The Implications of the Depletions of Foreign Currency Reserves in Bhutan

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Abstract

A country should have enough foreign exchange reserves to guard against any potential external shocks. The study is exploratory and qualitative wherein the research uses secondary data from relevant sources to analyze the effects on the social and economic aspects of the depletion of the foreign exchange reserve in Bhutan in order to address the growing concerns over the pattern of the country's foreign exchange reserves. The study concluded that Bhutan's current trade deficit trend will have implications on its foreign reserve, including a ban on non-essential items and essential ones as an approach to saving depleting foreign reserves. Since the majority of essential items are imported, a complete ban on these items will cause a social and economic crisis and will have an impact on people's ability to support themselves. There is a need for the policymakers and concerned authorities to leverage the export, tourism, remittances and FDIs sector which are the sources of foreign currency in Bhutan.

Keywords: Bhutan, Foreign Reserves, Trade Deficit, Export, Tourism, Remittances, FDIs

Introduction

Foreign exchange reserve is inevitable to achieve development needs and economic stability. It is essential to maintain financial cum economic stability through liquidity and safety in the economy. Developing nations require more foreign exchange reserves to meet their needs for development, but they only have a limited supply available. Earning foreign currency from export, foreign aid, foreign direct investment, tourism and remittance is positively related to the nation's economic growth. Remittances are now recognized as a growing source of foreign exchange income. Developing nations require higher foreign exchange reserves so they can raise money to meet their country's needs for welfare development since economic growth is the only effective method for raising people's living standards (Kargbo, 2012; Rodrik, 2008 as cited in Kaphle, 2021).

Bhutan is a developing nation with a weak infrastructure, so it must import modern technology and raw materials, which costs more foreign currency. Research indicates that foreign exchange aids in achieving faster economic growth (Kaphle, 2021) however, at present, Bhutan has suffered a fall in its foreign exchange reserves due to rising imports, a decline in remittance inflows, a lack of export revenue, and no revenue from tourism. The Russian invasion of Ukraine is driving up commodity and fuel prices globally, which is driving up import costs. A foreign currency reserve is crucial for trade in a nation where imports dominate the economy. Bhutan's trade deficit increased to Nu 27.3 billion as of June 2022 as a result of a jump in imports. The substantial, persistent, and steep trade deficit has caused Bhutan's stable currency reserve to collapse (Zangpo, 2022b).

"A minimum foreign currency reserve that is adequate to match the cost of not less than one year's essential import must be maintained", the Constitution of the Kingdom of Bhutan's Article 14, Section 7 stipulates. Bhutan presently has USD 845 million(M) in foreign exchange reserves, including USD and INR. According to the Royal Monetary Authority of Bhutan's records, the reserve was down over 30% from April 2021 ($1.46B) to March 2022 ($984.8 M). The foreign currency reserve was just enough to cover the minimum necessary imports for 9 months (Palden & Zangpo, 2022).

Studying the effects of Bhutan's foreign reserve depletion has been prompted by the foreign exchange reserve crises experienced by neighbour countries, such as Sri Lanka. Since Bhutan's economy is heavily dependent on imports, there is a need for Bhutan to comprehend the ramifications of the declining trend of the foreign reserve since reserve adequacy and economic stability are mutually correlated (Gajurel, 2022). This concern prompts research into Bhutan's declining foreign exchange reserves. Additionally, this work fills a research need in Bhutan and serves as a baseline study by contributing knowledge and background for further discussion by future researchers.

Objective

To study the implications of the social and economic dimensions of the depletion of foreign exchange reserves in Bhutan.

The Rationale of the Study

The growing concerns regarding the pattern of Bhutan's foreign exchange reserves dwindling have prompted to study of the implications. By giving background information on Bhutan's current economic scenario including trade deficit, and foreign exchange reserves, it fills a vacuum in the literature since no study on the foreign exchange reserves in Bhutan has been explored and studied. Ultimately, it equips decision-makers and concerned authorities with a solid understanding of the current scenario of the economy and on way forward for addressing the depletion of current foreign exchange to uphold stability in the country.

Literature Review

Understanding Foreign Exchange Reserve

The foreign currency that a nation's central bank holds as reserves are known as foreign exchange. They are also known as foreign reserves or foreign currency reserves. The management of the prices of respective currencies is the main reason for the nation to hold a reserve. Countries use their foreign exchange reserves to maintain a fixed exchange rate, make export prices competitive, stay liquid in times of crisis, inspire investor confidence, and pay their external obligations as well as fund various economic sectors (Amadeo, 2020).

Based on IMF data of "World-Official Foreign Exchange Reserves by Currency" and "World-Allocated Reserves by Currency for 2021Q3", most countries prefer to use the US dollar as the reserve currency. Having an adequate forex reserve level helps a nation in many ways. For instance, it assists the government in meeting its foreign exchange objectives and external debt commitments as well as absorbing the economic shocks brought on by financial crises, stabilizing the local financial markets, and so on. Effective management of the central bank's foreign exchange reserves with defined objectives, transparency, and clarity encourages the swift implementation of policies to achieve national goals and lessens external vulnerabilities (Wallstreetmojo Team, 2022).

A growing economy's economic growth is aided by the accumulation of Foreign Exchange Reserves (FER) by boosting capital productivity and the investment/GDP ratio. Because it boosts a recipient country's government's credibility and decreases the dollar value of real assets, FER build-up attracts foreign direct investment (Polterovich & Popov, 2003). As per the research done by Polterovich & Popov (2003), "the accumulation of Foreign Exchange Reserves (FER) leads to a lower exchange rate, which in turn stimulates export-led growth".

India faced the Balance of Payment crisis in 1991 due to a huge macroeconomic imbalance. The Balance of Payment (BoP) Crisis is also called a currency crisis. It occurs when a nation is unable to pay for essential imports or service its external debt payments. The Fiscal Deficit was high because government spending outpaced revenue. Due to the aforementioned factor, the government's internal debt increased. The nation imported more than it exported. Therefore, there was a large current account deficit. The increase in crude oil prices as a result of the Gulf War triggered the current account deficit. The result was a drastic reduction in India's foreign exchange reserves. Despite substantial IMF (International Monetary Fund) borrowings earlier in the year. India's foreign exchange holdings in June 1991 totalled less than $1 billion, barely enough to cover import demands for three weeks. India lacked sufficient foreign exchange reserves to transact business internationally. Investors withdrew their funds. Exporters were worried that they wouldn't get paid, therefore short-term funding dried up. The rate of inflation has increased (Saxena & Cerra, 2000).

When ongoing Balance of Payments (BoP) deficits threaten to deplete a nation's foreign exchange reserves, a balance of payments crisis results. BoP crises can be resolved in one of three ways: by borrowing foreign reserves, devaluing the currency, or switching to a floating exchange rate. Investors frequently buy foreign assets during a BoP crisis because they expect a currency devaluation or depreciation to happen soon which is called Capital flight. Because capital flight causes foreign exchange reserves to be depleted more quickly and exacerbate the BoP issue (Suranovic, 2010).

Global Scenario of Foreign Reserves

Foreign exchange reserves are essential to meet the needs of economic stability and development. By ensuring that the economy is safe and liquid (an asset that is easily converted to cash at the market price), financial and economic stability must be maintained. According to a country's international reserves, the term "foreign exchange reserve" refers to those easily accessible and controlled external assets that are used for maintaining the financial requirements for the balance of payments, for intervening in foreign exchange markets to change the exchange rate, for maintaining currency confidence and the stability of the economy, and as a medium for external borrowing (International Monetary Fund, 2009). Foreign currency reserves are a crucial link between developing and industrialized economies (Sá, 2012).

Financial globalization has been accompanied by recurrent and upsetting financial crises over the past ten years. Countries with less readily accessible foreign assets during these crises struggled to contain the financial market panic and prevent abrupt changes in capital flows. Thus, many emerging nations came to understand that enhanced liquidity was a crucial means of crisis self-defence. Many emerging nations used the technique of increasing their foreign exchange reserves (Fukuda & Kon, 2010).

1. Sri Lanka's Economic Crisis

Sri Lanka has been thrust into the limelight after plunging into a political and economic crisis. The country lacks a functioning government after the president fled from mass protests. Foreign exchange reserves have been depleted and the country is embroiled in a messy public debt default. Sri Lanka's turmoil is a result of the balance of payments crisis. Due to a decline in international travel, the COVID-19 epidemic damaged its tourism-dependent economy, putting pressure on a significant source of external revenues (Sanghani, 2022) and also Russia's invasion of Ukraine also had an impact, as both Russians and Ukrainians made up a large percentage of tourists to Sri Lanka (Etsuyo, 2022). As a result of lax fiscal policy and high foreign exchange borrowing, growing imports and high debt payment costs led to a sharp fall in Sri Lanka's reserves (Sanghani, 2022).

Due to low foreign exchange reserves, Sri Lanka was unable to import necessities. Sri Lankans' living standards have significantly declined as a result of the country's total reliance on imported petroleum. Citizens started utilizing wood fuel in place of gas and spent days in line at gas stations. In March of 2022, irate individuals discreetly started to take to the streets. Along with the reduction in commodity exports, remittances from Sri Lankans working abroad also declined. Sri Lanka doesn't have enough foreign currency to cover import costs or pay off debt. Through cash exchanges with Bangladesh and India, the government was able to survive until 2022. However, Sri Lanka's lack of foreign exchange reserves damaged its reputation and prevented the opening of import letters of credit, which are necessary to facilitate imports (Etsuyo, 2022).

Sri Lanka has suffered through one of the world's worst economic crises for most of the year, marked by soaring inflation, food and fuel shortages, and low supplies of foreign reserves and is driving millions of people into poverty, jeopardizing their rights to health, education, and an adequate standard of living. The United Nations estimates that 5.7 million people in Sri Lanka need humanitarian assistance, with 4.9 million - 22 percent of the population - being food insecure, meaning they do not have consistent access to adequate, nutritious food. Families were already struggling from the pandemic, with 36 percent reporting reducing their food consumption in a UNICEF survey in late 2020. That number doubled to 70 percent in a survey conducted in April 2022, just as the economic crisis hit (Human Right Watch, 2022).

2. Nepal's Forex Reserve

Never before has the 29-million-person Himalayan nation of Nepal confronted such a serious economic crisis on both the domestic and international fronts. The country is in a crisis on the international front as a result of diminishing remittances, a growing trade deficit brought on by an extraordinary increase in imports, skyrocketing balance of payments imbalances, an increased inflation rate and dwindling foreign exchange reserves. The cost of necessities has skyrocketed, and banks no longer offer loans for the majority of commercial endeavours. Many Nepalis are concerned about whether their country is headed in the same route as Sri Lanka due to some of these economic problems because Sri Lanka's pre-economic crisis symptoms were far more distinct than they are now in Nepal. The attraction of Foreign Direct Investment (FDI), reviving the tourism industry, and implementation of the Millennium Challenge Corporation pact is expected to strengthen the foreign exchange reserves (Jha, 2022).

Declining foreign reserves and other related phenomena caused structural retarding of the Nepali economy. The reserve crisis has had severe effects on the external sector of Nepal potentially creating a supply shock of imported goods in Nepal (Kaphle, 2021). The central bank of Nepal and policymakers were advised by the study conducted by Gajurel (2022) to concentrate on the productivity of gross fixed capital formation or domestic investment in order to maintain reserve adequacy. They were also advised to pay attention to the current account balance (import and export), which can maintain the foreign exchange reserve and financial/economic stability and safety.

The key factors of foreign exchange reserve holdings are trade volume, net remittance flow, tourism, foreign debt and grants, movement of physical and human capital, exchange rate policy, economic policy, availability of gold and minerals, etc. Therefore, any economy needs to retain a sufficient quantity of reserves. The size of trade (export and import), remittances, and foreign travel are primarily what determines Nepal's foreign exchange reserves (Gajurel, 2022).

Data Collection and Analysis

This study is exploratory and qualitative since the study expects to gain more understanding of the implications of the depletion of foreign exchange reserves in Bhutan using secondary data from relevant sources such as the

Ministry of Finance and Ministry of Economic Affairs in Bhutan which publish financial data annually and biannually. So far, no detailed study on the foreign exchange reserves in Bhutan has been explored and studied. A survey of the literature was done to gather pertinent secondary data from a variety of scholarly journals, official government documents, and other online sources of grey literature. When appropriate, tables and graphs were used to interpret the secondary data after being analyzed in MS Office and MS Excel. The paper gathered information on the concepts related to understanding foreign exchange reserves and studied its importance in maintaining economic stability in the country. The information was searched using a combination of key terms such as foreign exchange reserve, importance, implication, depletion, consequences, management and analysis.

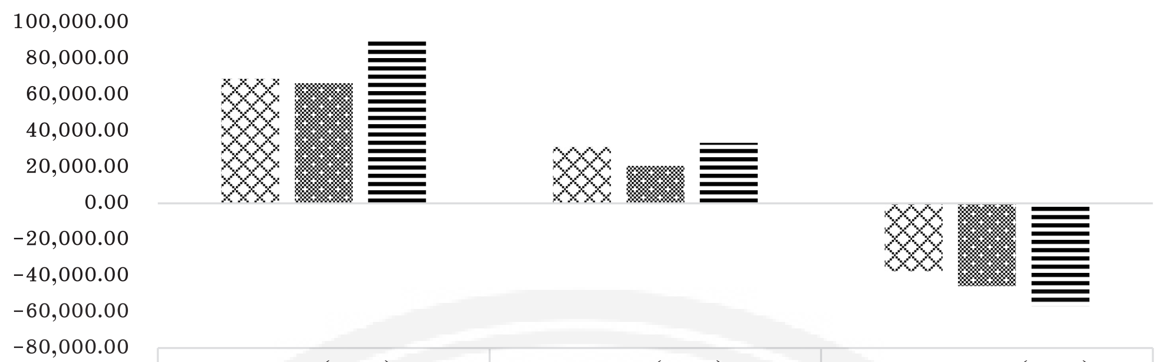
Then, the paper reviewed practices from neighbouring countries namely Sri Lanka and Nepal since both countries being a developing Himalayan nation and are largely import-driven and the foreign exchange reserves practices are similar such that both rely on tourism, remittances, and FDIs. Additionally, the paper has briefly studied India's 1991 economic crisis to understand more about the causes and effects of the depletion of foreign exchange reserves. So, the paper has studied the recent economic crisis in Sri Lanka to get knowledge on what kind of implications including economic and social will fall upon Bhutan. Nepal was studied as it is an agricultural country like Bhutan and to understand their current state of foreign exchange reserves including its management practices as it is predicted that Nepal heading towards an economic crisis given the current trend of rising imports, trade deficit and depleting foreign reserves which are similar to Bhutan's current economic scenario.

Results and Findings

Current State of Economy in Bhutan

With limited domestic production capacity, the overall economy has largely been driven by the usual sectors such as hydropower, agriculture and forestry and depending on imports. Since 2008, the Bhutanese economy has been in a trade deficit. The country's import bills increased to Nu 90,299 million in 2021 from Nu 66,456.11 million in 2020. The trade deficit of Bhutan has seen an increasing trend and if Bhutan had not exported electricity to India during the period, the trade deficit could have increased to Nu 27.3B (Department of Trade, Ministry of Economic Affairs, 2021).

As per the Royal Monetary Authority of Bhutan (2021), it states that the growth in the medium and long-term of the economy will be mainly driven by the commissioning of ongoing hydropower projects in the near future which will significantly increase the country's export to India. In addition, the opening of the country to tourists is also expected to have a significant positive impact on medium- and long-term economic growth. Figure 1 shows the overall balance of trade statistics.



	Import (M Nu)	Export (M Nu)	Trade Balance (M Nu)
2019	68,906.11	31,249.94	-37,656.27
2020	66,456.11	20,732.24	-45,723.87
2021	90,229	33,555	-56,674

2019 2020 2021

Figure 1 Overall Balance of Trade.

Data Source: Annual Trade Statistics (Trade Negotiation Division, 2021).

The major portion of external debt is on account of hydropower projects which are deemed commercially viable, with a ready export market in India. In addition, hydropower debt constitutes 73% of total external debt, and the major 91.2% of hydropower debt is denominated in Indian Rupee (INR), which does not pose any exchange rate risks as Ngultrum is pegged at par with INR. The balance 27% of the external debt is Convertible Currency (CC-denominated) debt, which is a concessional loan with nominal interest rates (from 0% to 1.5%), long grace periods (8 to 10 years), and repayment periods up to 40 years (Ministry of Finance, 2022). However, Table 1 shows that there is an increase in external debt both by INR and CC denomination in just three months with a drastic increase in CC debt. The decrease in US Dollar, the main convertible foreign currency reserve has sparked concern regarding the economic stability of the nation as it will limit the trade to only India. The total external debt in terms of INR and CC as of 30th June 2022, is presented in Table 1.

Table 1 External Debt by INR and CC Denomination

Category	Amount (M Nu) 31st March	Amount (M Nu) 30th June
Rupee Debt	154,904.161	155,397.67
Convertible Currency Debt	67,202.916	74,121.34
Total External Debt	**222,107.077**	**229,519.01**

Data Source: Public Debt Situation Report for the Quarter Ended 31st March & 30th June 2022.
(Royal Government of Bhutan, Ministry of Finance, 2022)

Inflation increased from 5.6% in 2020 to 7.4% in 2021, primarily as a result of supply chain interruptions and rising commodity costs. The price of fuel increased by 57.6% as a result of these disruptions, which are partly attributed to the ongoing conflict in Ukraine. It is anticipated that the rising price of fuel will have a cascading effect that could result in severe trade shocks with macroeconomic ramifications (Ministry of Finance, 2022).

Foreign Exchange Reserve in Bhutan

Foreign exchange reserve is important for trade to happen since the country trades over 70% with India and the remaining with other countries. Every year the government uses US $300 M to 400 M from reserves and in 2021, the government used US $600 M from the reserve for Covid (Dolkar, 2022). As per Chaudhury (2022), foreign currency reserve declined by over 30 percent to USD 970.4 million(M) as of December 2021 from USD 1.5 billion(B) in April. The main cause of the noticeable fall has been an expanding trade deficit brought on by increased import prices. As Bhutan's imports from China have continuously expanded over the past few years, China's emergence as a key provider of products to the nation is depleting the country's foreign exchange reserves. Total imports from China in 2021 were estimated to be over $100 million, with the first two quarters accounting for about $130 million in imports. However, India is Bhutan's largest source of imports, accounting for 90% of all imports. The peg of Bhutan's currency, the ngultrum, to the Indian rupee since 1974, which serves as an anchor for its economic planning and a required buffer against the instability of the world currency market, has proven to be a key factor that has facilitated the country's import from India (Chaudhury, 2022).

In a recent interview, the finance minister of Bhutan made clear that many nations in the area are attempting to limit imports of goods that are not absolutely necessary in order to preserve their foreign exchange reserves. Similarly, to this, the government of Bhutan intends to stop or scale back imports of non-essential goods in the event of a financial crisis in order to protect foreign reserves (Zangpo, 2022c). The Prime Minister of Bhutan has urged citizens to adjust their consumption habits and has urged them to buy local goods since import substitution may help to prevent the depletion of foreign currency (Bhutan Today, n.d.).

Bhutan's economy continues to be centred on hydropower and tourism, but challenges are present. In 2020, remittances provided 4.28% of the GDP and helped increase the foreign exchange reserve during the COVID-19 pandemic, when the nation lost its ability to generate foreign money. More than half of all remittances were made in Australian dollars, which helped replenish foreign reserves (Zangpo, 2021).

Bhutan needs more resources to accelerate economic growth and that demands hard currency which can be achieved through different sources. The economic growth rate is depicted in Figure 2 below, which indicates a negative growth rate of 10.08 percent in 2020, primarily as a result of the COVID-19 pandemic's disruption of economic activity. The GDP growth rate in 2021 increased to 4.09% from a negative growth rate in 2020, nonetheless, following a year of a stop in economic activity. Research suggests a link between foreign reserves and economic growth, highlighting the significance of maintaining sufficient foreign reserves for national economic development.

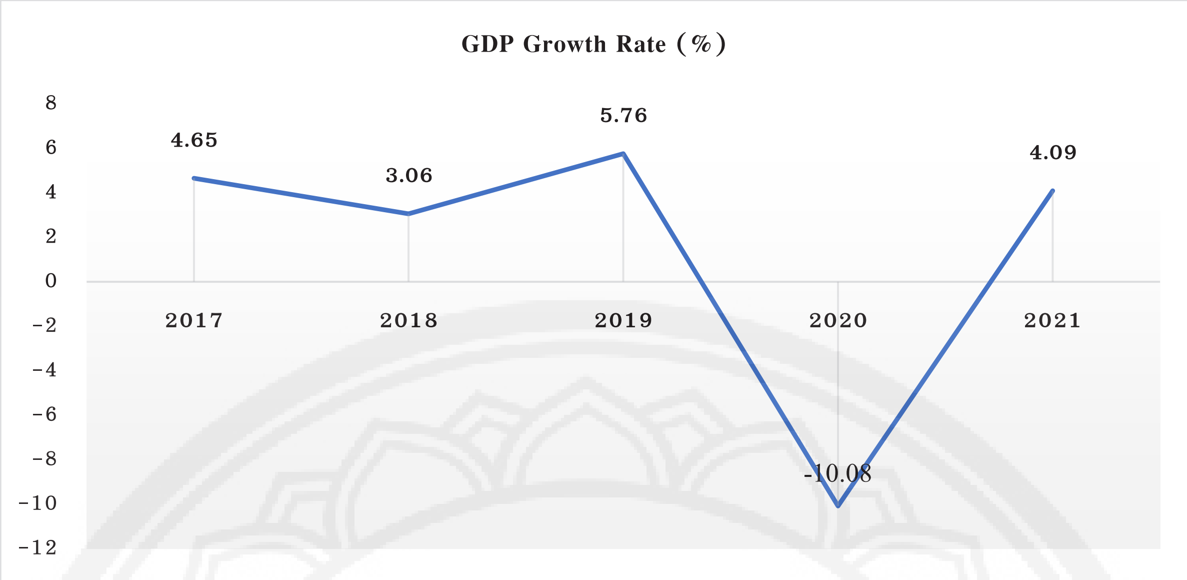


Figure 2 Bhutan GDP Growth Rate.

Source: Bhutan GDP Growth Rate (Macrotrends.net).

In June of 2022, Bhutan's trade imbalance had increased from Nu 13.8 billion(B) in the first three months of 2022 to Nu 27.3 billion(B). Over 8,000 automobiles were imported into Bhutan between June 2021 and June 2022. One of the main causes of the reserve's depletion is the import of vehicles. Recently, the country banned the import of all automobiles other than utilitarian vehicles under $20,000 and agricultural machines in an effort to preserve its depleting foreign exchange reserves. According to the Department of Industry in Bhutan, Foreign Direct Investment (FDI), which is one of the sources of foreign exchange reserves, decreased by 40 percent in 2021. The largest total FDI composition is seen in the service and hotel sector, where 40 percent of the projects are concentrated in Thimphu and the remaining are located in Paro and Chukha (Zangpo, 2022a).

According to Bhutan's Prime Minister, the country doesn't currently have any significant projects that would generate significant foreign income. Additionally, investors are reluctant to put money into ongoing initiatives. However, according to the Prime Minister of Bhutan, Druk Holding and Investments (DHI) is engaged in two to three significant projects. He stated that foreign currency is anticipated to be generated by the profits from those enterprises. The country's a trade and economy will suffer as a result of the decline in Foreign Direct Investments (FDI) and the amount of grants received from the Government of India (GoI). He voiced his worry that if Bhutan borrow foreign cash from outside sources, it would endanger the sovereignty of the country. It's likely that Bhutan might invite an economic crisis similar to a neighbouring country, Sri Lanka (Bhutan Today, n.d.).

Furthermore, it is certain that there will be a drop in foreign aid from international donors after Bhutan leaves the Least Developing Countries group, which will have a minor impact on the foreign reserves. The decline in USD reserves is also attributable to Bhutan's trade patterns, with India accounting for 90% of all trade. Despite the fact that the INR is not convertible, the government sells CC (USD) to acquire INR from the export of hydroelectricity as well as from the grants from the Indian government's five-year plan (GoI). Bhutan has seen a decline in its INR reserve during the past 2.5 years in addition to the depletion of CC. The central bank is mandated to reserve a threshold of 10 B INR and CC of USD 757 M (Bhutan Today, n.d.).

In the meantime, the budget report by National Budget Financial Year 2022-23 (Ministry of Finance, 2022) made a firm prediction of a total reserve of USD 99 million, which would be sufficient for 16 months' worth of necessary imports in 2023–2024. It has been predicted that the foreign reserves of CC will trend downward and that INR reserves will rise in 2023–2024. Additionally, there has been a downward tendency in recent months to cover the cost of imports of necessities, although it has remained above the minimum level required by the nation's constitution. With the months needed to cover the cost of necessary imports shown in the line graph, Figure 3 illustrates the reserve of INR and CC from 2020 and anticipated until 2024.

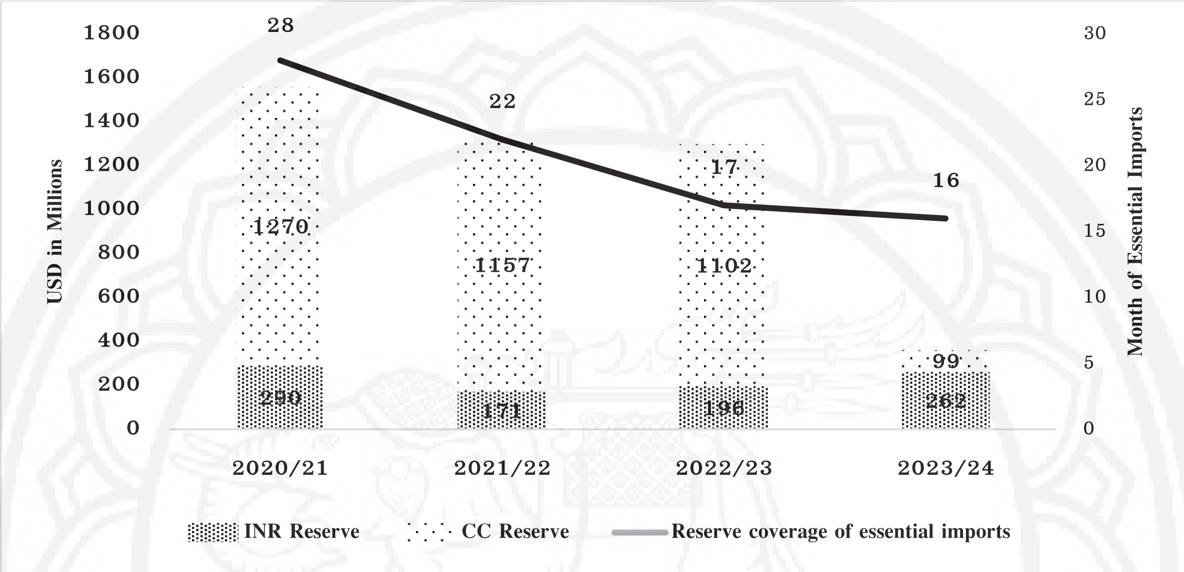


Figure 3 Trend of Foreign Reserves with Months to Meet the Cost of Essential Imports.
Source: National Budget Financial Year 2022-23 (Ministry of Finance, 2022).

Discussion

A nation should have sufficient foreign exchange reserves to protect itself from any potential external shocks. Due to its reliance on imports, Bhutan has a trade deficit since it imports more than it exports. We all know that the main factor contributing to the loss of foreign reserves is the trade deficit, and the trend in Bhutan's trade deficit at the moment is alarming and concerning. This concern stimuli research into studying the implication of Bhutan's declining foreign exchange reserves. This paper also provides a baseline study for future researchers and meets a research gap in Bhutan since no research on this topic has been studied so far.

As observed in Sri Lanka's economic crisis, India's balance of payment issue in 1991, and Nepal's present economic situation, an expanding trade deficit causes a balance of payments crisis which is also known as a currency crisis, which leads to the depletion of foreign reserves. The study found that Bhutan's trade imbalance and inflation rates have grown, leading to an increase in debt and a greater reliance on its foreign exchange reserves to finance imports and debt payments. In addition, despite the fact that Bhutan's largest source of imports is India and its foreign exchange reserves are stored in USD and INR, respectively, Bhutan has used its USD holdings to purchase more INR, further depleting its foreign exchange reserves. Import reduction and import substitution are the best options moving forward for economic stability because the trade deficit is the primary factor in the depletion of foreign reserves.

Government spending has to be reduced as a result of the decline in foreign reserves, and there will be a temporary restriction on luxury goods due to rising imports versus declining export revenues. If the economic crisis worsens, as it did in Sri Lanka, the import restriction will be imposed to necessities too. As the primary factor contributing to the loss of foreign exchange reserves, the study has determined that it is crucial to resolve the growing trade deficit. Therefore, there is a need to explore the opportunities to leverage Bhutan's export, tourism, remittance, and FDI sectors as sources of foreign exchange reserves to build up enough reserves to win investors' trust and confidence. The study found that having enough reserves increases a recipient country's government's credibility, which can aid in luring FDIs.

Any change in fiscal or monetary policy should ensure that it complies with the constitution of Bhutan, which requires the central bank to maintain a minimum foreign currency reserve sufficient to cover the cost of at least a year's worth of critical imports. The study found that developing countries need higher foreign exchange reserves so they can raise money to meet their country's needs for welfare development and economic growth, so it is advised that the central bank of Bhutan and policymakers focus on the current account balance (import and export) that can maintain foreign exchange reserves for economic and social stability. It is found that the accumulation of foreign exchange reserves stimulates a country's economic growth.

The research methodology and the fact that this study only looked at some of the constraints, not all of them, must be taken into consideration while analyzing the study's results. Furthermore, as this study merely looked at the broad ramifications of the depletion of Bhutan's foreign exchange reserves, it will serve as a baseline study for future researchers. There is also plenty of room for further analysis of the repercussions of the depletion of foreign exchange reserves in Bhutan.

Conclusion

Reserves are an essential external liquidity buffer such that the foreign exchange reserves of a nation should be sufficient to protect it from any potential external shocks and it would be a sign of economic hegemony at this point in economic reliance. Bhutan is a country with an import-dependent economy; hence the depletion of the foreign exchange reserve is a major problem. Therefore, achieving an ideal reserve level is a challenge, especially for small economies that depend on imports, and the ongoing depletion of foreign exchange reserves has implications including;

1. Ban on Non-essential Import

In comparison to imports from other countries, Bhutan imports more than 90% of its goods from India. Foreign reserves won't be able to maintain our nation's economic stability due to rising trade deficits and insufficient foreign reserve sources. The government is working hard to address the declining foreign currency reserve by adopting comprehensive measures to intervene and replenish the reserve. For example, Bhutan has stopped importing cars above 1.5 million Bhutanese ngultrums in order to preserve the country's declining foreign exchange reserves because if we continue with the current import trend, we will not have enough reserves to meet this type of demand as the import of cars is one of the causes of depletion. To safeguard the convertible currency reserve, the government may also impose import restrictions on luxury and non-essential items, or it may increase the tax rate on imported commodities to deter imports.

2. Inadequate Foreign Reserves to Meet Essential Items/ Economic Crisis

Furthermore, given the current import trend and trade deficit, a ban on imports of necessities like fuel—the top import—might not be too far off. With the trend of falling foreign exchange reserves, a moment will come when the country won't be able to purchase necessities, which will cause an economic crisis. Without sufficient reserves, a nation might be unable to pay for essential imports like crude oil or pay off its external debt. Although Bhutan's currency is pegged equally with INR, it is important that Bhutan maintain reserved foreign currency since USD is the most demanded internationally. Bhutan, a nation that relies heavily on imports, needs to diversify its economy and increase the sources of incoming foreign cash. The central bank will be obliged to devalue its currency after the reserves are depleted, making it difficult to meet demand with the remaining foreign reserves.

A central bank's ability to respond to an economic crisis may be limited by insufficient reserves, and borrowing foreign reserves only increases the risk of a balance of payments crisis, which is a major factor in the loss of foreign reserves. For example, Sri Lanka's central bank recently made so many loans from abroad that the country's net foreign reserves have turned negative. However, political stability and social peace are two essential prerequisites since they were problems in reviving Sri Lanka's economy. These conditions must be met before one can ask for financial assistance.

3. Social Instability

The COVID-19 pandemic and the conflict between Russia and Ukraine both had negative effects on the nation's economy and way of life, which hastened the loss of foreign reserves. The country's ability to import necessities will be hampered by the significant lack of foreign cash. Food, fuel, fertilizer, medicine, and essential items will be in short supply as a result, and the populace will experience lengthy power outages due to fuel shortages, which will cause disruptions in public services. Shortages of food and fuel could cause a humanitarian disaster similar to the one in Sri Lanka.

4. Leverage on Current Sources of Forex Reserves

Bhutan has a lot of potentials to earn foreign currency through remittances, tourism, exports, foreign direct investments, and foreign aid; however, foreign aid and grants are projected to decline once the nation leaves the Least Developed Countries category in the future year. Despite the fact that remittances have recently been a substantial source of foreign reserves in many other countries as well, Bhutan's foreign reserves have recently fallen. Bhutan recently opened its borders to tourists, which should bring in cash and help the country's foreign reserve be refilled. Additionally, once hydropower is put into service, it is expected that the country would earn enough foreign currency in the following years. While FDI has recently reduced nationwide, major FDI projects have been centred on Thimphu. The growth of foreign reserves has benefited from FDI returns and Bhutan will need to consider attracting FDIs, and the projects ought to be dispersed around the country seeing the current trend of FDI projects. Due to the projected ban on imports of non-essential and essential items, the nation is likely to shift toward import substitution, with consumers favouring locally produced goods which will require public support and cooperation which will be the biggest challenge for Bhutan.

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