

THE RUPEE BALANCE OF PAYMENTS ISSUE

SPECIAL ARTICLE BY RMA

Teacher



Kuzuzangpo La! Why are Indian Rupees so limited in Bhutan these days?

Student
"Dorji"



Kuzuzangpo Dorji! That's an interesting question. I will make this the topic for today's class discussion.

Let me give you a brief background of the related issues. First of all, we all need to understand the characteristics of Bhutan's economy.

1. Bhutan's economy and trade with India

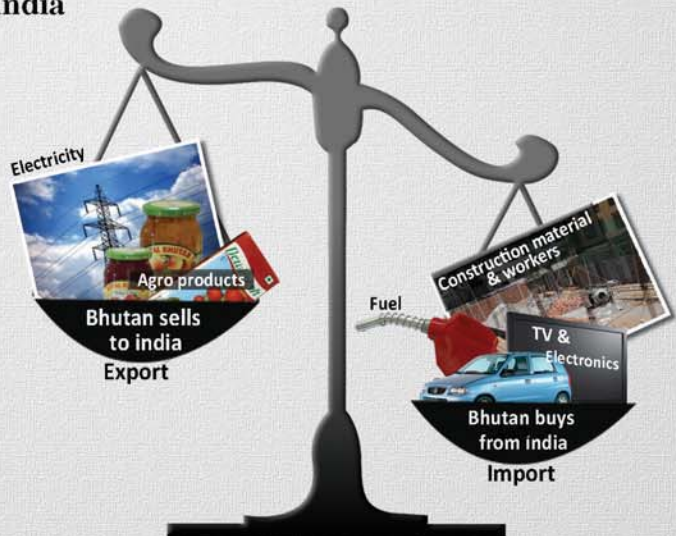
Teacher: We are spending more and more on goods like cars, TV and food but we do not produce most of the things we buy. Most of them are imported from India.

Dorji: But Bhutan also sells goods and services to India?

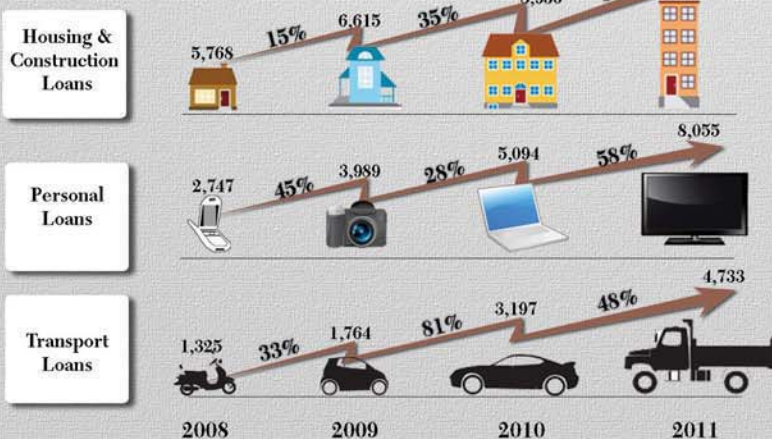
Teacher: That is true. We produce hydro electricity, fruits, etc, but we buy more than we sell. So our earnings are less than our expenditure.

Dorji: Sir, why are our imports growing faster than our exports in recent years?

Teacher: One important reason is the increasing amount of loans our banks provide. Look at the diagram below. It shows which loans have been growing faster in recent years.



Borrowing from bank by sector (Nu millions)



Growth of loans has contributed to the growth of imports

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Teacher: These loans are used to import more steel for construction, more cars and fuel for transportation from India. Then there are thousands of Indian nationals working in Bhutan who send their wages back home.

Dorji: What happens when we import more than we export to India?

Teacher: This is what we call "the balance of payments"(BoP) problem in

Economics. This is exactly what is happening right now. We import more than what we export, as a result we end up paying out more Rupees for our imports than what we earn from our exports to India. Look at the above diagram.

Dorji: Is this a real problem? How are we going to manage it?

Teacher: Yes, it is. The Royal Monetary Authority (RMA) has been trying to meet the demand for Rupees. When it runs short it borrows from Indian banks at a very high interest rate. In recent years, the RMA has been facing difficulty in meeting the increasing demand for Rupees. A country cannot afford to continue borrowing at such a high cost. It may lead to severe economic consequences in the long run by increasing our debt burden.



- Rupee drains out to pay for imported goods
- Export to India
- Import from India
- Rupee inflows as earning from Export

Deki



Excuse me Sir! But what exactly is the difference between holding the Ngultrum and Rupee?

Teacher



This is a very good question Deki. That brings me to my next discussion on what it means to have our Ngultrum pegged with the Rupee.

Royal Monetary Authority (RMA)
(Central Bank of Bhutan)



Issue & print

Ngultrum



Reserve Bank of India (RBI)
(Central Bank of India)



Issue & print

Indian Rupee



-RMA does not and cannot print Indian Rupees!

-Only RBI in India prints and issues Indian Rupees!

2. Peg between Ngultrum and Indian Rupee

Teacher: Let us understand this basic but important principle. Indian Rupee is a foreign currency and not like our Ngultrum. The legal responsibility to print and issue Indian Rupees rests solely with the Reserve Bank of India(RBI) which functions like the RMA as the central bank in India.

Dorji: Then why is the Indian Rupee used in Bhutan freely with the same value as the Ngultrum?

Teacher: Excellent question, Dorji. There are a few reasons why the Ngultrum is pegged with the Indian Rupee on a 1-to-1 basis. For decades, Bhutan and India has enjoyed very close trade relations. Over 75% of Bhutan's trade is with

India. To allow for smooth trade and transactions with India, the government pegged the Ngultrum at par with the Rupee. By doing so, we not only built confidence in our currency but also helped traders by providing stability in the value of the Ngultrum.



3. Consequences of the problem

Dorji: We earn enough Ngultrum so why can't we spend as much as we wish?

Teacher: Like I explained earlier, we do not produce enough within the country therefore, we rely heavily on imports. If your demand is met through domestic production, then you can spend as much of your income as you want. In our case, we meet most of our demand from India and this has caused imbalances in our earning and spending.

Teacher



Sir, can you explain how spending in Ngultrum gets converted into Rupees?

For example you buy a packet of milk powder and pay in Ngultrum. But where does that milk powder come from? The shopkeeper buys it from India using Indian Rupees.

Deki



4. Remedial measures

Deki: So what can we do to correct the immediate Rupee situation?

Teacher: The RMA is doing all it can by streamlining the use of Rupees. We need to produce evidence to support why we need Rupees from the banks. And the RMA is encouraging people to use banking services for all Rupee transactions. The Indian Rupee is a foreign currency which needs to be earned. We cannot expect to have access to as much Indian Rupees as we want anymore.

Dorji: How long will these measures continue and what are the long term solutions?

Teacher: Many of the measures taken by the RMA so far are short term and likely to continue until the Rupee inflow into the country improves. The government is also working on longer term measures to improving our domestic capacity to earn Rupees and to reduce unnecessary Rupee expenditure.

5. Our collective responsibilities

Sir, as I understand, this problem occurred mainly because we imported much more than what we exported, right? Will this situation improve in the near future?

Student
"Dorji"



Teacher



Very good question. The problem is a symptom of weaknesses in our economy. It will take a while to completely resolve the Rupee imbalances. Remember every one of us has contributed to this problem. We must collectively work together to improve the situation.

Dorji: I thought this was a problem that can only be resolved by the government and the RMA?

Teacher: No Dorji. Every citizen in the country including you and me are equally responsible and have the power to make a difference.

Deki



But how can we contribute to correct the Rupee BoP problem?

Teacher



There are many things that we can do together;

1. Remember! Rupee is a foreign currency that we all need to earn for our own spending.
2. Just because our Ngultrum is pegged at par with the Rupee and we have an open trade border with India this does not necessarily mean that we can get as much Rupees as we want.
3. As far as possible, we must buy our own domestic products rather than importing from India.
4. We need to work hard to produce more and export to earn enough Rupees. Likewise, our farmers need to work hard to produce more food to meet our domestic needs.
5. We all must try to spend less and save more.
6. We all need to avoid excessive borrowing for unproductive purposes such as luxury cars and other non-essential items.

Dorji: Okay Sir. From today, I will work hard, save and refrain from spending unnecessarily.

Deki: I will do the same. I will also convey this message to my friends, family and relatives. Thank you Sir for today's important lesson.

Teacher: Resolving today's problem is not easy and certainly will take time. However, It will be much easier if we work together as responsible citizens. I am very optimistic about this. Wish you all a GOOD DAY!

