of well-paid modern sector workers against the interests of the rest by widening wage differentials. They divert resources from needy areas to the manufacture of sophisticated products catering primarily the demands of local elites. They tend to worsen the imbalance between rural and urban economic opportunities by locating primarily in urban areas and contributing to the accelerated flow of rural-urban migration.

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43 Drysdale, n. 39, pp.8-9.

44 *Foreign Direct Investment....*, n.28., pp. 38-39.

45 For a detailed discussion by P. P. Streeten, "The multinational enterprise and the theory of development policy", *World Development,* Vol. 1, no.10, quoted in Todaro, n.10, pp.330-31.

ii) MNCs produce inappropriate products mainly demanded by a small rich group of people, stimulate inappropriate consumption pattern through advertising and their monopolistic market power.

iii) MNCs may damage host economies by suppressing domestic entrepreneurship and using their superior knowledge, worldwide contacts, advertising skills and range of essential support services to drive out local competitions and inhibit the emergence of small scale local enterprises.

iv) MNCs use their economic power to influence government policies in directions unfavourable to development.

Reconciling the Interest of Host and Investor

In the past, poor countries were overestimating the costs of foreign investment. Now, many countries recognize that private foreign investment may offer some special advantages over public capital.

The major problem for the recipient country is to devise policies that will succeed in both encouraging a greater inflow of foreign private capital and ensuring that it makes the maximum contribution feasible toward the achievement of the country's development objectives. Development requires both more effective governmental activity and more investment. The investors must be aware of the host country and understand how their investments fit into the country's development strategy. At the same time, the host government must recognize that if risks are too high or the return on investment is too low, foreign investment will be inhibited from making any contribution at all.[46]

At present, the policies taken by the developing countries reveal a mixed picture of restrictions and incentives. On the one hand, the foreign investors, freedom of action may be restricted by a variety of governmental regulations that exclude private foreign investment from certain key sectors of the economy, impose limitations on the extent of foreign participation in ownership or management, specify conditions for the employment of domestic and foreign labour, limit the amount of profits and impose exchange controls on the remission of profits and the repatriation of capital.[47]

On the other hand, a progressive liberalization of policy toward foreign investment has also occurred. A number of investment incentives measures have been recently adopted or are under consideration. These incentives devices include assistance in securing information on investment opportunist, the provisions of supplementary finance, the establishment of industrial estates, exemptions from import duties on necessary equipment and materials, the granting of exchange guarantees or privileges, tax concession schemes for the encouragement of desired new

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46 Meir, n. 21, p.247.
47 Ibid., p.247.

investments and special legislation for the protection of foreign investments.[48]

Foreign Trade

Foreign trade refers to import and export of goods and services among countries. It mainly takes place due to non-availability of the required items, comparative cost advantage of commodity and /or due to surplus production. The importance of trade springs from the extensive degree of specialization observed in our society. The high degree of specialization in our society increases the standard of living of all by making more goods and services available. But specialization necessarily implies trade and cannot occur without it. Each country tends to specialize in the production of those commodities which it can produce relatively more cheaply than other countries goods and services which they produce relatively more cheaply or which the first country can't produce at all.[49]

There are two broad themes in the theory of international trade. One is qualitative, being concerned with the pattern of trade, i.e. which country will export which good. The standard theory relates this to 'comparative advantage'. The other aspect is more quantitative and seeks to explain the terms of trade i.e., relative prices of exports and imports in a trading world. It also examines

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48 Ibid., p.247

49 Miltiades Chacholiades, *International Trade Theory and Policy*, (New York: McGraw Hill, 1978), pp.6-7.

how they are affected by changes in data such as factor supplies or technology, and policies such as tariffs.[50]

Similarly, there are two general theories of international trade that reflect the conflicting points of view of individual traders and the collective force of the state. One, called in its earlier manifestation 'mercantilism', emphasizes the right and duty of the state of control the nature, amount and flow of trade in the national interest. It therefore demands extensive government regulation of trade and submission of individuals to general policies laid down by the state. The second theory, calls for absolute freedom in movement of goods across national frontiers in response to economic laws, with no reference to government attitudes. 'Free trade' thus maximizes the role of profit and individual enterprise and contends that each sate and the world economy at large profits best when the volume of international trade is at its maximum.[51]

Besides, the above mentioned theories there are two broad theories regarding specialization in international trade-classical and neo-classical theory.

Classical Theory

This theory is better known as theory of 'comparative advantage'. According to this theory, a country specializes in the

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50 Avinash Dixit and Victor Norman, *Theory of International Trade: A Dual, General Equilibrium Approach*, (Cambridge: Cambridge University Press, 1989), p. 1.

51 Charles O. Lerche and Abdul A. Said, *Concepts of International Politics*, (New Delhi: Prentice-Hall of India Pvt., Ltd., 1972), p.251.

export of those products, which it can produce at the lowest relative cost. It implies that a country may have absolute cost advantage in some products compared to another country. But for more profit the first country should produce more commodity, which it can produce at the lowest relative cost i.e., the difference in cost of a product is highest between the two countries.[52]

Neo-classical theory

This theory is known as 'relative factor endowment' model. Unlike classical theory which is based on a static one variable factor; labour cost, this theory takes into account differences in factor supplies, mainly land, labour and capital, for international specialization. Factor endowment theory is based on two important propositions:

a. Different products require productive factions in different relative proportions.
b. Countries have different endowments of factors of production.

According to this theory, the basis for trade arises because of countries are endowed with different factor supplies. Trade, serves as vehicle for a nation to capitalize on its abundant resources through more intensive production and export of those commodities that require large inputs of those resources while relieving its factor

52 Todaro, n. 10, pp.278-79.

shortage through the importation of commodities that utilize large amount of its relatively scarce resources.[53]

Trade and Development

While free trade is being advocated to ensure access for exports and investment (FDI) from North, regulatory measures and ideological issues are being used or raised to contain the exports from South to North. Regulatory measure in the form of countervailing duties has become the most commonly used instrument to dampen the export growth rate from South. A concurrent efforts to establish the linkages between trade and labour standards, and trade and environment is also being made by developed countries, especially the USA and EU. Backed by some NGOs, which have taken up the cause of child labour, these governments want the WTO to put this issue on its work agenda.[54]

Trade is an important stimulator of economic growth. It enlarges a country's consumption capacities, increases world output and provides access to scarce resources and worldwide markets for products without which poor countries would be unable to grow. Trade helps countries to achieve development by promoting and rewarding these sectors of the economy where individual countries posses a comparative advantage whether in terms of labour efficiency

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53 Ibid., pp.279-80.

54 Bhattacharya, n. 6, pp.212-213.

or factor endowment. In order to promote growth and development, an 'outward looking' policy is required.[55]

Transfer of Technology

There is practically no country in the world, which did not depend to a greater or lesser extent, on borrowed technology in the early stages of its economic growth. This dependence is natural, for even capital formation, which is the first step in economic development, cannot take place without a minimum technological base. Not the technology can't be developed entirely through domestic skill formation, without any dependence on foreign sources, but it would be much more time consuming and costly to start practically from scratch and slowly develop sophisticated technology than to borrow it.[56]

Technology may be obtained by through licensing agreements or technology assistance or by means of investment. Normally transfer of technology is only transfer between firms belonging to same multinational concern, not to the country.[57]

From the host country's point of view, a major concern is to obtain the use of technology. It is not necessary to produce technology in order to use it. The strategies to gain technology-intensive goods are:

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55 Todaro, n. 10, p.282.

56 Jayantuja Bandyopadhyaya, *The Making of India's Foreign Policy: Determinants, Institutions, Processes and Personalities,* (New Delhi: Allied Pubs, 1979), p.54

57 Bos, n.41, p.38

- Import the goods, which embody the technology
- Import the producer goods embodying the technology in order to manufacture the final goods.
- Import the technology itself and carry out production
- Produce the technology itself.[58]

As Hall and Johnson state:[59] Technology can be transferred in two basic forms. One form embraces physical items such as drawings, tools, machinery, process information, specifications and patents. The other form is personal contact. Put simply, knowledge is always embodied in something or somebody, the form being important for determining the transfer process and cost. Technology transfer thus is a relationship, not an act.

Technology is transferred when it is used effectively in a new environment, sometimes even when the foreigners run the whole factory. Technology is also transferred when the local labour force is able to work with the imported technology, for example, when the local workers acquire the skill to operate imported machines correctly, to fix and repair them and the local managers are able to prepare input-output schedule and marketing plans. Technology transfer also occurs through transmission or diffusion when

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58 P. J.Buckley, et.al. (ed.), *International Technology Transfer by Small and Medium-Sized Enterprises*, (London: Macmillan, 1997), p.2

59 G. R. Hall, and R. E. Johnson, "Transfer of US Aerospace Technology to Japan" in R. Vernnon (ed.), *The Technology Factor in International Trade*, (New York: Columbia University Press for the National Bureau of Economic Research) quoted in Buckley, n.58, pp.2-3.

technology spreads to other local production units in recipient country. This could occur through sub-licensing agreements and demonstration effects. In most successful cases of technology transfer, techniques based on the imported technology may be upgraded. They may be able to copy existing design and develop new capabilities, undertake quality control and develop their own research and development(R&D) facilities.[60]

Issues Involved in Transfer of Technology

Developing countries demand for developed countries' technique is and remains, strong. Developed countries' patterns of development are tied to their technologies and in as much as developing countries try to adopt similar patterns of productions and consumptions, technology transfer becomes indispensable to their efforts. Developing countries see technology transfer as an ideal way of creating independent development capacity and want not only the transfer of technologies but also of technological capabilities.[61]

In the past, FDI has been a means for the transfer of technology. But the technology so transferred is frequently unsuited to the requirements because they are developed for industrial countries, especially since the multinational enterprises rarely

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60 Santikarn Mingsarn, *Technology Transfer: A Case Study,* (Singapore University Press, 1981), pp. 6-8.

61 *North-South Technology Transfer: The Adjustments Ahead,* (Paris: OECD, 1981), quoted in Jayshree Sengupta, *Evolving Patterns of Foreign Investment and their Impact on Technology Transfer in Developing Countries* in H. W. Singer, Neelambar Hatti and

conduct R&D in developing countries.[62] It may aggravate the development problems of developing countries as the R&D work done in the Western world is based on their requirements. Those technologies may be capital-intensive and proved to be harmful for labour-intensive LDCs.[63]

The indirect costs of technology transfer may be reflected in the developing countries' balance of payments through higher dependence on imported equipment, raw materials, and spare parts etc.[64]

Rameshwar Tandon, (ed.), *Foreign Direct Investment,* (New Delhi: Indus Publishing Company, 1991), p. 769.

62 Sengupta, n. 61, p. 770.

63 Bos, n.41, p.37

64 Sengupta, n.61, p.771

Chapter-II

II

PROFILE OF INDIA-BHUTAN ECONOMIC RELATIONS, 1950-89

Though Bhutan as a society is very ancient, as a nation-state it is not very old. On 17 December, 1907, Ugyen Wangchuck was formally elected as the King of Bhutan by an assembly comprising representatives of the monastic community, officials and the common people, and a hereditary monarchy was established.[1]

In this span of time, Bhutan has relatively limited foreign relations in terms of countries with which it has bilateral relations. This can be attributed to mainly two reasons. Firstly, Bhutan does not want to spend its limited resources on maintaining embassies in a large number of capitals.[2] Secondly, Bhutan is agreed to be guided by the advice of the government of India in its external relations under the 1949 Treaty of Friendship and Peace.[3]

Among all of India's neighbours, Bhutan is one with which its relations are perhaps the closest and relatively trouble free. Indo-Bhutanese relations derive their sustenance from close historical and spiritual bonds and common interests of the people of both countries. But modern day bilateral relations between the two countries began with the visit of a Bhutanese delegation to New

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1. Bhabani Sen Gupta, *Bhutan: Towards a Grass-root Participatory Polity*, (Delhi: Konark Pub., 1999), p-27.
2. Ibid., p.131.
3. Article 2 of the Treaty of Friendship and Peace signed between India and Bhutan in 1949.

Delhi in 1948, followed by a friendship treaty signed at Darjeeling on 8 August, 1949, almost on the same line of Treaty of Punkaha of 1910 signed between Bhutan and the British-India Government.[4]

With the departure of the British from the subcontinent, it became necessary for both India and Bhutan to define or redefine their mutual ties and to make a fresh beginning. Undoubtedly, there were apprehensions in the Bhutanese circles as to the motivations of independent India towards her small neighbours in the periphery. Bhutan feared that the new India may be imperialistic and ignore the urges and aspirations of the Himalayan Kingdom.[5]

However, a Bhutanese delegation came to India in 1948 to negotiate a fresh treaty with India. A ten-article Treaty of Friendship and Peace was concluded in 1949. Article 2 of the treaty explains the relationship between India and Bhutan, which states that, "the Government of India undertakes to exercise no interference in the internal administration of Bhutan. On its part, the Government of Bhutan agrees to be guided by the advice of the Government of India in its external relations". [6]

Two other provisions, which the treaty of 1949 included, reflect India's good intentions towards Bhutan. India returned an

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4 Kapileshwar Labh, *India and Bhutan,* (New Delhi: Sidhu Publication, 1974), pp.208-09.

5 Ram Rahul, *Modern Bhutan,* (Delhi: Vikas, 1971), p-56.

6 Manorma Kohli, *From Dependency to Independence: A Study of Indo-Bhutan Relations,* (Delhi: Vikas, 1993), p.40.

area of about 32 sq. miles in Dewangiri, which Bhutan had been demanding for a long time.[7] Secondly, the annual subsidy was raised to rupees-five lakhs.[8] This return of territory to Bhutan was obviously to allay the Bhutanese fear of India's alleged imperialistic designs and hunger for territory and to prevent Bhutan from looking to the north or elsewhere for friends and allies.[9]

Objectives of India-Bhutan Relations

Both India and Bhutan have strategic interests for a better relation between them. In the remote past, China, other neighbouring country of Bhutan has claimed suzerainty over it. The military invasion and tightened control of Tibet by China in 1951 and 1959 respectively contributed substantially to India's reassessment of its role in the Himalayas[10] as China came closer to Bhutan physically which is the northern neighbour of India.

Besides, India and Bhutan are linked culturally. Bhutan's relation with India have historically been both deep and extensive. The history of the early relations between the two countries is fascinating. In ancient times Bhutan formed part of Assam. In the eighth century, Padmasambhava of India visited Bhutan. Ever since the Bhutanese have considered India their spiritual home. The Bhutanese, like the Tibetans, always refer to Padmasambhava most

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7 Article 4 of Treaty signed between India and Bhutan in 1949.
8 Article 3 of Treaty signed between India and Bhutan in 1949.
9 Ram Rahul, n.5, pp. 57-58.
10 Seymour Schienberg, "Strategic Development in Bhutan", *Strategic Digest*, Vol. 3, no.3, March 1978, p.51.

reverentially as Guru Rinpochhe, the Precious Teacher. Bhutanese pilgrims travel south over high mountain passes and through warm valleys to visit the sacred places of Buddhism in India. Many of the Bhutanese hymns and *mantras* are in Sanskrit. Even the Bhutanese script, which is the same as the Tibetan script has been derived from an Indian script.[11]

In this chapter, the two critical elements of economic relations between India and Bhutan from 1950 to 1989 i.e. aid and trade have been discussed.

Initiation of Modern-day Economic Relations

Though Bhutan has abundant natural resources like minerals, hydel power, horticultural products, it's economic growth was constrained by several geo-physical factors such as land-locked position, mountainous terrain, small and scattered population, lack of skilled-labour, very limited industrial base, thick forests, inadequate transport facilities etc.[12] Still Bhutan was maintaining a self-imposed isolationism to preserve it's unique identity and culture.

In the 1950s, the intrusions across the northern part of Bhutan by the Chinese in Tibet compelled Bhutan to come out from her self-imposed isolation and change her foreign policy. Bhutan realized that the rapid development of it on modern lines was

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11 Ram Rahul, *Royal Bhutan*, (New Delhi: ABC Publication, 1983), pp.45-46.

12 Paramanand, *The Politics of Bhutan: Retrospect and Prospect*, (New Delhi: Pragati Pub., 1992), p.29.

essential for its security and stability. Thus, Bhutan opened a window of opportunity in her economic relations with other countries. In 1954-55, Bhutan accepted the help of an Indian agency to conduct a survey of its rivers and allowed the establishment of hydro-meteorological stations. In 1956, India gifted Bhutan 146 tons of fertilizers, 2000 maunds of cement and hospital equipment worth Rs. 2.6 lakhs.[13]

In September 1958, Indian Prime Minister Jawaharlal Nehru undertook an ardous journey to Bhutan and in his talks with the Bhutanese ruler emphasized the need for building roads between India and Bhutan and within Bhutan itself. He also expressed India's readiness to give technical aid and other kinds of assistance. After Chinese occupation of Tibet in 1959, Bhutan became earnest to modernize itself with Indian financial and technical assistance.[14]

In the mean time China also offered economic assistance to Bhutan and assured the Royal Government on several occasions that China had no aggressive intentions against Bhutan.[15] But Bhutan did not accept this Chinese offer.

After 1962 Sino-India war, there was fear among the people of Bhutan from China. Some elites in Bhutan advocated for a Nepalese model of foreign policy of maintaining equidistance from both India and China and not to be so close to India. But this view was

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13 S.S. Bhattacharya, "Planning in Bhutan,' *IDSA Journal*, Vol. XIV, no. 4, Apr-Jun, 1982, p. 617.

14 Labh, n.4, p.217.

15 Leo E. Rose, *The Politics of Bhutan*, (Ithaca: Cornell University Press, 1977), p-79.

rejected by the Royal Government as there is cultural difference between Nepal and Bhutan, and there is difference between the treaties of Nepal and Bhutan signed with India.[16]

Aid

In case of India giving aid to other countries is a paradox. Because India being a developing country, itself accepts aid from various bilateral and multilateral sources. But it is the humanistic character of India's foreign policy that India gives aid to countries which are less developed than it including Bhutan.

India has been instrumental for Bhutan's development. In 1961, an Indian Planning Commission team visited Bhutan to study the economic conditions and natural resources and recommended a development plan. [17] The First Five Year Plan (FYP) of Bhutan was launched in 1961 with the complete financial assistance from India and the priority was to end Bhutan's isolation from the rest of the world and to open channels of communication. Ever since India has been extending financial assistance to Bhutan's FYPs. India continues to be the principal donor for the economic development of Bhutan. So far seven FYPs of Bhutan have been completed two of which were totally financed by India. The VIII FYP (1997-2002) is under implementation.

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16 Ibid, p. 82.
17 Labh, n.4, p.217.

Planned Development in Bhutan

Development programmes in a planned manner started with the commencement of Five Year Plan (FYP) in Bhutan with Indian assistance in 1961. Here developments in Bhutan is discussed upto the end of sixth plan (1992).

Table 2.1
Financing of Developmental Plans

(Millions Ngultrums)

Sector	First Plan (1961-66)	Second Plan (1966-71)	Third Plan (1971-76)	Fourth Plan (1976-81)	Fifth Plan (1981-87)	Sixth Plan (1987-92)
India	107.2 (100.0 per cent)	200.0 (98.9 per cent)	426.6 (89.8 per cent)	853.0 (77.1 per cent)	2,017.5 (43.1 per cent)	2,612.7 (27.3 per cent)
Other external sources	--	--	15.8 (3.3 per cent)	193.7 (17.5 per cent)	978.0 (21.9 per cent)	2,609.3 (27.2 per cent)
Internal resources	--	2.2 (1.1. per cent)	32.8 (6.9 per cent)	59.0 (5.4 per cent)	1,460.6 (32.0 per cent)	3,160 (33.0 per cent)
Gap	--	--	--	--	228.2	1,777.0
Total outlay	107.2	202.2	475.2	1,106.2	4,684.3	9,559

Source: Kapileswar Labh, "Economic Development in Bhutan: Recent Trends and Prospects", *International Studies,* Vol. 31, No.2, April-June 1994, p.193.

Note: One Ngultrum is equivalent to an Indian Rupee.

First Plan (1961-66)

The first FYP of Bhutan was completely financed by India. Total outlay of this plan was 107.2 million ngultrums.

It gave the highest priority to the development of the infrastructure relating to transport to end Bhutan's isolation from the rest of the world and to open channels of communication with an allocation of 66 per cent of plan outlay.[18] Three main national highways were completed during this period.

i. Road from Phustsholing to Paro and Thimpu
ii. Road between Samdrup Jongkhar and Tashingang
iii. Road between Thimpu and Tashingang

Importance was also given to education (8.8 per cent of the outlay), forestry (3 per cent) and health (2.9 per cent).

Second Plan (1966-71)

Total outlay of second plan was 202.2 million ngultrums and India's contribution was 200.0 (98.9 per cent) million ngultrums.

Second plan also gave priority to the development of transport infrastructure and a road from Gaylegphug to Tongsa in Central Bhutan was constructed. It increased allocation in productive sector like agriculture from 1.8 per cent in the first plan to 10.7 per cent in second plan. Power sector was allocated 4.5 per cent of outlay, which got 1.4 per cent in first plan.

So second plan gradually ended Bhutan's physical isolation by improving the transport sector.

Third Plan (1971-76)

This was the first plan to be implemented under Bhutanese planning commission. Total outlay of the plan was 475.2 million ngultrums. India contributed 426.6 (89.8 per cent of total outlay)

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18 Kapileswar Labh, "Economic Development in Bhutan: Recent Trends and Prospects", *International Studies,* Vol. 31, no.2, April-June 1994, p.189.

million ngultrums. UNDP and internal sources of Bhutan contributed 3.3 per cent and 6.9 per cent of outlay respectively.

Tourism was given priority for the first time with the allocation of 3 per cent of plan outlay. Share of transport infrastructure declined and share of productive sector increased. Social sector was given importance with the allocation of about 27 per cent of the plan outlay.

Bhutan emphasized on industrialization during this plan and decided to set up the Penden Cement Project and Chukha Hydroelectric Project in 1974, with the help of India. But Chukha Hydroelectric project was excluded from plan outlay and was financed separately.[19]

The important thing of third plan is the financial assistance to Bhutan from United Nations System (UNDP). India was indirectly responsible for this as it sponsored Bhutan's name for membership in the United Nations in 1971. Bhutan's name appeared in the list of Least Developed Countries as prepared by the UN General Assembly[20] and it was able to get assistance.

Fourth Plan (1976-81)

Total outlay of fourth plan was 1106.2 million ngultrums, in which India's contribution was 853.0 million ngultrums accounting

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19 Ibid., p.191.

20 Prakash C. Adhikary, "Economic transition in Bhutan: A Study on the impact of Indo-Bhutan Trade and Economic Cooperation," *Asian Profile*, Vol. 21, no.6, December 1993, p.477.

77.1 per cent of plan outlay. Bhutan got 17.5 per cent resources from other sources and 5.4 per cent from internal sources.

Long term investments like Penden cement plan, surface irrigation development scheme were included in this plan. Development of industries continued to receive priority with the share of trade and industry increasing from 5.3 per cent in third plan to 15.8 per cent in fourth plan. Productive sectors like agriculture were also given priority with allocation of 23.4 per cent of plan outlay. However, the outlay for development of social sector decreased from 27 per cent in the third plan to about 17 per cent in the fourth plan.

During the plan UN sponsored projects were approved by Bhutanese Government after a great deal of debate and only after two conditions had been met.[21] The conditions were:

i. No UN resident official would be assigned to oversee the projected construction.
ii. UN assistance would complement, not duplicate Indian aid.

This plan also excluded the expenditure incurred on the Chukha project.

Fifth Plan (1981-87)

Total outlay of this plan was 4684.3 million ngultrums. India contributed 2017.5 million ngultrums which was 43.1 per cent of

21 Schienberg, n.10, p.55.

total plan outlay. During this plan Bhutan received 21.9 per cent resources of plan outlay from external sources other than India. Internal resources increased significantly to 32 per cent from5.4 per cent in fourth plan.

Two major changes took place during fifth plan, in the development strategy of Bhutan – decentralization of the process of development and increased self-reliance by promoting export-oriented industries. The king of Bhutan felt that if the people were directly involved in the formulation and implementation of the development plans, there would be a greater impact and a higher level of investment.[22] So, development plans were drawn up for each district, taking into consideration its developmental priorities and the available financial resources. District plans were then integrated into the fifth plan. So fifth FYP took a longer time, it covered six years instead of five years.

To make the country more self-reliant, decision was taken to set up a number of large export-oriented industries based mainly on Bhutan's abundant forest and mineral resources, whose products would find easy access to the large Indian market.[23]

Sixth Plan (1987-92)

Total plan outlay of sixth plan was 9559.0 million ngultrums. India gave 2612.7 million ngultrums accounting 27.3 per cent of

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22 Labh, n.18, pp.191-92.

23 *Bhutan: Development in a Himalayan Kingdom,* (Washington: World Bank, 1984), p.97.

plan outlay. Contribution of other external sources and internal sources were 27.2 per cent and 33 per cent of plan outlay respectively.

Emphasis on decentralization of the developmental process and increase in self-reliance continued during this plan.

Priority was given to the development of power and industries in the sixth plan. Allocation for power increased from 7.4 per cent in the fifth plan to 13.1 per cent in the sixth plan. Industries were allocated 7 per cent in the fifth plan which was increased to 13.3 per cent in the sixth plan.

A major change took place during the sixth plan – privatisation of enterprises. Previously government had played a leading role in developing the economy of the country through public sectors. But during sixth plan government recognized that economic growth could be achieved more efficiently through private enterprise than through active government involvement. So, this process began with the privatisation of Gedu Wood Manufacturing Corporation in 1990.[24] The Bhutan Tourism Corporation and the Bhutan Polythene pipe company were also privatized.

[24] Labh, n.18, p.192.

Table 2.2.
Outlays of Bhutan's Developmental Plans
(Percentage)

Sector	First Plan (1961-66)	Second Plan (1966-71)	Third Plan (1971-76)	Fourth Plan (1976-81)	Fifth Plan (1981-87)	Sixth Plan (1987-92)
Agriculture	1.8	10.7	12.3	23.4	9.0	9.2
Food Corporation of Bhutan	--	--	--	--	2.9	1.1
Animal Husbandry	1.4	2.8	5.1	5.6	3.5	3.5
Forestry	3.0	3.4	6.0	10.0	4.9	4.4
Power	1.4	4.5	6.3	4.6	7.4	13.1
Trade and Industries	1.0	0.5	5.3	15.8	7.0	13.3
Geological Survey	--	--	--	--	--	0.4
Public Works Department	58.7	34.9	17.8	11.6	16.9	9.3
Road Transport/Aviation	7.0	5.9	2.0	--	0.6	0.5
Post and Telegraph	0.5	2.9	2.5	1.5	1.4	0.7
Telecommunication	--	--	3.1	3.4	0.7	1.4
Tourism	--	--	3.0	1.1	0.6	--
Druk Air	--	--	--	--	--	4.1
Education	8.8	17.7	18.9	12.2	11.2	8.1
Health	2.9	8.3	8.0	4.9	5.1	4.2
Information and Broadcasting	0.1	0.7	0.8	1.0	0.8	1.0
Urban Development	--	--	--	--	4.0	2.6
General Government	--	--	--	--	24.0	20.6
Dzongkhaqs	--	--	--	--	--	2.5
Others	13.4	7.7	8.9	4.9	--	--
Total Outlay	100.00	100.00	100.00	100.00	100.00	100.00

Source: Kapileswar Labh, "Economic Development in Bhutan: Recent Trends and Prospects", *International Studies*, Vol. 31, No.2, April-June 1994, p.190.

Note: The figures exclude expenditures incurred on the Chukha Hydroelectric Project.

Sectoral Allocations and its Impact

As observed from the above table, development of infrastructure related to road and transport was given the highest priority in the first FYP with the allocation of 58.7 per cent of plan outlay to Public Works Department and 7 per cent to road transport sector. The objective was to end the physical isolation of Bhutan. Development of transport infrastructure continued to get priority in second FYP as pubic works and road transport received 34.9 per cent and 5.9 per cent of plan outlay respectively. Gradually allocation to this sector decreased from third FYP. But there has been significant change in Bhutan regarding road communication. Until 1960, Bhutan had no motorable road. By 1990, there were five national highways in Bhutan and it had constructed about 1472 km of highways.[25]

For the improvement of economic conditions of the people, emphasis has been given for the development of agriculture as it provides employment to about 93 per cent of the adult population of Bhutan. So, allocation to agriculture sector increased to 10.7 per cent of total plan outlay during second FYP from 1.8 per cent in first FYP and the allocation further increased to 12.3 per cent in third FYP, 23.4 per cent in fourth FYP. However, during fifth and sixth plan it decreased to 9.0 per cent and 9.2 per cent respectively. It enabled Bhutan to produce about 60 per cent of her food grains. Production of horticulture crops such as orange, apples also increased and the agricultural revenue in hard currency increased

25 S.S. Bhattacharya, "Bhutan Towards Modernization" in Ramakant, and R.C. Misra (ed.), *Bhutan: Society and Polity*, (New Delhi, Indus, 1996), pp.141-43.

from US$0.17 million in 1986 to US$6.5 million in 1989 due to export of those fruits and processed fruits products.[26]

Generation and consumption of power play a significant role in modernizing a developing country like Bhutan, Hence allocation for power sector increased from 1.4 per cent of plan outlay during first FYP to 4.5 per cent in second FYP and 6.3 per cent in third FYP. Though share of power sector decreased to 4.6 per cent in fourth FYP, it again increased to 7.4 per cent and 13.1 per cent during fifth and sixth plan respectively. Besides the plan outlay did not include the expenditure in major hydel project like Chukha Hydel Project during third plan. Generation of more power has decreased its import from India. Bhutan is today earning over $32 million by exporting the surplus electricity to India. Apart from this the electricity charges were reduced from 70 paisa per unit to 40 paisa in April 1987. From 1988 it became cheaper, about 25 paisa per unit.[27] Cheap and adequate supply of electricity has given a boost to the industrial growth in Bhutan.

Trade and industries were allocated 5.3 per cent of total outlay during third plan against 1 per cent and 0.5 per cent during first and second plan respectively, as Bhutan decided to set up Penden Cement Project in 1974. Allocation for this sector increased to 15.8 per cent in fourth plan. Trade and industries were allocated 7 per cent in fifth plan and 13.3 per cent in sixth plan as Bhutan

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26 Ibid., pp.149-50.
27 Kohli, n. 6, p.189.

took the decision to set up a number of large export-oriented industries based mainly on its abundant forest and mineral resources.[28]

Though Bhutan has emphasized on industrialization and other productive sectors like agriculture, animal husbandry, it has not neglected the social sectors like education and health. Education was allocated 8.8 per cent of plan outlay during first FYP and it increased to 17.7 per cent in second plan, 18.9 per cent in third plan, 12.2 per cent in fourth plan, 11.2 per cent in fifth plan. Allocation during sixth plan decreased to 8.1 per cent. This has resulted in increasing the literacy rate as well as the skilled manpower in Bhutan. In 1990, there were 156 primary schools, 21 junior schools, 10 high school with 48051, 11517 and 1580 student's respectively. Besides there were institutions like Sherubtse college for higher education, National Institute of Education, Teachers' Training Centre for training of teachers and the Royal Institute of Management (RIM) to train the civil servants. By 1990 there were 834 graduates in Bhutan who had taken up good position in the civil services of the country replacing the Indians.[29]

Health was allocated 2.9 per cent of total plan outlay during first plan. Allocation increased to 8.3 per cent in second plan, 8 per cent in third plan, 4.9 per cent in fourth plan, 5.1 per cent in fifth

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28 Labh, n.18, pp.191-92.
29 Bhattacharya, n.25, pp. 145-48.

plan and 4.2 per cent in sixth plan. As a result health facilities which numbered 39 in the 1970s have expanded to 160 in the sixth plan. Encouraged by the UNICEF/WHO's goal of Universal Child immunization, 84 per cent of children under the age of five were immunized against the major targeted disease by 1990.[30]

Bhutan has enough potential for tourism, and it was given priority for the first time in third plan with the allocation of 3 per cent of plan outlay. Its share decreased to 1.1 per cent in fourth plan and 0.6 per cent in fifth plan.

Indian Assistance to Bhutan besides Five Year Plans

India has provided assistance to various developmental programmes in Bhutan besides contributing to its Five Year Plans. Some of the important programmes are mentioned here.

Roads and Transport

The key to the development of Bhutan is rapid construction of road and the provision of an adequate system of transportation. What is significant, in view of Bhutan's past of isolation, is its decision to give communication the main priority in its development plans, and not only internal communications but communications that will link it more closely with the world outside. India has eagerly assisted in developing Bhutan's means of communications.

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30 M. D. Dharamdhasani, "Economic Development and Modernization" in Bhutan in Ramakant and Misra, , n. 25, p.200.

Until 1960s, Bhutan was linked with India by a few narrow foot-and-mute paths which were very difficult and hazardous. The path lay through the deep forest and crossed the lofty mountain ridges in zig-zag way. The Border Road Development Organization, a unit of the Indian civil and Military Engineers, with a work force of nearly 4,000 labourers have laboriously cleared the dense forest and laid roads across high ranges so that now heavy vehicles can reach up to Punakha in Central Bhutan. The new roads are fairly broad and have been made of heavy materials. About 400 miles of roads were constructed during the First-Plan period. Altogether four main roads were constructed from the Indo-Bhutan border to different places in Central Bhutan. These are : (1) Phuntsoling-Paro road, extended upto Thimpu and north of Wangdiphodrang on the Sarbhang-Punakha road (2) Sarbhang-Punakha road, (3) Gaylegphung-Tongsa road and (4) Samdrug-Jonkhar (Daranga)-Tashingong road.

The opening in June 1961 of Bhutan's first motor road, the 120-mile highway from Phuntsoling on the India-Bhutan border to Paro, was an event of great significance. The road was surveyed by the Indian engineers in 1959, work on it began in January 1960 and its completion in two working sessions was something of a record. The road was subsequently extended upto Thimpu. The

Indian Prime Minister, Mrs. Indira Gandhi, inaugurated the road at Thimpu in May 1968.[31]

Further roads were constructed during the Second, Third and Fourth Plan periods.. Internal road were also constructed in the townships of Sarbhang, Gaylegphug, Phuntsoling, Paro, Samchi, etc., A 300-mile east-west lateral road between Thimpu and Tashingong through the heart of the country was opened. That brought about greater integrity between the eastern and the western regions of Bhutan and facilitated the economic development in these regions. Connecting the north-south Indo-Bhutan highways that road passes through important places like Tashingong, Byakar, Tongsa and Wangdiphodrang. Strategically, it is very important as it crawls through a number of high passes.[32]

The Government of India also assists Bhutan in the air development. Bhutan's first airfield was constructed at Paro. The Paro airfield runway was further extended by 1,400 meters and the construction of another airfield at Yongphulla in Eastern Bhutan was completed.[33] A weekly Air Service between Hashimara in West Bengal and Paro in Western Bhutan started functioning form December 1968.[34]

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31 *Asian Recorder*, vol. XIV, no. 22, 27 May-2 June 1968, p.8339.

32 Ravi Verma, *India's Role in the Emergence of Contemporary Bhutan*, (Delhi: Capital Pub., 1988), p.99.

33 The Indian Express, 14 June 1974.

34 *Annual Report 1968-1969*, Ministry of External Affairs, Government of India, New Delhi, p.16.

Communication

Communication was a major problems for Bhutan. Lack of communication was an obstacle for economic development of Bhutan and its relation with India. India helped Bhutan to come out of this problem.

For speedy communication facilities, Government of India supplied 15 wireless units to Bhutan in 1960s[35] and Bhutanese operators were trained in their use. In 1964, the telephone system was set up in Thimpu to link the country directly with Calcutta. By 1977,12 automatic exchanges had been established in Bhutan with Indian assistance.[36]

Because of India's active financial and technical assistance, Bhutan could develop also other means of communication like a wireless system and a medium wave radio service.

An agreement for exchange of postal correspondence between Postal administrations of India and Bhutan was signed in New Delhi on 11 September 1962.[37] The agreement, which took effect immediately, provided for the regular exchange of unregistered correspondence, letters, post cards, printed papers, business papers, and samples of merchandise. Under the agreement, the Postal administration of India would forward to such of the member-countries of the Universal Postal Union as indicated by the

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35 K. Krishna Moorty, "Bhutan: The Economic Scene", *Far Eastern Economic Review*, 23 Feb 1961, p.333.

36 Schienberg, , n.10, p.56.

37 *Asian Recorder*, vol. VIII, no. 40, 17 October 1962, p.4815.

Postal Union as indicated by the Postal administration of Bhutan, articles of correspondence of Bhutanese origin, under the provisions of the Universal Postal Convention. The Bhutanese administration would prescribe appropriate postage rates for surface and air mail correspondence which would be in conformity with the Indian postage rates.

Two agreements in this connection were again signed between India and Bhutan on 21 April 1967.[38] One related to the letter post which, *inter alia,* provided for the exchange both of registered and unregistered correspondence, and replaced the previous agreement for the exchange of correspondence which had been signed in September 1962. The other was for the exchange of money-order. With India's sponsorship and support, Bhutan became a member of the Universal Postal Union in 1969.[39] A telephone service was made available between Thimpu and Siliguri in India. A teleprinter link between Phunstsoling and Siliguri was commissioned with Indian assistance in 1969.[40]

A Philatelic Wing set up during the last stages of the First Plan, has made phenomenal progress. The department has brought out a large number of stamp issues, which have been uniformly attractive and are highly regarded all over the world. Postal stamps are Bhutan's one of the biggest foreign exchange earners.[41]

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38 *Annual Report,* 1967-1968, n.34, pp.22-23.
39 *Annual Report,* 1969-1970, n.34, p.33.
40 Ibid., p.35.
41 Verma, n. 32, p.102.

Agriculture

Organized development of agriculture in Bhutan began with the inception of the First Five Year Plan in 1961 when the Department of Agriculture was established for modernization of agriculture with India's assistance. Development measures have been connected with the following aspects:

1. Better use of land through intensive methods of cultivation;
2. Bringing more and more land under cultivation;
3. providing irrigation facilities to more land;
4. Flood-control measures;
5. Soil conservation.

During the plan periods emphasis has been on increasing food production by providing high-yielding seeds, fertilizers, pesticides, improved tools and implement's and adequate irrigation facilities. Emphasis has also been laid on introducing new and improved varieties of seeds popularizing fruits and vegetable cultivation, and intensification of the research aspects.

The help of the Indian Council of Agricultural Research Project Coordinators were sought in the fields of rice, wheat, fruit and vegetables. The Bhutanese were invited to participate in the Annual ICAR workshops on these crops. Bhutan's Soil Conservation Officers were trained at the Dehradun Centre of the ICAR. The field level staff, like Forest Rangers, Inspectors and Overseers, were trained in the Assistant's Training Centres run by the ICAR and the

Department of Agriculture at Hazaribagh. Some lower staff were trained in the training centres run by the Government of Uttar Pradesh.[42]

Bhutan started a project for the production of temperate vegetable seeds with the assistance of an Indian expert from the Punjab Agriculture University.[43] A potato seed production centre was also set up recently at Pelela in Central Bhutan under the supervision of an Indian expert.[44] An Indian agriculturist provided guidance and technical know how for the cultivation of menthe crop in Bhutan. A number of feasibility studied carried out by the Indian experts showed that the whole belt of Southern Bhutan was favourable for growing mentha crop.[45] With the help of the Indian experts, a model farm was set up at Gaylegphug to train in the method of sugarcane cultivation. For the first time, sugarcane was grown in Bhutan on a large scale and the use of a cane crusher was introduced.[46] Over the years, agriculture in Bhutan has been considerably modernized with technical and financial aid from India.

Hydro-electricity Projects

Bhutan has enough potential for hydro-electricity generation. In September, 1961, India and Bhutan signed an agreement to

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42 Lal Babu Yadav, *Indo-Bhutan Relations and China Interventions,* (New Delhi: Anmol, 1996), p.172.
43 *Kuensel,* 19-25 June 1978, p.3.
44 *Kuensel,* 18-24 December 1978, p.1.
45 *Kuensel,* 15 July 1979, p.2.
46 *Kuensel,* 3 January 1980, p.4.

harness the river Jaldhaka for hydroelectric power.[47] Rising in Sikkim, the Jaldhaka river runs along the Indo-Bhutanese border for about 12 miles. In the spring of 1968, Bhutan received its first electricity. Although West Bengal is the chief beneficiary of the project, Bhutan received Rs.2.5 million from West Bengal as royalties for use of Bhutan's river water. Besides, Bhutan was able to get 250 kilowatts of electricity cost free.[48]

By the end of the Third Five Year Plan, a total capacity of 3,229 KW of power (2,270 KW of hydro-power and 959 KW of thermal power) was available.[49] The investigations of these projects were carried out by the Central Water and Power Commission (CWPC) of India with the Bhutanese funds. The construction was, however, financed by the Government of India. The Hydel Directorate of Bhutan was manned by Indian experts. During the Second Plan, the CWPC on their own incurred an expenditure of Rs.13 lakhs on surveys and investigations of hydel projects.[50]

The Chukha Hydro Power Corporation (CHPC) is the biggest and most successful of many projects in Bhutan which were implemented with India's technical and financial assistance. This power project on Raidek river began in 1974 and was completed in 1988. India entirely financed this project of 2460 million ngultrums,

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47 Vishnu Prajapati (ed.), *South Asia: Power and Politics (vol. 1),* (New Delhi: Commonwealth Pub., 1998), p.120.

48 Schienberg, n.10, p.56.

49 *Kuensel,* 22-28 March 1978, p.5.

50 Verma, n.32, p.111.

60 per cent of the sum as grant and the rest 40 per cent as loan.[51] After commission of the project in 1988, generation of electricity in Bhutan has increased substantially, as Chukha hydro power project has a capacity to generate 336 megawatts of electricity. Indeed it is an important source of internal revenue for Bhutan. It has also changed the balance of trade situation of Bhutan.

Education

Ever since the beginning of the planning era, great emphasis has been laid on the growth of literary and the spread of educational facilities. Perhaps there are few countries of the world like Bhutan that spend more than 10 percent of their national expenditure on the growth of education. Bhutan started from a narrow base. Before the commencement of the First Five Year Plan the education in Bhutan was limited only to the primary stage. In 1961 there were 59 lower and upper primary schools in Bhutan, there was not a single higher secondary school. The total enrolment of children was about 2,500.

In 1990, there were 156 primary schools in the country with a total enrolment of 48,051 students out of which 29,582 were boys and 18,469 girls. Moreover, in 1990 there were 46 community schools also know as Extended Class Rooms (ECRs) with an enrolment of 3978 pupils (2460 boys and 1518 girls). A community school is generally located in a locality with a minimum of 30

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51 Labh, n.18, p.195.

students to be enrolled with a walking distance of one hour. The curriculum of the primary education has been revised since the Sixth Five Year Plan to include courses on history, culture and environmental study of Bhutan.

In the secondary education system, after the final examination in class VIII, students are allowed to sit for the Indian Certificate School Examination class X. Only High Schools have courses up to class X. Thereafter for the course of XI-XII the students are sent to either the Sherubtse College or the Yangchenphug High School in Thimphu. In 1990 there were 21 Junior Schools and 10 High Schools with enrolments of 11,517 and 4467 students respectively.[52]

Higher education is provided in the Sherubtse College which offers general degree courses for Bachelor of Arts, Science and Commerce. The National Institute of Education located in Samchi is providing courses for Post Graduate Certificate in Education, B.Ed., and Primary Teacher Training examinations. There is one Teacher's Centre in Paro. It had an enrolment of 59 students in 1990. In the same year, there were 345 students enrolled with the National Institute of Education. The Curriculum in the Higher Secondary and University level of education is based on the Indian system of

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52 Bhattacharya, n. 25, pp.145-146.

education. The Sherubtse College is affiliated to the Delhi University of India.[53]

Other Developmental Assistance

Since the industrial base of Bhutan is still in its infancy due to limited infrastructure facilities and limitations on extracting natural resources, Bhutan possesses mainly cottage industries. Several other projects are coming up in Bhutan with Indian assistance, mainly agro-based industries like Gedu Wood factory. The other areas of economic co-operation between the two countries are in the fields of Geology and exploitation of minerals. It was way back the early 1960s, that the Geological Survey of India carried out a survey. According to this survey, Bhutan has rich deposits of dolomite, limestone, copper and gold. Later to extract these deposits the Government of India helped for the construction of laboratories and staff training centers. Another organization of the Government of India involved in the development of Bhutan is the Border Road Development Organization known as DANTAK, a unit of the Indian civil and military engineers. It undertook the responsibility for developing Bhutan's transport infrastructure.[54]

Government of India established the Penden Cement Plant at a cast of 150 million ngultrums with a capacity of 300 tonnes per day and handed it over to Bhutan. This plant commenced

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[53] A.C. Sinha, *Himalayan Kingdom Bhutan: Tradition, Transition and Transformation*, (New Delhi: Indus Publishing Company, 2001), p. 201.

[54] P.P. Karan and Jenkins, Jr., *Himalayan Kingdoms: Bhutan, Sikkim and Nepal*, (New Jersey: Nostrand Co. INC-Princeton, 1963), p.48.

production in 1981 and besides meeting the domestic needs it is exporting cement to neighbouring Indian states such Assam, Sikkim, and West Bengal.[55]

India also sponsored Bhutan's name for membership of various multilateral forums like as an observer at the 14th meeting of consultative committee of the Colombo Plan for co-operative economic development in South and Southeast Asia, in Melbourne in 1969, for United Nations in 1971 and for NAM in 1973.[56] This enabled Bhutan in getting assistance from multilateral sources.

Evaluation of Indian Assistance

The internal economic situation of Bhutan prevents the exploitation of its natural resources to their fullest potential. Bhutan lacks the factors, which would boost the domestic formation of capital. Looking at its economic background, low level of industrial development, lack of entrepreneurial capacity, shortage of skilled manpower, inadequate infrastructure, Bhutan was compelled to look for external assistance. It is well known that foreign assistance is used as an instrument of foreign policy. The donor country tends to have an upper hand. But for Bhutan, India is a good cooperative neighbour and its assistance to Bhutan can be considered as sharing of resources for the common benefit. India

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55 Labh, n.18, p.194.
56 Ram Rahul, n.11, p.39.

has helped Bhutan to develop its economy without interfering in its internal affairs.

To encourage the all-round development of Bhutan, the country needed a well-knit transport system. So India wanted Bhutan to undertake the development of roadways in a big way, so that this would make the commuting between both countries easy. India was not oblivious of the political and strategic implications of this road project. During the Chinese invasion of Tibet in 1959, the Government of India apprehended designs against India, through Bhutan. It would be very difficult to counter China due to extremely mountainous terrain and severe Himalayan climate and the absence of all-weather roads. So the first task was to construct the roads. Priority was given in the first FYP for development of road infrastructure. Due to India's active involvement, the principal highway of Bhutan from Phunchholing on the border of India to Paro was completed in the spring of 1962. With the completion of this road, Paro saw its first motor vehicles in 1962.[57] Now Bhutan is well connected with roads.

Hydroelectricity projects established in Bhutan with both financial and technical support of India have increased the facility for industrialization. Besides, it has increased the revenue of the government of Bhutan. By exporting the surplus electricity, Bhutan has diversified its composition and balance of trade.

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57 Prajapati, n.47, p.124.

Imparting training to Bhutanese personnels from different fields and allowing higher education to the students, of Bhutan, India has helped in improving the manpower of Bhutan.

Changing the priority in various plans and accordingly allocating resources, Bhutan has improved its socio-economic conditions. Health and education services has expanded substantially. Bhutan has improved in the field of agricultural production, cottage industries etc.

One noteworthy point is India's share of contribution to the five years plans of Bhutan has decreased significantly – from 100 per cent in first plan to 273 per cent in the sixth plan. But it does not explain the complete picture. Though percentage of India's contribution decreased, the plan outlay of Bhutan has increased dramatically, from 107.2 million ngultrums in first plan to 9559.0 million ngultrums in the sixth plan. In absolute terms India's assistance has increased from 107.2 million ngultrums in first plan to 2612.7 million ngultrums in sixth plan.

During this period share of external assistance other than India and internal resources has increased significantly. Indirectly, India has contributed to this. Due to India's sponsorship Bhutan could became member of various multilateral forums, which provided assistance to Bhutan. Besides due to India's active support surplus products like power and cement, internal source of Bhutan has increased.

Indo-Bhutan Trade Relations

Trade is another important aspect of India-Bhutan economic relations. Traditionally Bhutan had trade relations with regions like Bengal, Assam, Tibet and Cooch Behar. In those days they were trading musk, horses, dried chillies, walnuts, yaks, woolen goods etc. with Tibet and importing indigo, clove, tobacco, betel leaves, cotton cloth, dried fish etc. from India. [58]

For centuries there has been trade between Tibet and Bhutan with Bhutanese rice selling at high prices in Tibet and bringing back its value in salt, wool or Chinese silver dollars. Later on the Chinese communists in Tibet forced the acceptance of paper currency, worthless in Bhutan. More importantly, the traders had begun to bring back to Bhutan, along with their loaded mule packs, 'mental cargoes of propaganda'.[59] After Chinese occupation of Tibet, Bhutan imposed a ban on trade with Tibet in 1960. Bhutan's trade thus got completely oriented towards India.

Now major imports of Bhutan from India are fuel, food grains, metal containers etc. and exports to India power, cement, talc, fruit products, sawed timber, cardamom etc.

After India's independence, Indo-Bhutan trade relations were guided by Article-5 of the Indo-Bhutan Treaty of 1949, which provides for free trade and commerce between the territories of Government of India and the Government of Bhutan.

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58 Labh, n.18, p.195.
59 Prajapati, n.47, pp.124-25.

The first Indo-Bhutan Agreement on Trade and Commerce was signed on 17 January, 1972. The major features of the Trade and Transit Agreement, 1972, were as follows:

- Bhutan will continue to enjoy freedom from import duties on goods imported from third countries on the same basis as heretofore [article IV (1)].
- The Royal Government of Bhutan will continue to enjoy as heretofore freedom from import duties in respect of goods imported on official account from third countries for consumption in Bhutan or from export duties in respect of goods of Bhutanese origin exported on official account to third countries [article IV (2)].
- India agreed to 'provide foreign exchange to the extent possible for import into Bhutan such items as are essential for diversification and growth of Bhutan's economy (Article VI).
- The subjects of Bhutan and the citizens of India will have the right to carry on trade in each other's country, subject to such exceptions as may mutually agreed upon (Article VII).
- To ensure the effective and harmonious implementation of this Agreement, the two Governments undertake to consult each other periodically so that such difficulties as may arise in its implementation are resolved satisfactorily and speedily. The Royal Government of Bhutan has agrees to consult the Government of India in regard to its commercial, economic and trade relations with foreign countries(Article VIII).

Later given Bhutan's increasing need for international trade, the agreement was replaced by a new trade arrangement in 1978. This arrangement provides all the facilities to Bhutan's international trade to meet its development requirements. According to this arrangement Bhutan can develop its trade relation with third country and earn foreign exchange.

The Trade and Transit arrangements between these two countries has the following features.[60]

- the establishment of foreign exchange account at the State Bank of India (Overseas Branch) in Calcutta in the name of Government of Bhutan;
- simplified export procedure;
- depositions of all foreign exchange earnings from commodity exports and foreign exchange receipts of Indian travel agents for package tours to Bhutan into State Bank of India account, and complete freedom of these Bhutanese Government to utilize these funds in accordance with its own choice.

In September 1980, Bhutan signed a Treaty of Trade and Transit with Bangladesh.[61] But the problem regarding trading with Bangladesh was the absence of transit facilities through Indian territory. Hence, Bhutan and India decided to revise their earlier agreement which was finally signed on 27 December, 1983,

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60 Gautam Kumar Basu, *Bhutan: The Political Economy of Development,* (New Delhi: South Asia Publishers, 1996), p.65.

61 Labh, n.18, p.195.

providing free trade between the two countries India agreed to external transit facilities with third countries.

The major features of the treaty are as follows:[62]

- accepts Bhutan's right to impose non-tariff restrictions on the entry of Indian goods.
- releases all imports and exports involving third parties from Indian trade duties and any trade restrictions that may be operated internally in India;
- grants most-favoured nation (MFN) treatment to merchant ships engaged in non-coastal trade and sailing under the flag of Bhutan.

It was decided that annual consultations would take place to oversee whether duty free goods to Bhutan were making their way to Indian markets. A look into this treaty would make it clear that India concedes some of the Bhutanese demand simply to protect Bhutanese infant industries.

The major problem of Bhutan's trade with India has been the trade deficit of Bhutan. It was due to low industrial base of Bhutan and very few products in its exports basket.

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62 Basu, n. 60, p.65.

Table 2.3

Bhutan's Balance of Trade with India

(Ngultrums]

Year	Imports	Exports	Balance
1981	451,024,000	164,440,000	-286,584,000
1982	440,227,318	155,206,252	-285,021,066
1983	409,002,510	158,212,795	-250,789,715
1984	673,626,000	193,190,099	-480,435,901
1985	829,418,258	265,187,327	-564,230,931
1986	829,507,636	373,664,093	-455,843,543
1987	985,177,145	695,715,137	-199,462,008
1988	1,108,895,447	989,250,553	-119,644,894
1989	1,214,811,637	985,927,144	-228,884,493

Source: Kapileswar Labh, "Economic Development in Bhutan: Recent Trends and Prospects", *International Studies,* Vol.31, no.2, April-June, 1994, pp.196-97

Table 2.4

Bhutan's Export to India by Major Commodity

(percent)

Commodities	1981-82	1984-85	1988-89
Cement	21.5	20.9	11.2
Timber	9.6	7.0	9.2
Cardamom	6.5	8.0	2.8
Potatoes	9.4	6.0	3.2
Oranges	10.4	7.2	2.4
Alcoholic beverages	0.6	3.3	2.7
Sawlog and Veneerlays	0.2	3.0	11.3
Block board	--	3.2	3.4
Electricity	--	--	37..4
Total (Nu million)	166.2	200.0	989.8

Source: Mahendra P. Lama, "Bhutan: A Changing Development Paradigm" in Ramakant and R.C. Misra (ed.), *Bhutan: Society and Polity,*(New Delhi: Indus Pub., 1996), p.162

Table 2.5

Bhutan's Import from India by Major Commodity

(percent)

Commodities	1981-82	1984-85	1988-89
Diesel	7.6	9.3	6.5
Rice	3.0	3.0	6.2
Wheat	--	--	1.9
Tyres and Tubes	0.9	2.1	2.9
Electricity	--	--	10.5
equipment	--	--	4.9
Motor vehicles	2.8	3.4	--
Machinery parts			
Total (Nu million)	520.6	725.0	1108.9

Source: Mahendra P. Lama, "Bhutan: A Changing Development Paradigm" in Ramakant and R.C. Misra (ed.), *Bhutan: Society and Polity,* (New Delhi: Indus Pub.,1996), p.163

From the above tables it is clear that composition of Bhutanese trade with India has changed over the years. Now Bhutan is exporting less agro products and more manufacturing products like cement and electricity and importing more electrical equipment.

It is observed that Bhutan is heavily dependent on India for its development. India continued to be the major source of economic assistance and major trading partner of Bhutan.

Chapter-III

III

ECONOMIC RELATIONS IN 1990S – TRENDS, ISSUES AND CHALLENGES

In the previous chapter various aspects of economic relations between India and Bhutan from 1950s to end of the 1980s were discussed. This chapter deals with the major changes and issues in the economic relations between these two countries in the 1990s.

Planned Development

The 1990s period covers the second half of the Sixth Five Year Plan (FYP), Seventh FYP (1992-1997) and first half of Eighth FYP (1997-2002). Some trends of Bhutan's planning for development since the mid-eighties are all tuned to the goals set in subsequent five-year plans. The ten outstanding trend are.[1]

i. human resource development.

ii. modernizing the political economy without upsetting the social balance and jeopardizing the ethical-moral underpinning of Bhutanese society.

iii. exploitation of the country's considerable hydel and forest resources for generation of power and industries which keep the environment unspoilt, and more, generate among the population an awareness of the value of preservation of the environmental balance.

iv. building institutions of governance as well as development, and continuous development of legal structure of the political economy.

v. making the grass-root participatory mechanism-the District Development Committees (DYTs) and Block Development Committees (GYTs), the main vehicle of sustainable development.

vi. gradually increasing the role of private sector in expanding the economy and lending it greater dynamism.

vii. gradually extending the arteries of modernization to the rural areas and diminishing the still dominant role of agriculture in the Gross National Product (GNP).

viii. increasing emphasis on infrastructural development throughout the kingdom.

ix. presenting social and political stability as the principal foundation of development.

x. keeping peace on borders and building trouble-free cooperative relationships with the neighbours, as well as the countries that contribute to Bhutan's economic development.

Sixth Five Year Plan (1987-1992)

Total outlay of Sixth Plan was 9559.0 million ngultrum. India contributed 2612.7 million ngultrum accounting 27.3% of plan outlay. Contribution of other external sources and internal sources were 27.2% and 33% of plan outlay respectively.[2]

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2 Kapileswar Labh, "Economic Development in Bhutan: Recent Trends and Prospects," *International Studies*, vol. 31, no.2, April-June 1994, p.193.

Major objectives of this plan were: [3]

- strengthening of government administration (including the continued campaign against corruption and nepotism).
- preservation and promotion of national identity (particularly through the strengthening of the newly-formed special (now National) commission for cultural Affairs and of traditional institutions).
- mobilization of internal resources
- enhancement of rural incomes
- improvement of rural housing and resettlement
- consolidation and improvement of services
- promotion of popular participation in the formulation and execution of development plans and strategies
- promotion of national self-reliance

As Bhutan kept up its emphasis on decentralization, the 'Dzonghaqs' (districts) emerged as a new sector under this plan, claiming 2.5% of the plan.The plan gave priority to the development of power and industries. So allocation for power increased from 7.4% in the Fifth Plan to 13.1% in the Sixth Plan. Education and Health were allocated 8.1% and 4.2% of the plan outlay.[4] A major change in the development strategy was effected through privatization of enterprises during Sixth Plan. Inorder to promote suitable institution and legal environment for

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3 *The Far East and Australia 2002*, London, Europa Publication, 2002, p.179.
4 Labh, n.2, p.192.

privatization government passed 'The Companies Act of Kingdom of Bhutan, 1989'. The companies registered under this act are free to take decisions and need not follow the Royal Civil Service Rules, thus giving the management freedom to act in the interest of enterprises' efficiency.[5]

The Royal Government of Bhutan claims a significant increase in per capita income which went up from Nu 6328 in 1987 to Nu 11,050 in 1991 in nominal terms, during Sixth Plan period. This plan period also saw notable achievements with the expansion of health and education facilities. Bhutan achieved universal child immunization in 1990 and more than 90% of the population have access to primary health care. Education has reached to almost 67% of all school going age children by the end of the Sixth Plan period. But industrial sector growth declined as manufacturing output was adversely affected by labour shortages, ethnic disturbances in the southern part of the country where most industries are located and the lack of new major projects.[6]

To develop its power sector further, Bhutan signed a Memorandum of Understanding with India in November 1990, in accordance with which India was to prepare the detailed project reports for the Tala Hydel Project (Chukha-II) and the Wangchu Reserviour Scheme (Chukha-III) for 1000 MW and 600 MW respectively.[7] India handed over the 336 MW capacity Chukha Hydel Project to Bhutan in June 1991.[8] The Gyesta

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5 Mahendra P. Lama, "Bhutan: A Changing Development Paradigm" in Ramakant and R.C Misra (ed.), *Bhutan: Society and Polity*, (New Delhi: Indus, 1996), p. 160.

6 Smita Mehrotra, "Economic Development in Bhutan: Recent Tends" in Ramakant and Misra (ed.), n.5, pp. 188-90

7 *Annual Report*, Ministry of External Affairs Government of India, New Delhi-1990-91, p. 4

8 *Annual Report*, n.7, 1989-90, p.4.

Hydel Project of 1.5 MW capacity involving a cost of Rs.4.42 crores was inaugurated in December 1989, which was commissioned in July 1988.[9]

During Sixth Plan period significant developments occurred in the field of communication also. ISD link between India and Bhutan was inaugurated in August 1989.[10] 50 MW Bhutan Broadcasting station, entirely built by Indian assistance was also inaugurated in March 1991.[11]

Thimpu-Paro sub transmission and distribution system project involving a cost of Rs.11.5 cores was completed in 1989. Survey were carried out by India for a second airport in Southern Bhutan.[12]

Seventh Five Year Plan (1992-97)

In December 1991, the Deputy Chairman of Planning Commission of India visited Bhutan to discuss in details about the revenue earning projects besides social sector during its seventh FYP.[13] Total outlay of seventh FYP of Bhutan was kept at Rs.2350.00 crores. India contributed Rs.750.00 crores accounting for 31.9% of total plan outlay.[14]

In the Seventh Plan the primary objective of Bhutan was to consolidate the nation's social and economic infrastructure. The major objectives of this plan were.[15]

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9 *Annual Report*, n.7, 1991-92, p.2.
10 *Annual Report*, n.7, 1989-90, p.4.
11 Ibid., p.3.
12 *Annual Report*, n.7, 1991-92, p.3.
13 Ibid.
14 *India-Bhutan Relations*, Ministry of External Affairs, Government of India, New Delhi, http://www.meadev.nic.in/foreign/bhutan.htm
15 M.D. Dharmdhasani, "Economic Development and Modernization in Bhutan" in Ramakant and Misra, n.5, p. 201.

Self-reliance with emphasis on the internal resources mobilization.:

- human resources development
- participation of the people in development through effective decentralization
- Integrated and well balanced regional development
- sustainable development with emphasis on environmental protection and
- efficiency with emphasis on privatization and support to the private sector.

During Seventh Plan allocation to power sector decreased to 2.5% from 13.1% in the sixth plan. Similarly trade and industries were allocated 5.4% of Seventh Plan outlay against 13.3% in the Sixth Plan. Allocation in the social sectors however increased during Seventh Plan. Education sector received 11.1% of outlay as against 8.1% in the previous plan and health was allocated 6.6% as against 4.2% in the Sixth Plan. Telecommunication sector got 7.0% of plan outlay which was allocated hardly 1.4% in the Sixth Plan. Allocation to general government sector increased dramatically to 39.7%, while it was allocated 20.6% of outlay in the Sixth Plan.[16]

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16 S.S. Bhattacharya, "Bhutan Towards Modernization" in Ramakant and Misra, n.5, pp.154-55.

Table 3.1
Outlays of Development in Sixth and Seventh Five Year Plan

(in percentage)

Sector	Sixth Plan	Seventh Plan
1. Agriculture	9.2	4.5
2. Food Corporation of Bhutan	1.1	--
3. Animal husbandry	3.5	2.1
4. Forestry	4.4	3.1
5. Power	13.1	2.5
6. Trade and Industries	13.3	5.4
7. Geological survey	0.4	1.0
8. P.W.D. (roads)	9.3	7.8
9. Road transport and aviation	0.5	0.6
10. Post and Telegraph	0.7	1.1
11. Telecommunication	1.4	7.0
12. Tourism	--	--
13. Druk Air	4.1	--
14. Education	8.1	11.1
15. Health	4.2	6.6
16. Information and Broadcasting	1.0	0.6
17. Urban Development	2.6	4.6
18. General Government	20.6	39.7
19. Dzongkhags	2.5	2.3
20. Others	--	--

Source : S.S. Bhattacharya, "Bhutan Towards Modernization" in Ramakant and R.C. Misra, *Bhutan: Society and Polity*, New Delhi, Indus, 1996, pp.154-55.

Compound growth rate of gross domestic product during Seventh Plan was 5.8% in which agriculture sector recorded growth rate of 2.4%, mining 14.1%, manufacturing 9.1%, electricity 3.9% trade and commerce 3.7% and transport and communication sector grew 5.9%.[17]

Sectoral composition of production changed significantly at the end of the seventh plan compared to its previous periods. In 1980, agriculture, industry and services contributed 56.7%, 12.2% and 31.1%

[17] *Eighth Plan Document*, Planning Commission Secretariat Royal Government of Bhutan, Thimpu, www.pcs.gov.bt/

to the GDP respectively while in 1997 their share changed to 36.2%, 28.0% and 35.9% respectively.[18]

Tala and Kurichu Hydro Electric Project, Dungsum Cement Plant, Bunakha Project, Sankosh Multipurpose Project, Paro Airport Development Project were taken up during Seventh FYP.

Tala Hydro Electric Project

A memorandum of understanding was signed during the Bhutanese king's visit to India in November 1990, in accordance with which India was to prepare the Detailed Project Reports (DPRs) for Tala Hydro Electric Project (Chukha-II) and Wangchu Reservoir Scheme (Chukha-III) for 1000 MW and 600 MW respectively.[19]

Following the bilateral agreement signed on March 5, 1996,[20] this 1020 MW Tala Hydel Project on Wangchu river, downstream of Chukha Project, was launched. This is a run-of-the-river (RoR) project with 6 units of 170 MW each. The initial estimates of Rs.1408 crores (at 1993 price levels) was revised to Rs.2816 crores at 1998 price levels. This project is funded by under the 'Plan' funds of Government of India, with 60% grant and 40% loan repayable at 9% interest per annum.[21]

The surplus power would be sold to India at mutually agreed rates. To oversee the implementation of the project, an 8-members Tala Hydro Electric Project Authority (THPA) has been constituted.

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18 *SAARC Survey of Development and Cooperation 1998-99,* Research and Information System for the Non-Aligned and other Countries, New Delhi, 1999,p. 18

19 Annual Report, n.7, 1990-91, p.4.

20 Annual Report, n.7, 1995-96, p.3.

21 *India-Bhutan Relations*, n.14.

Kurichu Hydro Electric Project

Kurichu Hydro Electric Project envisages 3 units of 15 MW each with provision for an additional 15 MW unit. Government of India had earlier signed a bilateral agreement for implementation of this project. Similar to THPA, Kurichu Project Authority (KPA) was constituted to oversee the implementation of the project. KPA has in turn signed a turnkey agreement on September 24, 1995 with National Hydel Power Corporation (NHPC) for execution of the project on turnkey basis. The contract value is Rs.273.01 crores. So far 12 project authority meetings of the KPA have been held, the latest in New Delhi on October 13, 1999.[22]

Sankosh Multi Purpose Project

During the visit of the king of Bhutan to India in 1993, both countries signed a memorandum of understanding on January 4, 1993 for the preparation of the detailed project report for the Sankosh Multi-purpose Project.[23] This project will be one of the largest multi-purpose project in South Asia and will generate 1525 MW of power.[24] After the completetion of the project, it can supply power to India's northen and eastern grid.

Other Hydel Projects

Bhutan signed a memorandum of understanding with India for preparation of the detailed project report for Bunakha Hydel Project of

22 Ibid.
23 Labh, n.2,p.204.
24 *India-Bhutan Relations*, n. 14.

120 MW capacity in November 1992.[25] Besides the above mentioned hydel projects, Bhutan took steps to develop the Tangsibi Hydroelectric Project of 45 MW capacity and the Basochu Hydroelectric Project of 46 MW capacity.[26]

Dungsum Cement Plant

The commercial success of Penden Cement Plant paved way for the keen interest of Bhutanese Government in seeking assistance from Government of India for Dungsum Cement Plant in Eastern Bhutan, a relatively underdeveloped and economically poor region. It is a dry process plant with capacity to produce 1500 tonnes of cement everyday.[27] As per the agreement on March 5, 1996, Government of India was to provide Rs.300 crores as funds for project and Rs.100 crores towards infrastructural facilities on the Indian side.[28] As 8-members Dungsum Cement Plant Authority (DCPA) has been constituted for implementation of the project. The first meeting of the DCPA was held in Delhi on June 18, 1996. The latest (sixth) meeting was held in Thimpu in May 1999. M/s. ACC Ltd., Mumbai joined the cement plant as joint venture partner with 20% equity and the remaining 80% equity was held by the Royal Government of Bhutan. But in October 1999, M/s. ACC announced its withdrawal from the joint venture on security reasons. An inter-governmental meeting was held in New Delhi on October 13, 1999 to review the project's progress and identify future course of action.

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25 *Annual Report,* n.7, 1993-94, p.2.
26 Labh, n.2, p.204.
27 *Annual Report,* n.7, 1992-93, p.16.
28 Labh, n.2, p.204.

Paro Airport Development Project

Phase-I of the Paro Airport was completed and the runway and hanger building were inaugurated in August 1990.[29] Phase-II of the project was carried out during Seventh FYP which includes terminal building, control tower, cargo tower and a cargo warehouse. This project of more than Rs.23 crores was handed over to Bhutan after its completion by the Minster of External Affairs of India, Mr. Jaswant Singh during his visit in April 1999. [30]

Eighth Five Year Plan (1997-2002)

Total outlay of Eighth FYP of Bhutan is Rs.32061 crores in which India's contribution is Rs.900 crores, accounting 27.6% of total plan outlay. This comprises Rs.400 crores as development subsidiary and Rs.500 crores as project-tied assistance.[31] This assistance is apart from the financing of three on going mega project. Tala Hydro Electricity Project (THEP), Kurichu Hydro Electricity Project (KHEP) and Dungsum Cement Plant (DCP).[32] Indian assistance to Bhutan for its Eighth FYP has focused mainly on the development of infrastructure involving the construction of roads, bridges, hospitals and creation of power generation capacity. In recent years, emphasis has been on the promotion of mutually beneficial economic and technical ties between the two

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29 *Annual Report,* n.7, 1990-91, p.5.
30 *Annual Report,* n.7, 1999-2000, p.10.
31 *India-Bhutan Relation,* n.14.
32 *Annual Report,* n.7, 1997-98, p.19.

countries. Some of the important projects to be taken up during the Eighth FYP are as follows:

Table 3.2
Projects during the Eighth FYP

S.No.	Name of Project	Estimated Cost (Rs Crores)
1.	Punakha Dzong Renovation	22.85
2.	Construction of three Bridges	8.36
3.	Strengthening and Upgradation of Sub-transmission and Distribution System in Thimpu and Paro (Phase II)	39.52
4.	Eastern Grid power Transmission	80.00
5.	Construction of High Court Building	10.80
6.	Improvement of National Highways (Thimpu-Paro Widening)	17.90
7.	Gaylephug-Sarpang-Tsirang Road	21.00
8.	Realignment of Roads Tamchhu-Chukha Sector	13.40
9.	Construction of Bakuli-Daifam Road	26.40
10.	Urban Electrification	39.38
11.	Improvement and Upgradation of Electrical Services	81.00
12.	Power Training Institute	13.23

Source: *India-Bhutan Relations,* Ministry of External Affairs, Government of India, New Delhi, http://www.meadev.nic.in/foreign/bhutan.htm

Self-reliance

Importance on self-reliance was given from Fifth FYP. The central theme of the Eighth FYP development programmes was mustering of efforts towards achieving self-reliance as expressed by His Majesty the King. "National self-reliance in the Bhutanese context means ultimately to be able to stand on one's own feet have the power of decision in one's own hands and not be dependent on others."[33]

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33 *Eighth Plan Document,* n.17.

The achievement of the goal of self-reliance is largely depended on progress in human resource development and the application of technology appropriate to Bhutan's development needs. The expansion and improvement of education and technical training and of HRD in all economic sectors were given importance in the plans. Vocational training, particularly in technical fields were given priority with improvement of management. Both as an essential tool for self-reliance and as an end in itself, the focus on HRD includes education and health as key elements. Therefore, eight FYP includes further investment in preventive medicine and improved health services, with continued efforts to maximize cost effectiveness.[34]

Investment was to be made in the economic sectors to increase GDP, personal incomes and government revenue. High priority was given for investment in essential infrastructure, particularly the development and improvement of surface transport and telecommunications.

Sustainability

Sustainability is another important objective of planned development of Bhutan. It requires that all development is consistent with environmental conservation and cultural values, and that it enhances the capacity of country to increasingly provide, from its own resources, the financial and other services required to support self sufficiency. With sound policies and management, Bhutan is trying to be self-sufficient in terms of skilled manpower and both capital and current

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34 Ibid.

resources. During the eighth FYP, the enhancement of national revenue to support development goals from both tax and non-tax sources was considered as an important objective.[35]

Preservation and promotion of Cultural and Traditional Values

The objective of preservation and promotion of Bhutan's unique cultural and traditional values continued in FYPs in the 1990s. For a small country with neither military might nor economic strength to safeguard its security, this distinct identity is seen as an important means to safeguard and strengthen Bhutan's status as a sovereign and independent nation. So, it was ensured that the culture of the country should not be eroded in the process of modern development.

National Security

Security for Bhutan, its people and its governing body, to lead a life and a path of development of their own choice without unnecessary external interference, is an over-riding objective which will be strengthened as the economy grows. In this regard Bhutan expects to be benefited from its continued collaboration with its friendly neighbours and with donors.

Balanced Development

Achieving balanced development was also a key objective which involves, as far as possible, providing equal access to basic service and

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35 Ibid.

facilities of comparable quality to all Bhutanese wherever they reside in the kingdom.

Institutional Strengthening and Human Resources Development

Government institutions concerned with all stages of development from planning to implementation were to be strengthened during Eighth FYP. There was a need to improve management as well as to supply the skilled manpower and to ensure its effectiveness and efficient utilization, in both public and private sectors. Bhutan needed donor assistance for its national HRD programme during Eighth FYP.

Decentralization and Community Participation

In Bhutan, community participation has long been customary in a range of local activities from house-building to the construction and maintenance of religious and cultural buildings. In recent years, communities have become further involved in development work such as construction of feeder and farm roads, schools and health clinics, and without their support costs of these services would be beyond government's limited budgetary resources. So, it is the government's objective to mobilize continued community participation for these essential services.

Since fifth FYP, the process of decentralization in development activities has been started. Local communities were to determine the priorities for developments which affect them, whether these are part of national programmes or of a limited local nature and to have more control over their implementation. During eighth FYP efforts were to be made to strengthen planning and implementation capacity at Gewog (Block) level.

Privatization and Private Sector Development

Privatization is a major step in the 1990s, which was initiated during Sixth FYP and continued in Seventh and Eighth FYPs also.

The privatization of some services such as agricultural input supply and produce marketing or the provision of a rural water supply provides opportunities for local participants or beneficiaries to undertake these services on a cooperative basis. In other cases, privatization provides new opportunities for individual entrepreneurs to undertake commercial activities initiated in the first place by the government, or to develop new business in areas such as surface transport, in which private sector investment is encouraged by government investment in improving the infrastructure. The king, however made it clear to the business community that privatization in Bhutan must tread its own path and not copy any foreign model. Privatization, he observed, was not meant to be *kidu* (welfare) for the business community, but to enable and promote economic growth for the benefit of the entire population of Bhutan. The ruler of the country has one eye fixed on social development, while his other eye explores how a strong and socially conscious private sector can be created gradually in the kingdom.[36]

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[36] Sen Gupta, n.1, p.93.

The government's general role in eighth FYP vis-à-vis private sector development was to be that of promoting an 'enabling environment'.[37]

Table 3.3
Profile of Major Enterprises for the Eighth Five-Year Plan

	Year of Estd.	Current Status	Private holding by the end of 6FYP (per cent)	Private holding by the end of 7FYP (per cent)	Targeted private holding by the end of 8FYP (per cent)
Bhutan Carbide and Chemicals Ltd.	1984	Operational	75	100	100
Bhutan Board Products Limited	1983	Operational	61	76.1	85
Penden Cement Authority Limited	1974	Operational	25	31.26	49
Distillery (Army Welfare Project)	1976	Operational	0	0	
Bhutan Fruit Products Limited	1973	Operational	100	100	100
Bhutan Logging Corporation	1984	Operational	0	0	
Gedu Wood Manufacturing Corporation	1982	Under Liquidation	100		
Lhaki Cement Private Limited	1989	Operational	89	100	100
Bhutan Tourism Corporation Limited	1974	Operational		93.3	95
Shumar Gypsum	1980	Liquidated			
Druk Satair Corporation Limited	1993	Operational		100	100

37 *Eighth Plan Document*, op. cit., n.17.

Bhutan Polythene Company	1986	Operational	51.1	60.06	70
Handicrafts Development Corporation	1974	Operational	0	0	
Namgail Cement Company Limited	1988	Operational	100	100	100
Bhutan Marbles and Minerals Limited	1989	Operational	100	100	100
Wood Craft Centre	1990	Operational	0	0	
Bhutan Agro Industries Limited	1993	Operational	0	0	
Penden Drukpa Coal Company	1988	Liquidated 1993			
Eastern Bhutan Coal Company	1993	Operational		100	100
Bhutan Ferro Alloys	1990	Operational		20	20

Source: Sen Gupta, Bhabani, *Bhutan: Towards a Gross-root Participatory Polity*, New Delhi, Konark Publication, 1999, p.94.

"Economic growth, however, is not the goal of development, human development is," says the Eighth Plan document. "Income expansion and increased commodity production are only means that have the potential for enhancing human capabilities. They are useful only to the extent that they can contribute to 'Gross National Happiness'. What matters is how secure people feel, the peace and comfort they enjoy, the richness of human lives. Recognizing that there is no automatic link between economic growth and human development, planning in Bhutan has put in place several policies that have enabled that translation of economic growth into human development."

Bhutan has given the topmost priority to investment in people. Every effort has been made to channel economic growth to ensure universal access to basic health, education and essential social services. Today, every family in Bhutan has shelter and access to landholding; every child is entitled to free education and every individual is offered free medical treatment. There is an effective health care system that is accessible to 90 per cent of the population. An extensive outreach system has been designed to ensure that help is made available as soon as possible even in remote villages 58 per cent of the rural population has access to piped drinking water and latrines.[38]

Table 3.4
Comparative Socio-Economic Indicators for Bhutan
(June 1998)

	1985	1998
INCOME		
GDP in million Nu	2392	11.714(a)
Per Capita GDP in US$	--	551 (a)
Average GDP growth	6.8%	6.7%#
Share of agriculture to GDP	53%	38.6%(a)
Saving as % of GDP	0%	26.3%(a)
Investment as % of GDP	45%	44.4%(a)
Inflation rate	4.4%	6.6%(*)
EXTERNAL ACCOUNT		
Export as % to GDP	11.4%	30.3% (a)
Import as % to GDP	43.5%	38.6%(a)
Foreign exchange reserves (i+ii_	20.6	208.89
i. US$ - 16801 m		
ii. Rupees – 1644.70m or US$ 40.88m		
(Exchange Base Rate US$1-Nu. 40.23)		
PUBLIC FINANCE		
Govt. revenue receipt	233	2860.3(b)
Tax revenue in million Nu	135.9	1360.9@

38 Sen Gupta, n.1, p.89.

	1985	1998
Govt. expenditure in million Nu	1217.7	6389.3(b)
Current	441.5	2709.3(b)
Capital	776.2	3351.1 (b)
Net lending and repayments	--	328.8 (b)
HUMAN RESOURCES		
Population	--	600,000 (Est.)
Population growth rate	2%	3% (est.)
HEALTH		
Life expectancy at birth		
Male	45.8 (c)	65.9 (d)
Female	49.1(c)	66.1 (d)
1. Infant Mortality Rate (per 1000 live births)	142 (c))	70.7 (d)
2. Crude Birth Rate (per 1000 live births)	39.1 (c)	39.9 (d)
3. Crude Death Rate (per 1000 live births)	19.3 (c)	9.0 (d)
4. Maternal Mortality Rate (per 1000 live births)	7.7 (c)	3.8 (d)
5. Health Coverage	50%	90% (d)
Health Institutes (nos.)	157	661
1. Hospital	27	28
2. Indigenous Hospital	1	1
3. Indigenous Units	4	11
4. Training Institutes	1	3
5. Basic Health Units	65	145
6. Dispensaries	44	**
7. Malaria Centres	15	19
8. Outreach Clinics	--	454
Universal child immunization	--	84% (e)
Rural pop. with access to piped water	14%	58%
Rural population with access to latrine	--	80%
EDUCATION		
School enrolment (Nos. of Students)	51,835	1,00,198†
Enrolment rate	--	72%
Literacy rate	23%	54%
Number of Educational Institutes	183	322
1. High Schools	8	18
2. Junior High Schools	22	44
3. Primary Schools (Including Community Schools)	145	243
4. Private Schools	--	7
5. Degree College	1	1
6. Others Institutes (Including Sanskrit Pathsalas)	7	9

	1985	1998
TRANSPORT AND COMMUNICATION		
Length of Road (Km)	1755.1	3375.65
Number of Telephone Exchanges	13	25
Number of Telephone Connections	1880	7445
Number of Post Offices	54	105
Number of WT Stations	18	39
Rural Water Supply Scheme	150	1768
Number of Suspension Bridges	175	320
RNR COMMON SERVICES		
RNR Centres	--	35
National Resources Training Institute	--	1
RNR Research Centre	2	4
RNR Research Sub-stations	--	6
Soil and Plant Analytical Laboratory	--	1
AGRICULTURE		
Agriculture Extension Centres	121	159
Agriculture Seed Production Farms	10	11
Plant Protection Centres	--	3
Farm Mechanization Centres	--	3
Farm Mechanization Training Centres	1	1
National Mushroom Centres	1	1
ANIMAL HUSBANDRY		
Veterinary Hospital	18	21
Livestock Extension Centres	87	110
Regional Veterinary Laboratory	--	4
Satellite Veterinary Laboratory	--	2
Livestock Farms	14	11
Fodder Seed Production Centres	1	2
Vaccine Production Centres	--	1
National Artificial Insemination Centre and Semen Processing Centre	--	1
Pheasant Rearing Centre	--	1
FORESTRY		
Territorial Division HQs	--	11
Range Offices	25	36
Beat Offices	83	53
Forestry Training Institutes	1	1
Nature Study Centre	--	1
Forest Cover (including 8% shrub)	--	72.5%
Protected Area	--	26.23%

	1985	1998
POWER		
Total Electricity Generation (million)	40.5	1833.307
Number of Villages Electrified	95	363
Number of Towns Electrified	23	39
Number of Electricity Consumers (Goongs)	9,750	30,321

Eighth plan projection.
(*) Figure pertains to 1997.
(a) figure pertains to 1996.
(b) Figure pertains to the revised estimates for 1997-98.
@ Figure pertains to the approved budget for the fiscal year 1997-98.
(c) Demographic Samples Survey, 1984.
(d) Health Survey, 1994.
(e) Figure pertains to 1990.
** Dispensaries upgraded to BHUs.
† Figure as June 1998, includes 1,842 students of the 54 NFE centres.
Compiled and verified by CSO, Bhutan.

Source: Central Statistical Organisation, Royal Governent of Bhutan, Thimpu, cited in Sen Gupta, Bhabani, *Bhutan: Towards a Gross-root Participatory Polity*, New Delhi, Konark Publication, 1999, pp.97-100.

The Eighth Five Year Plan document made an attempt for the first time to include a long 20-year perspective and a macro-economic outlook for the five years of the plan itself.

"It is important", it says "that there should be a longer-term assessment of the macro-economic variables that are expected to influence the realization of the country's vision of the future. However, a period ending fifteen years beyond the Eighth FYP is too far away to take more than a tentative look at the growth prospects. Hence, only the GDP and the population parameters are considered."[39]

The GDP for the eighth FYP is forecasted based on the past performance, future capacity utilization and investment, market expansion and new policy considerations. Overall GDP growth at market

[39] Sen Gupta, n.1, p.95.

prices is expected to average 6.7%.[40] The specific assumptions for each sector are as follows:

Agriculture

Reviewing past trends, a growth rate of 2.5% for annum is projected for this sector. The positive factors which contribute to this growth rate are productivity gains and horticultural development. In livestock a decreasing trend in numbers is more than compensated for by increased productivity in terms of output and weights of animals. Hence an increase of 3% per annum is projected. For forestry and logging a growth rate of 2% per annum is projected using past trends and continuing emphasis on environmental sustainability.

Mining and quarrying

After analyzing past trends and considering additional requirements of limestone due to expansion of Penden Cement Authority Limited (PCAL) and commissioning of Dungsum Cement Project (DCP), a growth rate of 19.4% is estimated.

Manufacturing

Since 1980s, the manufacturing sector was growing at an average of about 15% per annum, although the base is small. Though during the seventh FYP manufacturing growth slowed down to 9.1%, growth is projected at 12% per annum in eighth FYP taking into consideration the expansion of PCAL and production from DCP.

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40 *Eighth plan Document,* n.17.

Transport and Communications

Based on past trends and new expansion in communications, this sector is expected to grow by 10% per annum.

Electricity

Based on expected new micro and mini hydel projects, anticipated tariff revision early in the eighth FYP, expected additional power generation from Basochu project in 2000-01 and Kurichu project in 2001-02, the overall growth rate of electricity sector is expected to be around 7% per annum.

Construction

From 1993 to 1995, contribution of construction sector to GDP was substantial with a growth rate of 24% per annum. This was mainly due to the sewerage project and private construction activities. Based on past trends and future investment on power sector projects and Dungsum Cement Project, a growth rate of abut 7% per annum is assumed.

Service Sectors

Trade and commerce is projected to grow by about 4% per annum during the eighth FYP. This is accounted for by general business activity and tourism. Based on past trends, implementation of reforms in the financial sector and rise in the value of real estate, the finance, insurance and real estate sector is projected to grow by about 10% per annum. The government services sector is expected to grow by about 6% per annum.

Table 3.5
GDP estimates for the 7 FYP and projection for the 8 FYP by Sectors at factor cost in 1980 prices (Fiscal Year)

Sector	7 FYP Compound Growth (%)	1997 /98	1998 /99	1999 /2000	2000 /01	2001 /02	8 FYP Compound Growth (%)
1. Agriculture Sector							
1.1. Agriculture Proper	2.4	634.8	650.7	667.0	683.7	700.7	2.5
1.2 Livestock	3.5	263.2	271.2	279.4	287.8	296.4	3.0
1.3 Forestry and Logging	2.2	284.8	290.5	296.3	302.2	308.2	2.0
2. Mining and Quarrying	14.1	51.8	54.4	71.5	100.4	119.9	19.4
3.Manufacturing	9.1	327.8	350.7	410.2	514.7	540.5	12.0
4. Electricity	3.9	273.4	277.5	305.5	316.4	348.0	7.0
5. Construction	20.3	368.3	394.1	421.6	461.2	482.7	7.0
6. Trade and Commerce	3.7	190.6	198.2	206.1	214.4	223.0	4.0
7. Transport and Communication	5.9	273.6	301.0	331.0	364.2	400.6	10.0
8. Finance, insurance and real estate	7.7	338.3	37.2	409.3	450.3	495.3	10.0
9.Government services	6.7	355.4	376.7	399.3	423.2	448.6	6.0
Less: Imputed bank service charges		- 75.8	- 83.3	- 91.7	-100.9	-111.0	
Gross Domestic Product	5.8	3286.2	3453.6	3705.5	4007.4	4252.9	6.5
GDP growth preceding year		5.7	5.1	7.3	8.1	6.1	

Source: *Eighth Plan Document*, Planning Commission Secretariat, Royal Government of Bhutan, Thimpu, ch-4, www.pcs.gov.bt/

The saving ratio measured as percentage of gross domestic savings to GDP has been steadily increasing form15% in 1992-93 to 31.5% in 1994-95. This trend is expected to continue in the eighth FYP stabilizing at about 33%. Private sector savings, mainly corporate savings also show a marked increased and as a percentage of GDP, it stands at around 32%.[41]

Changes in Planned Development

The first two Five Year Plans were almost financed by India completely. From third FYP Bhutan could get resources from external sources other than India as it became a member of some multilateral forums like UN and was eligible to get aid. Contribution of internal

41 Ibid.

source to development planning increased significantly (32% of total plan outlay) during Fifth Plan after the commissioning of first two units of the Chukha Hydel Project which was set up by India.

Over the years India's share in Bhutan's FYPs is decreasing, from 100% in First Plan to 27.6% in Eighth Plan. But the size of the cake has also become bigger, Bhutan's plan outlay has increased Nu 107.2 million from First Plan to Nu 32610.0 million in Eighth plan, more than 304 times. Likewise India's contribution has increased from Nu 107.2 million in First Plan to Nu 9000.0 million in Eighth Plan, around 84 times. In fact, India remained the single largest donor of Bhutan. It provided 42.6% of grant in 1993-94, 41.2% in 1994-95, 49% in 1995-96, 42.4% in 1996.97 and 50.7% grant in 1997-98 to Bhutan.[42]

Upto March 1998, India provided Rs. 156.33 crores loan and Rs. 808.15 crores grant to Bhutan, which is 10.12% and 40.6% of total loan and grant provided by India to other countries. [43] It shows that Bhutan gets highest amount of grant given by India.

Table 3.6
Assistance Extended by India

(Rs. Crores.)

Year		Loans	Grants	Total
Upto March 1995	Bhutan	156.3	808.1	964.4
	All Countries	1163.58	1667.99	2831.57
Upto March 1996	Bhutan	156.33	808.15	964.48
	All Countries	1313.63	1698.48	3012.11
Upto March 1997	Bhutan	156.33	808.15	964.48
	All Countries	1412.6	1698.48	3111.08
Upto March 1998	Bhutan	156.33	808.15	964.48
	All Countries	1543.65	1766.36	3310.01

Source: *Repot on Currency and Finance,* Vol.II, (various years), RBI, Mumbai.

42 Computed form the data provided in *Statistical Year Book of Bhutan 1999,* Central Statistical Organisation Planning Commission, Royal Government of Bhutan, Thimpu, January 2001, p. 179

43 *Report on Currency and Finance 1997-98, Vol.II,* Reserve Bank Of India, Mumbai, 1998, p.309.

Bhutan has changed its priority during each FYPs to achieve its goals. In the first two plans, more resources were allocated for development of infrastructure related to transport to end Bhutan's physical isolation. To become self reliant productive sectors like agriculture and animal husbandry were also given importance from Second Plan. Trade and industries were allocated more resources from Fourth Plan onwards. Bhutan has never neglected social sectors like education and health as evident from plan allocation. Urban development and general government department are gradually getting more importance in the plan allocation.

Other Areas of Cooperation

Besides providing economic aid, India has assisted Bhutan in various other fields. India continues to provide experts in the fields of forestry, industry, telecom, hydel survey etc. There are 1500 Indians working with the Royal Government of Bhutan and 44 deputationists from various government of India departments.[44]

India is supplying essential commodities like wheat, rice, sugar, oil, coal, steel at controlled prices under a special quota system.[45]

Government of India's scholarship are granted to Bhutanese

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44 *India-Bhutan Relation*, n.14.

45 *Annual Report*, n.7, 1989-90, p.4.

students every year in institutions of higher learning in India . Bhutan's Sherubtese College is affiliated to Delhi University. Many India based lecturers are posted at this College.[46] Bhutanese king has endowed a chair for Buddhist studies in Nagarjuna University in Andhra Pradesh. Cooperation between cultural institutions of both countries, especially museums is growing apace. First ever 'Bhutan Week' organized in New Delhi in March 1989 was quite popular.[47]

In 1989 ISD link between India and Bhutan was inaugurated by Bhutanese King and the then Prime Minister of India Mr. Rajiv Gandhi.[48] 50 KW Bhutan Broadcasting Station entirely built by Indian assistance was inaugurated in March 1991.[49]

Details for the development of indigenous capacity in Bhutan for survey and mapping, and supply of equipment and technology transfer in this field were discussed in the fifth Joint Technical Level meeting on Bilateral Survey Collaboration Project held in Thimpu from 6th to 9th August 1998.[50]

An air services Agreement between the two countries was signed on September 10, 1991, during the visit of the king of Bhutan to India.[51] On 24th and 25th April, 1997, discussions were held relating to operation of air services and to review the existing agreement, in New Delhi.[52]

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46 *India-Bhutan Relation*, n.14.
47 *Annual Report*, n.7, 1989-90. p.4.
48 Ibid., p.3.
49 *Annual Report*, n. 7, 1991-92, p.2.
50 *Annual Report*, n. 7, 1998-99, p.10.
51 *Annual Report*, n. 7, 1991-92, p.3.
52 *Annual Report*, n.7, 1997-98, p.20.

Trade Relations in the 1990s

In the previous chapter, it was observed that negative balance of trade against India was a grievance for Bhutan. To decrease its over dependence on India, Bhutan diversified its economic relations in the 1980s.

In September 1980, Bhutan signed a trade agreement with Bangladesh and the two countries agreed to accord the Most Favoured-Nation (MFN) treatment to each other in the matter of trade. Bhutan expressed its willingness to export dolomite gypsum, dust coal, slate, graphite, copper and timber products, cardamom, gum, resin, ginger and dry chillies, oranges and apples; Bangladesh on its part undertook to export to Bhutan items such as newsprint, jute products, leather tea, tobacco, pharmaceuticals and medicine. But trade between Bhutan and Bangladesh was very slow to pick up. In 1986, Bangladesh waived 50% of the tariff on imports from Bhutan. This tariff concession boosted Bhutan's exports to Bangladesh and it picked up from 1987 onwards. Bhutan had a favourable balance of trade with Bangladesh in the years 1987-89.[53]

However, Bhutan faced difficulties in the 1990s as Bangladesh reimposed duties on imports from Bhutan, saying that it has to maintain a uniform tariff regime for all the countries to which it has accorded MFN treatment.[54] In November 1990, Bhutan requested Bangladesh to include a number of items such as timber and allied product, marble, cement,

53 Labh, n.2, pp.195-96.
54 Ibid., p.205.

calcium-carbide, ferro-silicon and fresh vegetables in the list of commodities for export and waiver of the custom tariff. But, Bangladesh, due to its adverse balance of trade with Bhutan did not consider the Bhutanese request. Bhutan's attempt to increase its imports from Bangladesh and thereby to reduce the trade imbalance between the countries was also not fruitful due to various reasons like supply problems, natural calamities and organizational difficulties in Bangladesh.[55]

A new Indo-Bhutan Trade and Commerce Agreement (1990-95) was signed in Thimpu on March 2, 1990, during the commerce Minster's visit to Bhutan, which provided for the continuation of free trade between the two countries and also opened it to Bhutanese traders, besides, simplifying entry procedures.[56] Other major features of this agreement are:

- The kingdom of Bhutan was allowed to be involved in international trade. [57]
- Bhutan assured India that while authorizing its private sector to do trade with Third World Countries, it would be ensured that the Indian market is not affected and neither would it be flooded with foreign goods.[58]

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55 Ibid.

56 *Annual Report,* n. 7, 1990-91, p.4.

57 Gautam Kumar Basu, *Bhutan: The Political Economy of Development,* New Delhi; South Asian Publishers, 1996, p.65.

58 Manorma Kohli, *From Dependency to Interdependence: A Study of Indo-Bhutan Relations,* New Delhi, Vikas, 1993, p.190

- Bhutan was allowed to impose such non-tariff restriction on the entry into Bhutan of certain goods of Indian origin as may be necessary for the protection of industries in Bhutan. Such restriction, however, will not be stricter than those applied to goods of third country origin. (Art.-II)
- Each of the Governments agreed to provide appropriate refund to be mutually decided annually in respect of excise duties on goods of its origin exported to the other. (Art-VIII).

For the first time this agreement was signed at the level of ministers. The earlier agreements were signed by the secretaries of the two countries. A special feature of the 1990 agreement is that private parties were allowed to enter into national trade, previously it was only the state trading institutions which were allowed.[59]

For its international trade, Bhutan got three new entry points- Raxaul, Jogbani and New Delhi with the existing ten entry points. [60]

This agreement was renewed in March 1995 and effective for a 10-years period from April 1995 to March 2005.[61]

However, India continued to be the most important trading partner of Bhutan in the 1990s. Export and import between the two countries has increased significantly. Besides, exporting primary goods such as coal, dolomite, gypsum, Bhutan is exporting manufactured goods like cement, chemicals and a number of forest and food products, and is

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59 *Asian Recorder*, Vol. XXXVI, no.12, March 19-25, 1990.

60 Basu, n.57, p. 65.

61 *Eighth Plan Document*, n.17.

importing textiles, fuel, motor cars, electric goods, machinery equipment and computers.

Eighth FYP of Bhutan projected that Bhutan's exports to India is to be increased by 15% per annum, from1996-97 to 2001-2002. This is assumed considering the enhanced production and exports of power, cement, ferro alloys, calcium carbide and horticultural products. Based on the past trends, Bhutan's imports from India during the same period was estimated to increase by 15% per annum also.[62]

Composition of Trade

The Directorate General of Commercial Intelligence and Stastistics under Ministry of Commerce for the first time in 1991 published composition of Indo-Bhutan trade.[63]

Table 3.7
India's import from Bhutan by Principal Commodities

(Rs. lakhs)

Commodities	1998-99	1999-2000
Wheat	-	1.85 (0.023)
Cashewnuts	-	53.36 (0.668)
Frutis & Nuts	0.21 (0.008)	0.00
Spices	-	24.53 (0.307)
Pulp and Waste Paper	-	2.55 (0.032)
Wood and Wood Products	1957.05 (75.92)	950.22 (11.902)
Textile, Yarn, Fabrics	0.49 (0.019)	0.00
Skin, Raw hides	-	4.26 (0.053)
Other Crude Mineral	13.80 (0.535)	27.44 (0.343)
Ore and metals scrap	-	0.11 (0.001)
Coal, Coke	35.23 (1.366)	67.65 (0.847)
Inorganic Chemicals	180.52 (7.003)	3567.49 (44.688)
Pharmaceuticals	-	0.61 (0.006)
Plastic Materials	0.58 (0.022)	54.70 (0.685)

62 Ibid.

63 Prakash C. Adhikary, "Economic Transition in Bhutan: A Study on the Impact of Indo-Bhutan Trade and Economic Cooperations", *Asian Profile,* Vol.21, no.6, December, 1993, p. 477.

Chemical Materials & Products	8.38 (0.325)	5.81 (0.072)
Paper Board	. -	173.14 (0.168)
Cement	-	26.50 (0.331)
Non Metallic Minerals	1.73 (0.067)	9.44 (0.118)
Primary Steel, Pig Iron	178.23 (6.914)	2721.78 (34.094)
Iron & Steel	-	100.17 (1.254)
Manufactures of Metals	-	0.12 (0.001)
Other Commodities	201.52 (7.817)	191.35 (2.396)
Total	**2577.74 (100)**	**7983.08 (100)**

Note: Figures in bracket indicates the percentage of the commodities in total import.

Source: *Foreign Trade Statistics of India (1999-2000),* Directorate General of Commercial Intelligence and Statistics, Government of India, Kolkata, 2000.

Table 3.8
India's Export to Bhutan by Principal Commodities

(Rs. Lakhs)

Commodities	1998-99	1999-2000
Rice (Other than Basmati)	845.70 (21.019)	478.37 (14.57)
Poultry & Dairy Products	4.83 (0.12)	2.92 (0.089)
Tobacco Unmanufactured	-	0.90 (0.027)
Tobacco Manufactured	-	0.65 (0.019)
Spices	-	3.83(0.116)
Sugar	229.67 (5.708)	122.81 (3.74)
Spirit and Beverages	326.82 (8.123)	255.12 (7.77)
Castor Oils	6.06 (0.15)	0.00
Fresh Vegetables	-	1.93 (0.058)
Processed Fruits & Juice	26.37 (0.655)	9.38 (0.285)
Misc. Processed Items	22.03 (0.547)	46.13 (1.405)
Marine Products	13.59 (0.337)	4.41 (0.134)
Coal	-	25.35 (0.772)
Other Ores & Minerals	-	20.07 (0.611)
Footwear of Leather	10.14 (0.252)	0.00
Footwear Components	-	10.78 (0.328)
Drugs & Pharmaceutics	23.51 (0.584)	15.63 (0.476)
Agro Chemicals	74.78 (1.858)	17.57 (0.535)
Cosmetics	17.90 (0.444)	0.14 (0.004)
Rubber Products	12.74 (0.316)	0.00
Footwear of Rubber	4.57 (0.113)	0.00
Paints	80.32 (1.996)	259.54 (7.905)
Gems & Jewelry	-	2.00 (0.06)
Gls/Glswr	155.70 (3.869)	33.53 (1.021)
Paper/wood Products	29.94 (0.744)	32.01 (0.957)
Plastic Products	27.55 (0.684)	18.61 (0.566)
Chemical & Allied Products	124.10 (3.084)	31.04 (0.945)
Ferro Alloys	-	1.76 (0.053)
Aluminum other than Products	12.76 (0.317)	0.00
Non-Ferrous Metals	-	48.72 (1.48)
Manufactures of Metals	337.22 (8.381)	391.11 (11.913)

Machine Tools	5.60 (0.139)	93.83 (2.852)
Machinery & Instruments	1036.46 (25.761)	455.76 (13.882)
Transport Equipments	149.48 (3.715)	127.83 (3.898)
Engineering Items	4.08 (0.101)	0.00
Iron & Steel Bar	36.38 (0.904)	32.10 (0.977)
Semi-Finished Iron	106.78 (2.654)	119.72 (3.464)
Electronic Goods	179.96 (4.472)	364.14 (11.099)
Cotton Yarn, Fabrics	0.09 (0.002)	14.88 (0.453)
RMG Wool	3.92 (0.097)	2.99 (0.091)
Handicrafts	12.90 (0.32)	12.61 (0.384)
Project Goods	26.01 (0.646)	143.05 (4.357)
Other Commodities	74.27 (1.848)	81.83 (2.492)
Total	**4023.34 (100)**	**3283.05 (100)**

Note: Figures in bracket indicates the percentage of the commodities in total import.
Source : Same as Table 3.7

It is observed from the data that Bhutan is importing more machinery and equipment, transport equipment, oil, spirit and beverages from India for its industrial needs. It is exporting to India cement, inorganic chemicals, primary steel and pig iron, agro products and wood products.

Table 3.9
Bhutan's Import in the 90s

(US$ mn.)

Year	India	Other Countries	Total	Percentage of India
1991-92	70.2	12.9	83.1	84.48
1992-93	75.1	49.9	125.0	60.08
1993-94	65.8	27.0	92.87	70.90
1994-95	70.9	26.3	97.2	72.94
1995-96	81.4	29.5	110.9	73.4
1996-97	85.8	45.5	131.3	65.35
1997-98	96.0	40.1	136.1	70.54
1998-99	115.5	46.8	162.3	71.16
1999-2000	139.0	46.0	185.0	75.14

Source : Computed from *Europa Year Book* (Various Issues), Europa Publication, London.

Table 3.10
Bhutan's Export in the 90s

(US$ mn.)

Year	India	Other Countries	Total	Percentage of India
1991-92	56.7	6.5	63.2	89.72
1992-93	54.8	11.4	66.2	82.78
1993-94	56.9	6.5	63.4	89.75
1994-95	65.6	4.4	70.0	93.71
1995-96	89.8	7.9	97.7	91.91
1996-97	90.2	9.1	99.4	90.74
1997-98	105.3	6.1	111.4	94.52
1998-99	98.21	6.6	104.8	93.70
1999-2000	108.0	6.3	114.3	94.49

Source : Same as Table 3.8.

It is obvious from the above tables that Bhutan's more than 70% import is from India and around 90% export is directed towards India.

Data shows that India's export to Bhutan during the period 1992-93 to 1998-99 has grown 65.8% and India's import from Bhutan during the same period grew 110.3%.[64]

India's share in Bhutan's export has been increased as Bhutan is exporting more manufactured products like electricity, cement and calcium carbide etc. to India.

Given the low economic development and the narrow industrial base in Bhutan, India focused on new areas of cooperation like tapping energy resources, wherein Bhutan can earn revenues by selling surplus electricity to India. Production of more electricity will lead to further economic development in Bhutan as it helps in establishment of

64 *Report on Currency and Finance*, Reserve Bank of India, Mumbai, 1998-99, pp. IX-22-23.

industries which require large amount of electricity. So, India financed some major hydel projects like Tala, Kurichu in the 1990s. Indian financial and technical assistance has been critical to these projects, but then India will receive at a fair price, a good proportion of the electrical power produced.[65]

Bhutan has emphasized self-reliance as a long-term objective from Fifth FYP. As its tax base is very low (7% of GDP in VII FYP), Bhutan decided to revise electricity tariffs for more revenue. In 1990, a new protocol was signed to equalize the rates at which India purchase firm and seasonal power from the Chukha Hydel Project, which involved substantial rise in the Bhutan's revenue.[66] At the request of the king of Bhutan, India agreed to revise the Chukha power tariff from Re. 1.00 per unit to Rs.1.5 per unit from 1st July 1999.[67] Export of electricity to India has resulted in a favourable balance of trade for Bhutan with India from 1996-97. Bhutan has earned Nu. 10003.8 million revenue by exporting electricity from Chukha Hydel Project to India.[68]

Table 3.11
India's Balance of Trade with Bhutan in 1990s

(Rs. Crores)

Year	Exports from Bhutan to India	Imports to Bhutan from India	Trade Balance
1990-91	112.957	125.492	12.535
1991-92	146.513	181.414	34.901
1992-93	152.218	208.262	56.408
1993-94	178.598	206.590	27.992
1994-95	208.800	275.000	66.203

65 Leo E. Rose, "Nepal and Bhutan in 1998: Two Himalayan Kingdoms", *Asian Survey*, Vol. 39, no.1, January, 1999, p.161.
66 *Annual Report*, n. 7, 1990-91, p.4.
67 *Annual Report*, n. 7, 1999-2000, p.11.
68 Calculated from *Europa Year Book* (various issues), London, Europa Publication.

1995-96	248.918	285.641	36.723
1996-97	322.000	289.000	- 33.000
1997-98	404.00	345.00	- 59.00
1998-99	418.00	362.00	- 56.00

Source: *India-Bhutan Relations*, Ministry of External Affairs, Government of India, New Delhi, http://www.meadev.nic.in/foreign/ bhutan.htm

Bhutan's Financial System and India's role

The Bank of Bhutan was established on 28 May 1968 by a Royal Charter to provide banking facilities throughout the Kingdom.[69] Its main function was to supply Indian rupees for *tikchung*, a Bhutanese coin equivalent of half an Indian rupee. The coin was minted at Calcutta and it was brought into circulation in 1959. Branches of the Bank was opened at many places. Starting as a commercial bank, it was to function later as a Central bank issuing notes.

Bhutan's efforts to introduce its own currency, with *tikchung* at the base, and a banking system to meet the growing needs of trade and development activities did not meet with easy success. The bank ran into troubles within two years as it failed to provide enough Indian rupees backing for the *tikchungs* in circulation. The problem was explained by Lynpo Chogyal, Bhutan's Finance Minister as follows:

"The major problem that the Bank faced during 1970 continued to be its inability to readily convert into Indian currency the *tikchungs* that were tendered at the counters of the bank. The problem was discussed at the Board's meeting when it was decided to withdraw that portion of

69 *Asian Recorder*, Vol. XIV, No. 25, 17-23 June 1968, p. 8371

the tikchung from circulation which repeatedly came back into Banking system, without getting absorbed in the country's economy".[70]

An Indian Banking team, comprising officials from the Finance Ministry, the Reserve Bank of India and the State Bank of India , visited Bhutan in August 1971 to discuss the problem with the Bhutanese authorities[71]. As a result of these discussions, an agreement between the Royal Government of Bhutan and the State Bank of India was concluded in 1972.[72] It was a significant step in the decade-long efforts of the Kingdom to transform its economy from the traditional barter to money system and to otherwise modernise it.

The State bank of India, under the collaboration agreement, became a 40 percent shareholder of the reorganised Bank, and nominated three Directors, including the Managing Director of the bank.[73] The State Bank of India also undertook to provide training facilities for the Bhutanese Banking official.

Alongwith the collaboration, the Royal Government also proposed to replace a substantial portion of *tikchungs*, then in circulation, by the Indian currency so that the use of *tikchung* in heavy payments could be avoided. *Tikchung* continued to be in circulation as legal tender but it essentially played the role of a small coin.

From April 1974 onwards Bhutan has issued it own currency, the ngultrum, which is at par with the Indian rupee and circulates the same

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70 *Asian Recorder*, Vol. XVIII, No. 8, 19-25 February 1972,. p. 10625
71 Ibid
72 Ibid
73 *The Far East and Australasia 1974*, p. 360

inside the country.[74] The value of Ngultrum is pegged to the Indian Rupee at one panty. Hence its value vis-a-vis US dollors also depend upon the behaviour of the Indian Rupees.[75] One very new and important Bhutanese policy was the decision in to permit Asian Development Bank (ADB) and Citi Bank to purchase 40% of the shares in Bhutan National Bank (BNB). This is the first instance in which non-Indian foreign financial concerns have been allowed to purchase shares in Bhutan's banking system.[76]

Political Disturbance and its Impact

South Eastern Bhutan adjoins Assam and is consequently affected by the Bodo problem. With free movement of Indian nationals to Bhutan and vice-versa, a number of Bodo camps have sprung up in southern Bhutan. This situation is causing concern to both India and Bhutan. The issue has been discussed in the 76th and 77th the sessions of the National Assembly of Bhutan. The 77th session of the National Assembly in July 1999 fully authorized the king to take all necessary measures to tackle the ULFA-Bodo insurgency problem.[77]

Presence of approximately one lakh Bhupali refugees (who are Bhutanese national of Nepali origin) in the camps of Nepal since 1990 and in the Indian districts bordering southern Bhutan has been a sensitive issue. A joint Nepal-Bhutan Ministerial Committee was

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74 *The Far East and Australasia 1976-77*, p. 200
75 Lama, Op.cit, n.5, p. 161
76 *Kuensel*, 27 August, 1998
77 *Annual Report*, n. 7, 1999-2000, p.11.

established and met in October 1993 in Kathmandu to resolve the problem. This issue being a bilateral matter of Nepal and Bhutan, India did not interfere. India hopes that both countries will arrive at an amicable settlement.[78]

However, the problems hardly had any impact on Indo-Bhutan economic ties. Rather the principles of non-reciprocity[79] from neighbours as enunciated in oft quoted Gujaral Doctrine has been a novel element for better relationship. The warm and cordial relationship is further sustained by the tradition of regular visits and extensive exchange of views at the highest levels between the two countries. So the future prospects of India-Bhutan economic relations is bright.

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78 *Annual Report*, n. 7. 1993-94, p.1.

79 I. K. Gujral, *A Foreign Policy for India*, External Publicity Division, Ministry of External Affairs, Government of India, New Delhi, 1998, p. 169.

Chapter-IV

IV
CONCLUSION

India's relation with Bhutan has had a remarkable warmth and cordiality. Both countries are linked with each other culturally from very ancient times. But modern day relations date back to the second half of twentieth century, as India got independence from British rule in 1947.

A fresh beginning of relations between these two countries materialized after the signing of the Treaty of Friendship and Peace in 1949. Since then both countries have maintained very smooth and close relationship.

Though both India and Bhutan have strategic interests in each other, economic aspect in their relations is also very important and crucial.

Due to its land-locked position, mountainous terrain, small and scattered population, lack of skilled-labour, very limited industrial base, thick forests, inadequate transport facilities, Bhutan was facing difficulty for economic development. Still it was maintaining a self-imposed isolationism to preserve its unique identity and culture.

Bhutan felt the necessity of maintaining economic relations in the 1950s to modernize itself observing the political developments on its northern side. After Chinese occupation of Tibet in 1959, Bhutan wanted to develop itself for its security and stability. Seeing the aggressive nature of its northern neighbour, Bhutan did not want to maintain economic relations with China; though China offered economic assistance to Bhutan. Rather Bhutan readily accepted Indian assistance after the visit of Indian Prime Minister Jawaharlal Nehru to Bhutan in 1958, where he expressed India's readiness to give technical and other kinds of aid to Bhutan.

Aid is an important component of economic relations between India and Bhutan. Though India itself is a developing country, it gives aid to other countries which are less developed than it including Bhutan. It gets the highest amount of aid that India extends to other countries.

India does not assist Bhutan only by providing aid. As Bhutan lacked infrastructure, technical and managerial skill, India got involved in the entire development process of Bhutan.

To develop the country in an organized manner, Bhutan initiated Five Year Plan (FYP) with the help of India. Planning Commission of India formulated the first FYP (1961-66) of Bhutan and it was completely financed by India. Second FYP of Bhutan was also formulated and financed by India completely.

Third FYP was implemented under Bhutanese Planning Commission. During this plan Bhutan was able to get aid from external sources other than India and its internal resources were also increased significantly. So far, Bhutan has implemented eight five year plans and achieved significant progress in various fields.

development of a country, these sectors were given primary importance during the first two five years plans. Now each and every part of the country is well connected with roads. By 1998, Bhutan constructed 3375 km of roads. This has helped Bhutan in ending its physical isolation and provided infrastructure for further development. Now Bhutan is linked by air with New Delhi, Dhaka, Calcutta, Bangkok and Kathmandu.

Bhutan has made significant progress in the field of information and communication. Before 1960, Bhutan had no modern communication facilities. With India's help, now Bhutan is connected with other countries by ISD links. The Bhutan Broadcasting System airing programme in English, Dzongkha, Nepali and Scharchopa in built by India.

In the field of social sectors, significant advancement has been achieved, as Bhutan has emphasized on human resources development. Previously Bhutan was almost totally dependent on India for skilled man powers as there were hardly any people available with technical or managerial skill. Many Bhutanese students have received higher education with scholarships from India and now occupied posts in their country's civil services. Now Bhutan has specialized institutes for managerial training, training in the field of forestry, agriculture etc.

Now Bhutanese people have access to modern health facilities. By 1998, Bhutan had 661 hospitals, providing medical facilities in the remote areas of the country.

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As agriculture provides employment to about 93% of adult population of Bhutan, it has been given importance with sizable allocation in the plans. India has provided experts to help Bhutan in producing more cash crops and fruits which earn more revenue for it. India imports both fruits and processed products like jam, juice, sauce etc. from Bhutan.

Production of hydro electricity is an important area of cooperation between India and Bhutan. Generation and consumption of power play a significant role in modernizing a developing country. Bhutan has huge potential for hydro electricity power and India has provided both financial and technical support for its exploitation.

Chukha Hydro Power Corporation is the biggest and most successful of many projects in Bhutan which were implemented with India's assistance. After its commissioning in 1988, Chukha project has changed the entire economy of Bhutan. As more electricity was produced, it became cheaper for domestic consumers. Availability of cheap electricity helped in further industrialization of the country. Bhutan exports the surplus electricity to India and earns huge revenue. It has contributed in raising the internal resource of Bhutan and changing the balance of trade situation. India is also benefited as it gets power for its

India has emphasized more on the hydel projects in the 1990s like Tala Project, Kurichu Project and Sankosh Multi Purpose Project as these will further benefit both the counties.

India has helped Bhutan for its industrialization. Though Bhutan has abundant mineral resources like dolomite, limestone, gypsum etc., it lacked technology for making use of it. So, India provided assistance for Penden Cement Plant and purchases cement produced from it. The commercial success of this plant paved the way for Dungsum Cement Plant in a relatively underdeveloped region of Bhutan.

It is observed that, over the years share of India's contribution to Bhutan's five year plans has decreased from 100% in first FYP to 27.6% in eighth FYP. But this does not explain the complete picture. Though India's share has decreased, in absolute terms India's contribution to Bhutan's FYPs has increased around 84 times. Besides the size of Bhutan's plan has also increased significantly. India has carried out some major projects like Chukha Hydel Project, Pendem Cement Plant outside the plan. Another noteworthy point is that India is responsible for the increase in both internal and external sources other than India. India assisted Bhutan for industrialization and purchases the surplus products like electricity, cement etc, which earn revenue for Bhutan. India also sponsored Bhutan for its membership in various multilateral forums including United Nations, which enabled her getting external aid. Still India continues to be the single largest donor of Bhutan.

Trade is the other important aspect of India-Bhutan economic relations. Traditionally, Bhutan had trade relations with Tibet and the Indian states of Assam and Bengal. After Chinese occupation of Tibet, Bhutan imposed a ban on trade with Tibet in 1960 and thus Bhutan's trade was completely oriented towards India.

Article 5 of the Treaty of Friendship and Peace signed between India and Bhutan in 1949 provides for free trade and commerce between the two countries. The first Indo-Bhutan Agreement on Trade and Commerce was signed in1972, which allowed duty free import and export to Bhutan. Later given the increasing need for Bhutan's international trade, an trade arrangement was signed in 1978 which provided that Bhutan can develop its trade relations with third country and earn foreign exchange.

Bhutan tried to diversify its trade relations to reduce the over dependence on India. Hence it signed an agreement with Bangladesh in 1980. But the problem was the absence of transit facilities through Indian territory. For a land-locked country like Bhutan, transit facility is very crucial as it has impact on the economy of the country. India allowed Bhutan this facility and released all imports and exports in involving third parties from Indian trade duties in an agreement signed in 1983. A new agreement on Trade and Commerce was signed in 1990 between the two countries, which allowed for the first time the private parties of two countries, which allowed for the first time the private parties of Bhutan to be involved in international trade. Bhutan also got three more entry points for its international trade with the existing ten entry points. This agreement was renewed in 1995 for a period of ten years.

While analyzing the composition and balance of trade, it is observed that Bhutan is importing more machinery equipment from India for its industries and exporting more manufactured products like cement, electricity to India in recent years unlike the previous periods when Bhutan was exporting mainly agro and forest products. This has resulted in a favourable balance of trade for Bhutan from 1996-1997. India continued to be the major trading partner of Bhutan with Bhutan's 90% export and 70% import directing to/from India.

In the 1990s India-Bhutan economic relations were more strengthened, with India focusing on the mutually beneficial projects and giving more concessions in trade to Bhutan. As the King of Bhutan once said, "We don't look upon India's size with any suspicion. We look upon the 900 million population of India as an advantage. It is big market for anything we produce".[1]

Now India-Bhutan relation is of interdependent in nature. There are adequate and strong indications that, this relationship will grow further in a very steady manner.

[1] *Indian Express*, 7 March, 1996.

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