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## India-Bhutan economic relations

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**Working Paper 384**

# **India-Bhutan Economic Relations**

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**August 2019**



**INDIAN COUNCIL FOR RESEARCH ON INTERNATIONAL ECONOMIC RELATIONS**

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## Abstract

The year 2018 was a milestone year for India-Bhutan relationship as the countries celebrated the accomplishments of the last fifty years of time-tested and special ties. The mutually beneficial economic ties have been the centre-piece of India-Bhutan relationship. India is Bhutan's largest export market, the biggest source of its imports and one of the top foreign investors in the country. India also provides Bhutan transit facility through its territory to access sea ports for trading with rest of the world. Cooperation in hydropower projects is one of the most significant examples of win-win cooperation between India and Bhutan. These projects are a reliable source of inexpensive and clean electricity to India, a major contributor towards Bhutanese GDP and strengthening India-Bhutan economic integration.

Bhutan has been pivotal to two of India's major foreign policies – the 'Neighborhood First Policy' and the 'Act-East Policy'. After coming into power in 2014, the Narendra Modi-led BJP government has laid special emphasis on India's neighborhood as well as its relations with Bhutan, which have mostly been tension free.

It is in this context that this paper examines the bilateral economic relationship between India and Bhutan. The paper analyses the bilateral trade patterns of India and Bhutan along with their maximum additional potential. The paper discusses Bhutan's transit arrangement with India, the importance of connectivity between the two countries, the flow of Indian investment in Bhutan and the cooperation between India and Bhutan in hydroelectric power projects. The paper discusses several constraints to trade and transit infrastructure. It also discusses issues related to cross-border trade in electricity. The paper concludes by making policy recommendations that could enhance the economic relationship between India and Bhutan.

**Keywords:** India-Bhutan, Bilateral Trade, Bilateral Investment, Trade in Electricity, Connectivity

**JEL Classification:** F10, F13, F15, F50, P45

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## India-Bhutan Economic Relations

Nisha Taneja, Samridhi Bimal, Taher Nadeem and Riya Roy

India and Bhutan have had a long-standing cordial relationship based on goodwill and friendship, shared historical links and interests and close understanding and cooperation. This relationship has been strengthened by the ‘Treaty of Friendship’ which was signed between the two countries as early as in 1949.<sup>1</sup> Among other provisions in the treaty, it provided for “perpetual peace and friendship” between the governments of the two nations (Ministry of External Affairs, 2019a).<sup>2</sup> Further, the seeds of free trade between India and Bhutan were sown in this treaty. Article 5 in this treaty specified that there would be free trade and commerce between India and Bhutan and that the Indian government agrees to grant Bhutan transit facility, both by land and water. Subsequently, an Agreement on Trade and Commerce between Bhutan and India was signed in 1972 (Ministry of External Affairs, 2019b).<sup>3</sup> It established a free trade regime between the two countries and also allowed duty- free transit of Bhutanese exports to third countries. Since then the treaty has been renewed regularly.

Bhutan has been pivotal to two of India’s major foreign policies – the ‘Neighborhood First Policy’ and the ‘Act-East Policy’. After coming into power in 2014, the Narendra Modi-led BJP government has laid special emphasis on India’s neighborhood as well as its relations with Bhutan, which have mostly been tension free.

As the year 2018 has recently marked 50 years of friendship between the two countries, it becomes imperative to examine the economic relationship between them. It is in this context that this paper examines the bilateral economic relationship between India and Bhutan in the four key areas of trade, connectivity, investment, cooperation in the hydropower sector and also discusses various issues related to these.

The study makes use of “mixed methods”, based on secondary sources and primary information collected through stakeholder’s consultations. Secondary sources include published papers, reports, books, government policies, agreements, regulations and protocols. Secondary data on India’s trade with Bhutan has been collected from the Directorate General of Foreign Trade (DGFT), Ministry of Commerce and World Integrated Trade Systems (WITS) database published by the World Bank. Stakeholder consultations were conducted with importers, exporters, freight forwarders, clearing agents, government officials and academics on various issues at different points in time during 2017-18, both in India and Bhutan.

The paper is organized as follows. Section 1 of the paper analyses the bilateral trade patterns of India and Bhutan along with their maximum additional potential. Section 2 discusses Bhutan’s transit arrangement with India. Section 3 discusses the importance of connectivity

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<sup>1</sup> The India-Bhutan Friendship Treaty was updated and signed on 8 February 2007.

<sup>2</sup> Treaty of Perpetual Peace and Friendship Between the Government Of India and the Government Of Bhutan is available at <https://mea.gov.in/bilateral-documents.htm?dtl/5242/treaty+or+perpetual+p>

<sup>3</sup> Agreement on Trade and Commerce between the Government Of India and the Government Of Bhutan is available at <https://www.mea.gov.in/bilateral-documents.htm?dtl/5671/Agreement+on+Trade+and+Commerce>

between the two countries. Section 4 focuses on India's FDI in Bhutan. Section 5 discusses the cooperation between India and Bhutan in hydroelectric power projects. Section 6 discusses several constraints to trade and transit infrastructure and issues related to cross-border trade in electricity. Finally, section 7 concludes the paper by listing down policy recommendations that can help strengthen the economic relationship between India and Bhutan.

## 1. Trade Trends and Potential

Trade trends are examined in terms of value, trade balance, composition and structure.

### 1.1 Trade Trends

Total trade between India and Bhutan has increased by nearly 50 times during 2000-01 and 2018-19. Growth in bilateral trade has been driven largely by the rapid economic growth and greater commercial integration between the two countries. In the last eight years, trade balance has been in India's favour and the divergence between India's exports to Bhutan and imports from Bhutan has only increased over time. However, between 2006-07 to 2010-11, India had a trade deficit with Bhutan due to a surge in imports of wires of refined copper (HS 740811) and refined palm oil and derivatives (HS 151190) in 2006-07 and 2007-08. In the following years, import of these two items declined sharply and the import of ferro silicon (HS 720221) and carbides of calcium (HS 284910) grew rapidly and was mainly responsible for India's imports exceeding its exports to Bhutan. In the last few years our exports to Bhutan have picked up and this is reflected in the recent total trade and trade balance figures (Table 1).

**Table 1: Trade Trends between India and Bhutan (US\$ million)**

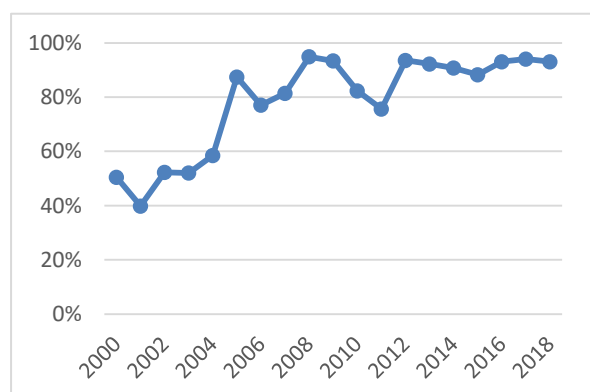
Year	India's Export to Bhutan	India's Import from Bhutan	Trade Balance	Total Trade
2000-01	1.1	21.1	-20	22.2
2001-02	7.6	23.9	-16.3	31.5
2002-03	39.1	32.2	6.9	71.2
2003-04	89.5	52.4	37.1	141.9
2004-03	84.6	71	13.6	155.6
2005-06	99.2	88.8	10.4	187.9
2006-07	57.7	142.1	-84.4	199.7
2007-08	86.7	194.7	-108	281.5
2008-09	111.2	151.8	-40.6	262.9
2009-10	118.9	153.1	-34.3	272
2010-11	176	201.6	-25.5	377.6
2011-12	229.9	202.6	27.3	432.4
2012-13	233.2	164	69.2	397.2
2013-14	355.6	152.2	203.4	507.8
2014-15	333.9	149.9	184.1	483.8
2015-16	469	281.3	187.7	750.2
2016-17	509.3	307.8	201.5	817.1
2017-18	546.1	377.9	168.2	924.1
2018-19	657.3	369.5	287.8	1,026.80

Source: Directorate General of Foreign Trade, Ministry of Commerce and Industry, Government of India



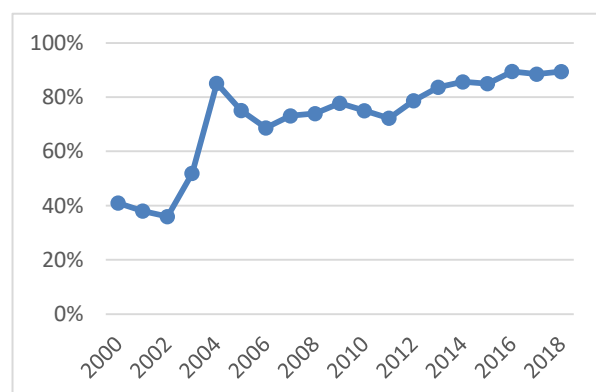
Next, we examine the relative importance of India among Bhutan's global trading partners. It comes as no surprise that the bulk of Bhutan's trade is with India. India is by far the largest destination for Bhutan's exports and the most prominent source of its imports. India's share in Bhutan's export to the world has averaged 92% in the last five years from 2014-2018 (Figure 1a). Similarly, India's share in Bhutan's total import from the world, on average, has been close to 88% during the same time period (Figure 1b).

**Figure 1a: India's Share in Bhutan's Total Exports to World**



Source: IMF DOTS Database

**Figure 1b: India's Share in Bhutan's Total Imports from World**



Source: IMF DOTS Database

Based on Bhutan's cumulative trade over the last five years we have ranked the top 10 trade partners of Bhutan in terms of their share in Bhutan's total exports and imports. In case of export partners of Bhutan, the second-highest share in Bhutan's total exports to the world is close to 4% for Bangladesh. In the case of Bhutan's import partners, Singapore has the second-highest share with 1.5% of Bhutan's total imports from the world.

**Table 2: Bhutan's Major Trading Partners in the Last Five Years (2014 to 2018)**

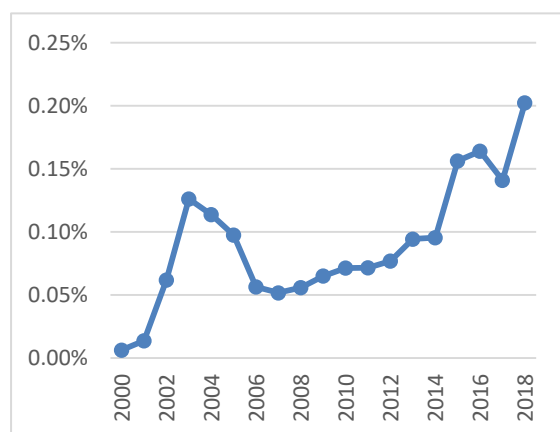
Rank	Bhutan's Export Partners	Share of Bhutan's Total Export	Bhutan's Import Partners	Share of Bhutan's Total Import
1	India	91.7%	India	87.9%
2	Bangladesh	3.9%	Singapore	1.5%
3	Germany	1.2%	Japan	1.2%
4	Netherlands	1.2%	Korea	1.1%
5	Italy	0.7%	Thailand	1.1%
6	Nepal	0.4%	United States	1.1%
7	Japan	0.2%	Germany	0.9%
8	United States	0.1%	Nepal	0.9%
9	Singapore	0.1%	China	0.9%
10	Malaysia	0.1%	Area not specified	0.7%

Source: IMF DOTS Database

On the other hand, Bhutan as a trading partner for India holds very little significance in terms of the total value of trade India conducts with the world. Bhutan's share in India's total exports to the world has not been steady and has been fluctuating a lot. It has however gone up over time from almost zero to under 0.2% of India's total exports. (Figure 2a). At the same

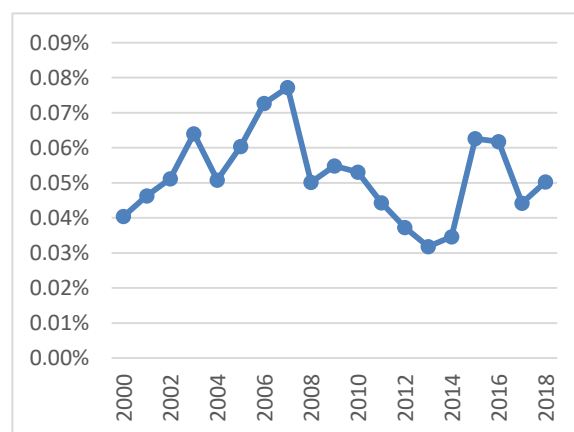
time, Bhutan's share in India's total imports from the world has also been low and varied from 0.03% to 0.08% of total global imports in the last two decades (Figure 2b).

**Figure 2a: Bhutan's Share in India's Total Exports to World**



Source: IMF DOTS Database

**Figure 2b: Bhutan's Share In India's Total Imports from World**



Source: IMF DOTS Database

## 1.2 Composition of Trade

At a disaggregated level (HS-6 classification), top commodities exported from India to Bhutan in 2018-19 included petroleum oils and oils obtained from bituminous minerals, motor vehicles, ferrous product obtained by direct reduction of iron ore, light oils and preparations and wood charcoal. In the same year, India's top imports from Bhutan included electrical energy, ferro-silicon, carbon products, plate sheets of polymers of ethylene and cement. An interesting observation here is that while the top ten items of export from India to Bhutan make up for 41% of India's total exports to Bhutan, the top ten items imported from Bhutan make up for 93% of its total imports from Bhutan (Table 3 and 4). On the imports side, two products namely electrical energy and ferro-silicon comprise 71% of India's total import basket from Bhutan.

**Table 3: India's Top 10 Exports to Bhutan in 2018-19 (US\$ million)**

HS Code	Product Description	Value	Share in India's Total Exports to Bhutan
271019	Other petroleum oils and oils obtained from bituminous mineral setc	101.0	15.4%
870423	Motor vehicles with compression ignition internal combustion engine (diesel etc), g.v.w.>20 tons	29.7	4.5%
720310	Ferrous product obtained by direct reduction of iron ore	29.5	4.5%
271012	Light oils and preparations	25.1	3.8%
440290	Other : wood charcoal	21.5	3.3%
870421	Goods vehicles, with compression ignition internal combustion engine (diesel/semi diesel), g.v.w.<=5ton	14.6	2.2%
271320	Petroleum bitumen	14.3	2.2%
270400	Coke and semi/coke of coal/lignite/peat w/n agglomerated; retort carbon	12.5	1.9%
870331	Other vehicles, with compression ignition internal combustion piston engine (diesel/semi-diesel), of a cylinder capacity<=1500 cc	10.7	1.6%
870422	Goods vehicles, with compression ignition internal combustion engine g.v.w.>5 tons but <=20 tons	9.6	1.5%
<b>Total of Top 10 Items</b>		<b>268.5</b>	<b>40.8%</b>
<b>Total Exports to Bhutan</b>		<b>657.3</b>	<b>100.0%</b>

Source: Directorate General of Foreign Trade, Ministry of Commerce and Industry, Government of India

**Table 4: India's Top 10 Imports from Bhutan in 2018-19 (US\$ million)**

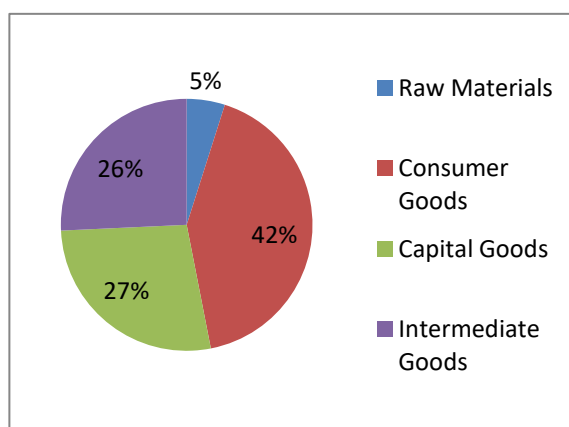
HS Code	Product Description	Value	Share in India's Total Imports from Bhutan
271600	Electrical energy	136.1	36.8%
720221	Ferro-silicon containing >55% of silicon	128.9	34.9%
251810	Dolomite not calcined or sintered	26.8	7.3%
720719	Other products containing by wt<0.25% of carbon	23.3	6.3%
284920	Carbides of silicon w/n chemically defined	11.4	3.1%
392010	Plates sheets etc. of polymers of ethylene	5.5	1.5%
252329	Other Portland cement	4.8	1.3%
220299	Other sweetened flavoured waters	2.7	0.7%
151190	Refined palm oil and its fractions	2.5	0.7%
200989	Other juices	2.3	0.6%
<b>Total of Top 10 Items</b>		<b>344.1</b>	<b>93.1%</b>
<b>Total Imports from Bhutan</b>		<b>369.5</b>	<b>100.0%</b>

Source: Directorate General of Foreign Trade, Ministry of Commerce and Industry, Government of India

Finally, we also look at the composition of trade (by end use) using the WTO classification (Figures 3a and 3b). We find that consumer goods comprised half of India's exports to

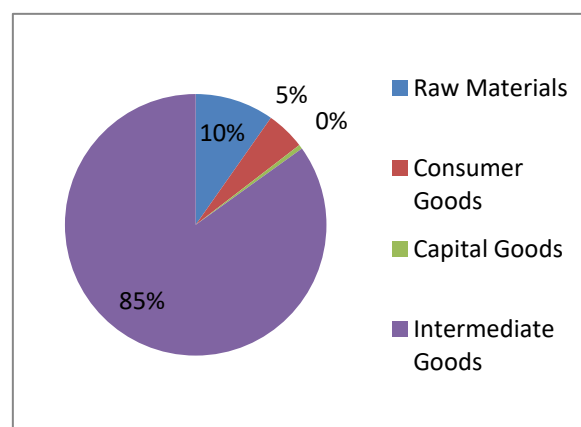
Bhutan in 2018. In case of India's imports from Bhutan, intermediate goods accounted for majority of the imports (share of 85% in 2018).

**Figure 3a: India's Exports to Bhutan (by End-Use)**



Source: UNCTAD WITS Database

**Figure 3b: India's Imports from Bhutan (by End-Use)**



Source: UNCTAD WITS Database

### 1.3 Additional Trade Potential

We have also attempted to estimate the maximum additional trade potential that exists between India and Bhutan. Trade potential is defined as the trade that could be achieved at an “optimum trade frontier” in the case of open and frictionless trade possible given the current level of trade, transport and institutional technologies or practices (Drysdale et al., 2000; Kalirajan, 2000; Armstrong, 2007). In simple words, it is an estimate of the maximum possible trade that would be in the hypothetical case of most frictionless and free trade possible under current conditions observed between the two countries. There exists a gap between potential and actual trade, which is associated with various socio-political and institutional factors that may be hindering the actual trade to grow to the upper limit of the production frontier. It is of significant importance to know the trade potential that exists at the disaggregate commodity level between the two countries so that they can engage in negotiations for market access. Additionally, commodity-wise trade potential also reflects the need for countries to undertake domestic trade policy reforms to increase the efficiency and competitiveness in the partner countries (Taneja et al, 2019).

Following the methodology used in Taneja et al (2013), we estimate additional trade potential using the “trade possibilities approach”. Trade possibilities are determined by the exporting country's supply capabilities and importing countries demand capabilities. We define trade possibilities to exist in items that the two countries can import from each other instead of from elsewhere in the world. In order to identify items having trade potential and assess the magnitude of trade possibilities (referred to as trade potential) between the two countries, products having trade potential are identified as those with (a) adequate demand in the receiving country and (b) adequate supply capabilities in the source country.

Potential trade for any commodity is given by  $\text{Min}(\text{SE}, \text{MI}) - \text{ET}$  where SE, MI and ET are supplier's global exports, receiver's global imports and existing trade between the supplier and the receiver. The exercise is conducted by first posing India as a supplier and then by posing Bhutan as the supplier country.

The results of the exercise show the existence of an estimated additional trade potential of around US\$ 105 million if the two countries were to import from each other what they import from the rest of the world. Of this total trade potential, India's export potential to Bhutan accounted for US\$ 54.6 million and its import potential from Bhutan accounted for US\$ 54 million (Table 5).

**Table 5: Additional Trade Potential between India and Bhutan (US\$ million)**

	Actual Trade	Additional Trade Potential
India's Exports to Bhutan	652	51.1
India's Imports from Bhutan	306	54.6

*Source: Author's calculations based on UNCTAD-WITS data*

*Note: All above figures based on 2018 data*

The trade potential exercise reflects that there is limited scope for expanding trade between India and Bhutan. As mentioned in Section 2(i), India is already Bhutan's largest trading partner with shares in Bhutan's total global export and import close to 88% and 92% respectively. Hence, additional untapped trade potential between the two countries is untapped is not very large. The list of top ten items in which there is some additional potential for India's exports to and imports from Bhutan is given in Appendix (Table A1 and A2).

## **2. Bhutan's Transit Arrangement with India**

The Agreement on Trade, Commerce and Transit between India and Bhutan provides for the transit of Bhutanese goods through Indian Territory either from one part of Bhutan to another part of Bhutan or to/from other countries located in South Asia and rest of the world. The goods in transit are exempted from customs duties and all transit duties or other charges except reasonable charges for transportation and such other charges commensurate with the costs of services rendered.

The Protocol to the Agreement on Trade, Commerce and Transit specifies mutually agreed 21 entry-exit points: Jaigaon, Chamuchi, Ulta Pani, Hathisar, Darranga, Kolkata, Haldia, Dhubri, Raxaul, Panitanki, Changrabandh, New Delhi, Mumbai, Chennai, Phulbari, Dawki, Dalu, Gasupara, Loksan, Kulkuli and Nagarkata. Of these, Kolkata, Haldia, Mumbai and Chennai are the designated seaports; Dhubri is the riverine route; New Delhi, Chennai, Mumbai and Kolkata are the air routes and Raxaul is the rail route. The others are the designated road routes. The bulk of Bhutan's foreign trade is through the Kolkata and Haldia port due to their close proximity to the major Bhutanese cities like Pheuntsholing and Thimphu.

The Protocol mentions in detail the import and export procedure that should be followed while transporting goods to (from) Bhutan from (to) the Indian ports. When goods are imported from third countries for Bhutan through India, the clearance of goods is done against a Letter of Guarantee (LG) issued by the Royal Bhutan Customs or representative of the Royal Government of Bhutan (RGoB). The importer or his agent needs to present the bill of lading (B/L), invoice and packing list at the Indian port of entry. On arrival of the Bhutanese containerized cargo, the Indian customs at the port of exit check the ‘one-time-lock’ of the container put on by the shipping agent or the carrier authorized by the shipping company and if found intact allow transportation of the containerized cargo without examination. In respect of non-containerized cargo, the customs make a selective percentage examination of the goods. On arrival of the cargo at the port of exit, the Indian customs adopts the same process of examination and verification as done at the port of entry.

When Bhutan is importing goods from third countries through the Kolkata port, the following two conditions have to be met: first that the Indian custom officials at the Kolkata port and the LCS have to examine the vehicles to check whether the goods are in accordance with the LG and then approve them for onward movement and second, the movement is allowed only through the Jaigaon LCS and has to be covered by the LG issued by the Royal Bhutan Customs/ representative of the RGoB.

Transit goods arriving in Kolkata, Delhi, Mumbai and Chennai airports and destined for Bhutan also have to follow the import procedure mentioned in the Protocol. The import procedure described here also applies *mutatis mutandis* for Bhutan’s exports to third countries (Ministry of Commerce, 2016).

The Protocol also mentions the detailed procedure for the movement of goods from one part of Bhutan to another part through the Indian Territory. In this case, the Bhutan Customs issue a ‘Transit Declaration’ to the owner of the goods or his agent. In the case of third-country goods, this declaration has to carry an undertaking from the Bhutan Custom authorities mentioning that the goods are meant for consumption in Bhutan only. Movement of such transit goods from one part of Bhutan to another part through India is not subjected to any sample checking by Indian authorities.<sup>4</sup> At the Indian port of entry, the Transit Declaration is presented to the Indian customs who endorse and return it to the owner or his agent and allows the movement of goods. The Transit Declaration is then deposited with the Bhutan Customs officials at the point of re-entry in Bhutan who release the goods after inspecting the same.

### **3. India-Bhutan Connectivity in BBIN**

India and Bhutan have been working on improving connectivity for better trade and economic relations within different regional and bilateral frameworks. Both countries are a part of the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation

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<sup>4</sup> Except in cases where specific information is made available to the Indian custom authorities about the consignment carrying goods which are contraband in nature or contrary to the importability of those in any manner.

(BIMSTEC).<sup>5</sup> The BIMSTEC as a regional framework was conceptualized on the doctrine of open regionalism bringing together countries from South Asia and Southeast Asia. Under the ambit of BIMSTEC, Bangladesh, Bhutan, India and Nepal signed a landmark Motor Vehicles Agreement (MVA) for the Regulation of Passenger, Personnel and Cargo Vehicular Traffic was signed by the transport ministers of the four BBIN countries in Thimpu, Bhutan on 15<sup>th</sup> June 2015. The MVA agreement is expected to pave the way for a seamless movement of people and goods across their borders for the benefit and integration of the region and its economic development. Trial runs for cargo vehicles under the MVA were conducted along the Kolkata-Dhaka-Agartala and Delhi-Kolkata-Dhaka routes in the past. The trials were successful in establishing the Agreement's economic benefits (Press Information Bureau, 2018).

Once implemented, MVA will allow vehicles to enter each other's territory and eliminate the need for transshipment of goods from one country's truck to another at the border, thereby reducing the transaction cost and time involved in trading. The agreement envisages electronic tracking of cargo vehicles, issuance of permits online and electronically sending it to all land ports. Bangladesh, India and Nepal have already ratified the MVA and have agreed to start the implementation of the MVA among the three signatory countries, with Bhutan joining after it ratifies the Agreement.<sup>6</sup>

Even though Bhutan has not yet ratified the MVA, efforts are being made to improve connectivity between India and Bhutan. An Asian Development Bank-financed project under the South Asia Sub-regional Economic Cooperation (SASEC) program is working on improving the road connectivity and facilitating trade between India and Bhutan along the Phuentsholing-Jaigaon border. The ADB-financed project is constructing a bypass road from Jaigaon in India to Pasakha in Bhutan and includes the construction of a mini-dry port in Phuentsholing. The by-pass road will provide an alternate route to vehicles that ply on the Phuentsholing-Jaigaon border-crossing point thereby improving connectivity with India and easing traffic congestion in Bhutan (SASEC, 2015). In 2016, India approved an ambitious US\$ 1.04 billion project for constructing and upgrading 558 km of roads to improve the country's connectivity link with Bangladesh, Bhutan and Nepal and ease the movement of passengers and cargo (IANS, 2016). In 2018, India has also agreed in- principle to build a four-lane 264 km highway along the India-Bhutan border (Business Standard, 2018).

#### **4. India's FDI in Bhutan**

Historically, Bhutan pursued a conservative and restrictive FDI policy regime as the country had concerns regarding the impact of FDI on the tradition and culture of Bhutan. This resulted in the existence of only a handful of foreign investments in Bhutan (Jigme, 2006). It

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<sup>5</sup> In June 1997, Bangladesh, India, Sri Lanka and Thailand Economic Cooperation (BIST-EC) was formed that evolved into BIMST-EC (Bangladesh, India, Myanmar, Sri Lanka and Thailand Economic Cooperation) with the admission of Myanmar, and subsequently into the BIMSTEC with the admission of Nepal and Bhutan in February 2004.

<sup>6</sup> There have been reservations among some sections within Bhutan about the viability of this agreement which are discussed in section 6.3.

was only in the early 2000s that the Government of Bhutan formulated a clear-cut policy on FDI. The Bhutanese economy welcomed FDI formally for the first time through the adoption of FDI Policy, 2002 and its subsequent implementation in 2005. The policy was amended in 2010 to “re-align to changing needs of the economy and changes in global investment environment” (Dorji, 2019). The 2010 amendment used a ‘negative list’ approach wherein all activities other than those listed in the negative list were open for foreign investment. This policy was again amended in 2014 with more changes in pursuit of creating a more enabling and conducive environment for foreign investors. For example, the amended policy allows foreign institutional investors to invest in Bhutan with a minimum stake of 10% and the ownership is permitted up to 100% in select sectors. Minimum investment levels have also been reduced in most sectors. Many foreign exchange restrictions related to the repatriation of dividend and operational needs have also been liberalized.

These policy liberalization efforts have made Bhutan an important foreign investment destination with investment flowing in from several countries around the world (Box 1). However, it is India which is the major source of FDI into Bhutan. In fact, the first flow of Indian investment came to Bhutan as early as 1972 when the State Bank of India (SBI) invested 40% equity in Royal Bank of Bhutan (RBOB) to develop the banking sector in the Bhutanese economy (Cole and Carrington, 2016).

#### **Box 1: Snapshot of FDI in Bhutan**

As per FDI Annual Report 2018, FDI inflow in Bhutan (in terms of the number of projects) has increased significantly over the years. The total number of projects has increased from 57 in 2017 to 73 in 2018. As of December 2018, Bhutan has approved 64 FDI projects, with a record number of 16 projects approved in the year 2018. In terms of value, Bhutan recorded Nu 5.7B worth of FDI projects in the year 2018 alone, registering a 10-fold increase from 2017.

In terms of source of FDI, majority of investment comes from Asia (64%) followed by Europe (21%) and North America (11%). From within Asia, India is the major source of investment in Bhutan (51%) followed by Singapore (15%) and Thailand (13%). In terms of sectoral distribution, the services sector has received the maximum share (65%) of FDI in Bhutan. The remaining 35% has gone to the manufacturing sector. Hotel sector attracts the maximum foreign investment accounting for 42% of total FDI received in Bhutan.

In terms of location of FDI, 62% of approved FDI projects are located in Thimphu, Paro and Phuentsholing. Thimphu is especially the preferred destination for FDI in the service sector such as hotel industry and IT/ITES sectors. Foreign investors in Bhutan are mostly private companies (72%) followed by individual investors (19%). According to the Annual Report, FDI companies have a total of 5,307 Bhutanese employees in 2018, showing an increase of about 8.4% from the previous year.

*Source: FDI Annual Report 2018, Department of Industry, Ministry of Economic Affairs, Government of Bhutan*

India’s cumulative investment in Bhutan over the period July 2007 to March 2019 is US\$ 50.12 million. Over the years, many Indian parties have established their operations in Bhutan in the electricity, gas and water sector in order to take advantage of the cheap and reliable electricity available in the country. This sector has received a share of 42% of India’s



cumulative investment in Bhutan. Investments in this sector have been primarily driven by the joint venture between the Tata Power Company Ltd and the Dagachhu Hydro Power Corporation Ltd for the Dagachhu Hydropower Project. Tata Power invested around 6 million USD in the Hydroelectric Power project in collaboration with the Bhutanese firm Dagachhu Hydropower Corporation which is a subsidiary of Druk Green. The project is located in the Dagana district. In the same year a huge investment of 11 million USD was also made by an Indian firm Sunayana Commodities Pvt. Ltd. as it entered into a Joint Venture with the Bhutanese firm Quality Gases Pvt. Ltd. These firms deal in the production of liquid nitrogen and oxygen. The other surges in the flow of FDI from India into Bhutan (between 2010 and 2013) are also attributable to the subsequent investments made by Tata Power in the Dagachhu Hydropower project.

The second most important sector receiving the maximum flow of Indian investment is the wholesale, retail trade, restaurants and hotels sector with a share of 26%. This is followed by the manufacturing sector and agriculture, hunting, forestry and fishing receiving a share of 14% and 7% respectively.

**Table 6: India's Sector-wise FDI in Bhutan (July 2007-March 2019)**

Sector	Total FDI Outflow (US\$ million)	Share
Electricity, gas and water	21.26	42%
Wholesale, retail trade, restaurants and hotels	13.17	26%
Manufacturing	6.8	14%
Agriculture , hunting, forestry and fishing	3.42	7%
Miscellaneous	2.17	4%
Agriculture & mining	2.02	4%
Construction	1.22	2%
Community, social and personal services	0.05	0%
Financial, insurance and business services	0.01	0%
<b>Cumulative Indian FDI in Bhutan</b>	<b>50.12</b>	

Source: RBI Data on Overseas Investments

## 5. Cooperation in Hydroelectric Power Projects

Cooperation in hydropower projects is one of the most significant examples of win-win cooperation between India and Bhutan. These projects are a reliable source of inexpensive and clean electricity to India, a major contributor towards Bhutanese GDP and strengthening India-Bhutan economic integration.

India's engagement in Bhutan's hydropower sector goes back to 1961 when the two countries signed one of their first hydropower cooperation pacts with the intent of harnessing hydroelectricity from the Jaldhaka river.<sup>7</sup> In 1974, India and Bhutan signed an agreement on Chukha hydropower project. This was the first mega power project which was fully funded

<sup>7</sup> This project was completed in 1966. The total capacity of the plant was around 18,000 kilowatts. According to the 1961 pact, Bhutan would receive the free supply of 250 kilowatts electricity (Ranjan, 2018).

by the Indian government (60% grant and 40% loan basis)<sup>8</sup>. In 2006, a comprehensive agreement in the hydropower sector was signed between the two countries. As part of the agreement, it was decided that for the projects to be implemented jointly by the two governments through Joint Ventures or government owned agencies, an 'Empowered Joint Group' would be set up.<sup>9</sup> India agreed to assist Bhutan in developing a minimum of 10,000 megawatt of hydropower by 2020. India also agreed to import surplus amount of electricity from those hydro projects (Central Electricity Authority, 2018).

Following the 2006 agreement, India has collaborated with Bhutan on several hydroelectric power projects, some which are currently operational while the others are under construction. Out of a total of 11 projects, four are operational. At present the Tala Hydroelectric Power project (1020 MW) is the largest operating power plant, in terms of capacity. However, the Punatsangchhu I and II projects, once completed, will have a combined generating capacity of 2400 MW.

The earlier projects (Chukha, Kurichhu, Tala, Punatsangchhu I&II and Mangdechhu) were implemented under the Inter-Governmental (I.G) modality. Under this mode of operation, Government of India extended support towards the projects in the form of both loans and grants to the Royal Government of Bhutan. Over the years, the ratio of loan to grant has also undergone a change, with the balance tilting more towards loans from grants. The Chukha and Kurichhu projects were developed with a 60% as grant and 40% as loan. While the funding for Punatsangchhu I & II was 40% as grant and 60% as loan and for the Mangdechhu project it has been 30% as grant and 70% as loan. After the completion of the projects, the ownership of the project would be transferred to Bhutan.

The more recent projects have been developed under the Joint Venture (JV) modality in which the project is developed and owned by a JV Enterprise between Indian and Bhutanese Public-Sector Undertakings. The Kholongchhu Hydro Energy Limited has been developed as a Joint Venture between an Indian Public-Sector enterprise (SJVN Ltd.) and a Bhutanese Public Sector enterprise Druk Green Power Corporation (DGPC). Similarly, the Bunakha Hydropower Project is a Joint Venture between THDC India Ltd and DGPC. The Dagachhu Hydropower Corporation Limited has been developed under Public-Private Partnership (PPP) among Druk Green Power Corporation, Tata Power Company Limited and National Pension and Provident Fund of Bhutan. The Wangchu and Chamkarchu projects have a similar JV structure. A summary of the major hydropower projects is given in Table 7.

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<sup>8</sup> The capacity of this hydropower project was 336 megawatts. It was fully commissioned in 1988.

<sup>9</sup> Accordingly, an Empowered Joint Group (EJG) has been constituted between GoI and RGoB on 16.03.2009 to fast track the approval of the implementation modalities, financing mechanisms, fund flows, contingencies plans and monitoring of the progress of all activities of preparation of DPRs and construction of the selected hydro power projects. EJG is headed by Minister of Economic Affairs, RGoB with four members from RGoB namely Secretary, Ministry of Economic Affairs, Secretary, Ministry of Finance, Director General, Department of Energy and Chief Executive Officer, Druk Holding & Investment and three members from GoI namely Principal Advisor (Finance), MEA, Joint Secretary (North), MEA and Joint Secretary (Hydro), MOP and Member (Hydro), CEA as permanent Invitee.

**Table 7: Status of Hydroelectric Power Projects in Bhutan with Indian Collaboration**

<b>Name of the project</b>	<b>Key Features</b>	<b>Funding</b>	<b>Current Status</b>
Chukha Hydroelectric Project	336 MW project, located over Wangchu river in Chukha district	Fully funded by the Government of India with 60% grant and 40% loan at the interest rate of 5% payable over 15 years after commissioning	Operational
Kurichhu Hydropower Plant	60 MW run-of-the-river project, located at Gyalpozhing, Mongar, on the Kurichhu River in Eastern Bhutan	Funded by the Government of India with 60% grant and 40% loan at low interest rate	Operational
Tala Hydroelectric Project	1020 MW run-of-the-river and largest HEP project in Bhutan, located on the Wangchu river downstream of the Chukha HEP	Funded by the Government of India with 60% grant and 40% loan at low interest rate	Operational
Punatsangchhu-I HEP	1200 MW run-of-the-river project, located on the left bank of Punatsangchhu river in Wangdue Phodrang District in Western Bhutan	Funded by the Government of India with 40% grant and 60% loan	Till September, 2017, 80% complete, expected to be completed by first quarter of 2022
Punatsangchhu-II HEP	1200 MW run-of-the-river project, located on the left bank of Punatsangchhu river in Wangdue Phodrang District in Western Bhutan	Funded by the Government of India with 40% grant and 60% loan	Till September, 2017, 70% complete, expected to be completed by last quarter of 2019
Mangdechhu Hydroelectric Plant	720 MW run-of-the-river project, located on river Mangdechhu in Trongsa district in Central Bhutan	Funded by the Government of India with 30% grant and 70% loan at 10% annual interest rate to be paid back in 30 equated semi-annual installments	As of March 2017, 90% complete, expected to be completed by June 2018
Kholongchhu Hydroelectric Plant	600 MW run-of-the-river project, located on the lower course of Kholongchhu river in Trashiyangtse district of Bhutan, first HEP in Bhutan implemented under the Joint Venture modality	Financed by a debt equity ratio of 70:30. The equity is shared equally between SJVN Ltd, an Indian public-sector enterprise and DGPC, a Bhutanese public-sector enterprise. DGPC's share of equity in the project is financed by GoI as a grant	Initial stages of construction
Bunakha Hydroelectric Plant	180 MW, located near Bunakha village in Chukha district of Bhutan, 3,25 kilometers upstream of existing Chukha	Financed by a debt equity ratio of 70:30. The equity is shared equally between THDC Ltd, an Indian public-sector enterprise and DGPC, a Bhutanese public-sector enterprise. DGPC's share	Pre-construction stage

	dam	of equity in the project is financed by GoI as a grant	
Wangchu Hydroelectric Plant	570 MW, run of river scheme on the river Wangchu in Chukha district of Bhutan	Financed by a debt equity ratio of 70:30. The equity is shared equally between SJVN Ltd, an Indian public-sector enterprise and DGPC, a Bhutanese public-sector enterprise. DGPC's share of equity in the project is financed by GoI as a grant	Pre-construction stage
Chamkarchu Hydroelectric Plant	770 MW, run of river scheme on the river Chamkarchu	Financed by a debt equity ratio of 70:30. The equity is shared equally between NHPC Ltd, an Indian public-sector enterprise and DGPC, a Bhutanese public-sector enterprise. DGPC's share of equity in the project is financed by GoI as a grant	Pre-construction stage
Dagachhu Hydropower Project	126 MW, run-of-the-river project, located in Dagana district of Bhutan, first cross border CDM project in the world, first PPP venture in the hydropower sector of Bhutan	Financed by a debt equity ratio of 60:40. Partnership among DGPC (59%), Tata Power Company (26%) and NPPF of Bhutan (15%). Loans provided by ADB and RZB, Austria	Operational

*Source: Authors own compilation from various publications of Central Electricity Authority, Ministry of Power, Government of India and Embassy of India, Bhutan*

## **6. Impediments to India-Bhutan Trade, Transit and Connectivity**

Based on an extensive literature survey and stakeholder consultations held in India and Bhutan, this section discusses several constraints to trade and transit infrastructure. It also discusses issues related to cross-border trade in electricity.

### **6.1 Trade and Transit Infrastructure**

The Land Customs Station at Jaigaon-Phuentsholing border is India's most important trading point with Bhutan. Almost 90% of bilateral trade takes place through this border point. Additionally, the corridor linking Jaigaon-Phuentsholing border to Kolkata seaport is an important transit corridor for Bhutan's trade with rest of the world. Bhutan also conducts trade with Bangladesh through the Indian Territory primarily through two border points: Changrabandha (India)-Burimari (Bangladesh) and Phulbari (India)-Banglabandha (Bangladesh). The majority of Bhutan's exports to Bangladesh move through the Changrabandha-Burimari border point.

Based on stakeholder consultations, this section analyzes the issues at the Jaigaon-Phuentsholing border hampering bilateral trade, issues regarding time spent in transit through the Kolkata-Phuentsholing corridor and issues regarding Bhutan's trade with Bangladesh through the Changrabandha-Burimari border point.

### ***6.1.1 Impediments at Jaigaon-Pheuntsholing LCS***

Our stakeholder consultations reveal that the physical and technological infrastructure at the LCS in Jaigaon is inadequate relative to the volume of trade it handles. This is the root cause of inefficiencies and delays arising in the passage of cargo into or out of Bhutan. We list down the following key constraints were identified at the Jaigaon-Pheuntsholing LCS:

- The LCS is located on the main highway that connects Jaigaon and Pheuntsholing. It is a congested and narrow 2-lane road (one lane for either way) and every time a truck stops at the LCS for inspection, a traffic jam ensues.
- The LCS has no dedicated parking lot where the trucks can be parked for inspection by Customs officials. Hence, in case of Bhutan's imports, the trucks are parked on the outskirts of Jaigaon and a person goes to the LCS on a two-wheeler to submit the documents to complete the Customs procedures. Once, the paperwork is completed the truck is brought to the LCS where it is inspected and allowed to pass through. The truck operators have to pay parking charges to the owner of the land or field where their vehicles have been parked. This cost gets added to the Bhutanese importer's transaction cost. Similarly, in the case of Bhutan's exports, the goods have to pass through the LCS at Jaigaon.
- Prior to the operationalization of EDI at Jaigaon and implementation of GST in India, the clearance procedure was fast and simple. The goods would be inspected, papers would be checked manually and consignments cleared quickly as there were no duties to be collected. However, GST requires electronic submission and processing of documents, but due to poor internet connectivity at Jaigaon, data transfer between the LCS at Jaigaon and the central servers of the Indian Customs takes more time. The bandwidth provided by state-owned BSNL is inadequate to facilitate data transfer. This has resulted in a significant increase in the time taken to obtain clearance from Customs at Jaigaon.

### ***6.1.2 Impediments at Kolkata-Phuentsholing Transit Corridor***

This section focuses on the transit corridor (Kolkata-Phuentsholing) which is immensely important for the economic exchange of goods between Bhutan and rest of the world, transiting through the Indian Territory. Based on a field survey, we have made an attempt to assess the time taken and processes involved in moving goods between the Bhutan-India border and Kolkata port for transit trade consignments from and to Bhutan. We also compare our findings with UNESCAP-ADB (2017a) study which has estimated the time taken and processes involved in moving goods into and out of Bhutan through India starting from the signing of contract till the final payment. The difference is that our study focusses on the procedures involved in the movement of goods between India-Bhutan border at Pheuntsholing and Kolkata port.

A comparison of results from the UNESCAP-ADB study and ICRIER study are provided below in Tables 8 and 9.

**Table 8: Process and Time Involved in the Import of Goods from Foreign Countries (Other than India, Bangladesh and Nepal) into Bhutan Transiting through India**

	Process	UNESCAP-ADB	ICRIER
		Time (Days)	
1	Clear customs transit process at Kolkata	1	1
2	Release import cargo from dock	1	2-3
3	Transport cargo to Pheuntsholing	2	4-6
4	Clear customs at Pheuntsholing	1	1

Source: UNESCAP-ADB (2017a); ICRIER Survey (2017)

Our stakeholder consultations validate the time taken in case of clearing customs transit process at Kolkata and Pheuntsholing. However, our survey shows that it takes 2 to 3 days for goods to get cleared from the Kolkata dock and not 1 day as estimated by UNESCAP-ADB study. The reason being that due to shortage of berths, at the docks, the ships have to anchor away from the port and await their turn to enter the port. At times there are delays in the arrangement of transportation to transport the goods from the dock. Hence, the average time taken to clear the goods from the port is usually 2 to 3 days which could be reduced if the constraints at the port are addressed.

Our survey also showed that the time taken for transportation from Kolkata to Pheuntsholing could be between 4 to 6 days and not just two days as indicated in the UNESCAP-ADB study. The study has identified factors that are causing inefficiencies leading to delays. Due to restrictions on the movement of heavy goods vehicles within Kolkata city during the day it takes one day just to exit the city limits. Also, slow speed due to the poor condition of the roads and heavy traffic along the route leads to delays.

In the case of Bhutan's export to foreign countries, the time taken to complete these processes as estimated by the UNESCAP study group is similar to the findings of our study.

**Table 9: Process and time involved in the export of goods from Bhutan to foreign countries (other than India, Bangladesh and Nepal) transiting through India**

	Process	UNESCAP- ADB	ICRIER
		Time (Days)	
1	Complete Export documentation and Customs clearance at Pheuntsholing	0.5	0.5
2	Transport cargo to Kolkata	5	5
3	Complete export and transit procedures at Kolkata port	3	3

Source: UNESCAP-ADB (2017a); ICRIER Survey (2017)

The process of completing the export documentation and getting clearance from the Customs at Pheuntsholing could be done in half a day to one day as shown in Table 9. Moreover, it has been estimated that it takes about eight days for cargo to reach Kolkata from Pheuntsholing and complete the transit and export formalities at Customs and port.

### **6.1.3 Impediments at Changrabandha-Burimari LCS**

Bangladesh is the second-largest export partner of Bhutan after India. There are two border points that are primarily used for Bhutan's trade with Bangladesh through India-Changrabandha (India)-Burimari (Bangladesh) and Phulbari (India)-Banglabandha (Bangladesh). Goods from Bhutan are exported to Bangladesh mainly through the Changrabandha-Burimari border point. This section analyzes the issues involved in Bhutan's transit trade with Bangladesh through the Changrabandha-Burimari border point.

Before discussing the issues, we briefly provide an overview of the transit trade taking place at this border point. At Changrabandha LCS, in a day, on an average, approximately 250 Indian trucks, 100 Bhutanese trucks cross the border. The gate is open from 9:00 AM to 5:00 PM. In the second half i.e 2:30 PM to 6:00 PM only Bhutanese trucks are allowed to cross the border. No Indian trucks are allowed to move during this time-period. This system has been instituted by the local truck drivers operating there in consultation with the authorities including the Customs.<sup>10</sup> However, trucks carrying perishable items are given priority (irrespective of their origin) and do not have to adhere to these timings.

The main items of export from Bhutan to Bangladesh through Changrabandha-Burimari are minerals like dolomite, limestone, quartzite, and boulders for construction purposes and fresh fruits. The main items of imports from Bangladesh to Bhutan are potato chips, biscuits, readymade garments and melamine tableware. The volume and value of Bhutan's import from Bangladesh is significantly lower than exports to Bangladesh.

Bhutan's export to Bangladesh is monitored by the Bangladesh Customs. No bond or security (as insurance against diversion of goods into India) is executed as the RGoB takes responsibility for its exports. However, for import of goods from Bangladesh to Bhutan through India at Changrabandha, Bhutan Custom signs a Letter of Guarantee that the goods are meant for consumption in Bhutan. In case they get smuggled into India, RGoB would be liable to pay the import duties to India. Hence, a person appointed by the Department of Revenue and Customs, RGoB escorts Bhutanese trucks carrying their imports from the Indian LCS at India-Bangladesh border till Jaigaon-Phuntsholing border point.

We have made an attempt to assess the time taken and processes involved in moving goods between the Bhutan-India border and India-Bangladesh border for transit trade consignments from and to Bhutan. A comparison of results from the UNESCAP-ADB study and ICRIER study are provided below in Tables 10 and 11.

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<sup>10</sup> Our consultations reveal that most of the Indian trucks are operated by local drivers who prefer to cross the border in the morning and return to India by afternoon, pick up another load of cargo and join the queue again.

**Table 10: Process and Time Involved in the Import of Goods from Bangladesh into Bhutan via Burimari- Changrabandha**

	Process	UNESCAP-ADB	ICRIER
		Time (Days)	
1	Arrange car pass at Changrabandha/Burimari	0.5	1
2	Clear customs at Burimari	0.5	2-3
3	Transport transit clearance in India	1	2-3
4	Clear customs at Pheuntsholing	1	0.5

Source: UNESCAP-ADB (2017a); ICRIER Survey (2017)

According to the UNESCAP-ADB (2017a) study, the customs procedures on either India or Bangladesh side of the border take about half a day to one day to complete. However, our field survey reveals that due to the heavy volume of cargo that is being traded through the Burimari-Changrabandha border, there are long queues of trucks. At Changrabandha, on average, it takes three-four days for a truck to cross over to the other side after it has joined the queue. The infrastructure at Burimari is inadequate. There are similar delays at that side. The delays in reaching Pheuntsholing have already been discussed in the previous section. Therefore, our estimates of the time taken to transit through Indian territory and reach Jaigaon-Pheuntsholing and clear customs are significantly higher than those mentioned in the UNESCAP-ADB study.

**Table 11: Process and Time Involved In the Export of Goods to Bangladesh from Bhutan via Changrabandha-Burimari**

	Process	UNESCAP-ADB	ICRIER
		Time (Days)	
1	Transport and Transit to Changrabandha	1	2-3
2	Arrange car pass at Changrabandha	0.5	2-3
3	Deliver export to Burimari	0.5	1

Source: UNESCAP-ADB (2017a); ICRIER Survey (2017)

The UNESCAP-ADB study estimates that the movement of goods after exiting Pheuntsholing to Changrabandha-Burimari border takes only a day. However, our field survey finds that in addition to the time taken in transportation and transit from Jaigaon to Changrabandha, it takes the trucks on average two to three days to cross over to Burimari after joining the long queue near Changrabandha LCS. Furthermore, it takes more than a day to arrange a car pass at Changrabandha and deliver the export to Burimari.

Based on our field survey, we list down the key bottlenecks at the Changrabandha-Burimari LCS that are slowing down the smooth flow of goods across the borders:

- Infrastructure at the Changrabandha LCS is inadequate. Approach road to LCS is too narrow, weighbridge does not function properly, no proper parking space for trucks, no waiting area, plant quarantine facilities are practically non-existent. At the Burimari side



as well, infrastructure is inadequate. There is no weighbridge, no container yard facilities and no foreign exchange facility.

- Requirement of excessive documentation adds to the delay in clearance of goods. For example, for export of goods from Bhutan to Bangladesh requires the clearing and freight forwarding agents to prepare and submit Bill of Export to Bangladesh customs (Burimari) along with all other supporting documents according to the customs declaration. The customs declaration requires submission of filled Bill of Export Form, Export Registration Certificate, Telegraphic Transfer (TT)/Letter of Credit (LC) copy, Certificate of Origin (COO), SAFTA Certificate of Origin, pro-forma invoice, commercial invoice, packing and weight list, track receipt, VAT certificate and EXP form. 15 copies of each of the export documents are required for transit clearance (UNESCAP-ADB, 2017b). Once these are submitted physically and export declaration meets the customs requirements, Bangladesh Customs enters all the information electronically in ‘ASYCUDA World’ and issues a Bill of Export number.
- Lack of coordination between customs and other border agencies with respect to inspection and clearance of goods adds to the time taken.
- Often Bhutanese truck drivers passing through Indian territories of Assam or North Bengal have to face harassment at the hands of local hoodlums. Extortion of payment on various pretexts by local goons is extremely common along the Indian highways.

## **6.2 Cross-border Trade of Electricity**

Cross border trade of electricity between India and Bhutan has been taking place under the bilateral Power Trade Agreement signed between the two countries in 2006. However, in 2016, with an objective of facilitating and promoting cross border trade of electricity with “greater transparency, consistency and predictability in regulatory approaches across jurisdictions” and minimizing perception of regulatory risks, the Ministry of Power issued the ‘Guidelines on Cross Border Trade of Electricity’, (Ministry of Power, 2016).<sup>11</sup> Guidelines were laid down for agreement for cross-border trade of electricity, institutional framework governing Cross Border Trade of Electricity (hereinafter referred to as “CBTE”), cooperation with neighboring countries, tariff determination, trade through power exchanges, transmission system, scheduling and accounting, grid operation, safety and security and dispute resolution.

Our consultations in Bhutan revealed that there were several concerns amongst stakeholders regarding the 2016 guidelines. The key concerns are listed below<sup>12</sup>:

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<sup>11</sup> Guidelines for Import/Export (Cross Border) of Electricity-2016 available at <https://powermin.nic.in/sites/default/files/webform/notices/Guidelines%20for%20Cross%20Boarder%20Trade.pdf>

<sup>12</sup> Based on stakeholder consultations and Lamsang (2017) available at <https://thebhutanese.bt/much-apprehension-and-confusion-over-indias-new-electricity-trade-guidelines/>

- *Restriction on Investment Models:* The guidelines stated that only those power projects which are fully owned by the Indian government or its Public Sector Undertakings (PSUs), owned fully by the Bhutan government or controlled by it, or having 51% Indian company ownership can engage in cross border electricity trade, after a one time approval from India's Central Electricity Authority of India (CEA). Any other participating entity would be eligible to participate in cross border trade of electricity only after obtaining approval from the (CEA) on a 'case by case' basis.

The guidelines clearly favored the participation of Indian owned power trading companies. With the growing production of hydropower in Bhutan, there is an interest amongst some firms in Bhutan to enter into power trading. For example, at the time of stakeholder consultations in Bhutan, The Druk Holdings and Investment (DHI) expressed an interest in setting up a Bhutanese power trading corporation that would procure power from hydro projects in Bhutan and trade it in the Indian power market. However, under the guidelines of CBTE, trading companies would have to have 51% of Indian ownership to get access into the Indian power trading market. This limits the participation of new companies. There were also concerns that these guidelines would restrict the foreign investment (other than India) in Bhutan's hydropower sector.

- *Tariff Determination:* The guidelines mentioned that if tariffs for cross-border import/export of electricity have been agreed upon by the two governments, it would continue to be determined in the same manner. This raised apprehensions in Bhutan as the clauses related to tariff would prevent the liberalization of tariff rates between the two countries by locking it into a government to government negotiation. This would decrease Bhutan's chances of getting higher tariffs as its government projects may not be able to explore the commercial power market in India for higher tariffs.
- *No Trilateral Cooperation:* Though the CBTE 2016 guidelines in the beginning itself refer to the SAARC Framework Agreement for Energy Co-operation on Electricity, there is no mention about any form of trilateral or regional co-operation in cross border electricity trade. The guidelines only talked about bilateral electricity trade.

In 2018, India amended the cross-border power trading regulations addressing several concerns and apprehensions raised by Bhutan (Ministry of Power, 2018).<sup>13</sup> The 2018 guidelines rescinded the provision which stated that only those power projects which are fully owned by the Indian government or its PSUs, owned fully by the Bhutan government or controlled by it, or having 51% Indian company ownership can engage in cross border electricity trade after obtaining one-time approval from the designated authority in India. The 2018 guidelines brought changes to the tariff mechanism provided under the earlier guidelines. Tariff would now be determined through a process of competitive bidding as per the 'Tariff Policy'. The guidelines mentioned that it can also be done through mutual

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<sup>13</sup> Guidelines for Import/Export (Cross Border) of Electricity-2018 available at [https://powermin.nic.in/sites/default/files/uploads/Guidelines\\_for\\_ImportExport\\_Cross%20Border\\_of\\_Electricity\\_2018.pdf](https://powermin.nic.in/sites/default/files/uploads/Guidelines_for_ImportExport_Cross%20Border_of_Electricity_2018.pdf)

agreement between the buying Indian entity and the selling entity of the respective neighbouring country under the overall framework of agreements signed between India and the neighbouring country(ies) subject to a payment of the applicable charges for transmission or wheeling of electricity through the Indian grid. In the cases when the tariff is already determined through government to government negotiations, it would continue to be determined in the same manner till the expiry of the agreement or as may be decided by the countries including determination of tariff through competitive bidding process.

The revised guidelines paved the way for regional cooperation in the energy sector. The 2016 CBTE guidelines allowed India to trade electricity with its neighboring countries under bilateral agreements. However, as per the guidelines, no neighboring countries would be able to trade electricity within themselves using the territory of India. The revised 2018 guidelines mention that cross-border trade of electricity across India will be allowed under the overall framework of bilateral agreements signed between respective countries (India can either participate or approve by way of tripartite agreements).

## **7. Recommendations**

India and Bhutan have had a unique, time-tested and longstanding relationship characterized by trust, goodwill and mutual understanding. This paper analyzed several challenges that the two countries face in realizing the full benefits of economic cooperation, especially in the key areas of trade and transit, investment, connectivity and power cooperation.

In order to strengthen the economic cooperation between India and Bhutan, this paper makes the following policy recommendations:

### *Trade and Transit Infrastructure*

- In order to promote bilateral trade, both sides should share the regulatory and procedural requirements that have to be fulfilled at the time of exporting/importing any product so that the delays that occur related to the trade procedure, particularly related to meeting standards or regulatory requirements can be reduced.
- Infrastructure improvement can play a key role in facilitating trade and transit. This would require not only efficient hard infrastructure, but also soft infrastructure elements like creating a good business and regulatory environment, increasing transparency and improving customs management.
- There is an urgent need to upgrade the physical infrastructure at the LCS in Jaigaon. The alternative road route from India to Bhutan bypassing the Jaigaon town which is under construction should be completed in a timely manner. There should be a proper office space for customs officials and a parking area for trucks to facilitate trade. The main highway going from Jaigaon into Pheuntsholing should also be widened to overcome the acute congestion.
- The soft infrastructure at Jaigaon is inadequate. Improving internet connectivity to ensure that the EDI system works in an uninterrupted manner is crucial, especially post

implementation of Goods and Services Tax (GST). The possibility of switching over to a better Internet Service Provider (ISP) other than BSNL needs to be explored.

- Both countries should streamline trade procedures in order to facilitate trade. This could be done through implementation of automated customs systems, electronic exchange of data, automated risk management; automated border procedures; electronic, electronic single windows and other related digital customs and trade facilitation initiatives
- Regarding Bhutan's trade with Bangladesh through India, additional gates need to be opened at Changrabandha LCS. The current arrangement of time sharing between Indian and Bhutanese trucks to cross the border is only a short term solution. The infrastructure also needs to be upgraded both at the Changrabandha side as well as Burimari side. There is an urgent need to install and operationalize a fully functional single window to eliminate the use of hard copy of documents.
- Bhutanese transport operators often have to deal with harassment and extortion by local goons while crossing through the Indian Territory. A dedicated help-line system for distressed Bhutanese people moving within Indian territory could be set up for prompt redressal of their grievances
- A mechanism for regular consultations between border officials of India and Bhutan should be established.
- There is a need for regular trilateral consultation meetings between India, Bhutan and Bangladesh for better coordination of issues related to trade and transit. There is a need for co-ordination among the governments, border forces and customs agencies of all the three countries to facilitate cross border trade.

### *Connectivity*

- The BBIN Motor Vehicle Agreement is a landmark step towards achieving greater sub-regional integration. The free movement of cargo and passengers across the signatories of the Agreement is slated to bring greater prosperity to all the participants. The apprehensions faced by Bhutan regarding the Agreement need to be addressed so that they ratify it.
- In order to transform transport corridors into economic corridors there is a need to upgrade not just physical infrastructure but also implement certain policy and regulatory measures which can help address the non-physical barriers to seamless movement of cargo vehicles and people between two countries or within the sub-region.

### *Investment*

- Bhutan's increasing trade deficit with India has become a serious cause of worry for Bhutanese who fear that it could lead to a Balance of Payments crisis in the future. To keep its Balance of Payments in order Bhutan mainly relies on Indian investment in Bhutan and export of electricity and minerals to India. However, in the last three to four years, Indian FDI into Bhutan has gone down to negligible levels. India should take steps

to revive investments in Bhutan in a manner that would be mutually beneficial to both countries.

- Most of the existing Indian investment has gone in to the energy sector. Bhutan has potential to attract investment in other areas such as tourism and natural resources sector.
- Bhutan can conduct investor road-shows in different Indian cities to display potential the country has in different sectors, make contact with potential new investors and strengthen the investor relations.
- India and Bhutan can negotiate a Bilateral Investment Treaty (BIT), which can provide protection for the other country's foreign investments. A BIT can provide many benefits for Indian investors in Bhutan, such as national treatment, fair and equitable treatment, protection from expropriation and performance requirements for investments, and access to neutral dispute settlement.
- Till the time BIT is not in force, both countries should establish a well-defined dispute settlement mechanism to build a strong business environment between the two countries.

#### *Cooperation in Hydroelectric Power Projects*

- The new 2018 CBTE guidelines issued by India provide an opportunity for boosting regional connectivity in electricity trade.
- The guidelines should be used as a base to allow the regional market development and integration of neighboring countries.
- Adequate infrastructure should be developed for ensuring high power and efficient supply of electricity. A dedicated high-power station with a dedicated transmission system should be put in place to enhance supply.
- Both countries should work towards exempting export/import/duty/levies/fees etc. for cross-border trade and exchange of electricity between buying and selling entities.
- India and Bhutan should ensure non-discriminatory access to respective transmission grids as per the applicable rules, regulations and inter-governmental bilateral trade agreements.

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## Appendix

**Table A1: Top 10 Commodities with Export Potential at HS-6 (2018)**

HS Code	Product Description	India's Exports to Bhutan (in US\$ million)	India's Additional Export Potential to Bhutan (in US\$ million)
551323	Other woven fabrics of polyester	0.0	4.3
631090	Other	0.0	4.2
854460	Other electric conductors	2.6	3.4
870333	Of a cylinder capacity exceeding	0.7	2.7
902212	Computed tomography apparatus	0.0	1.7
210690	Other	2.4	1.6
870332	Of a cylinder capacity exceeding	0.5	1.4
950699	Other	0.1	1.3
851762	Machines for the reception	0.9	1.2
870210	With compression-ignition internal	1.0	1.2

Source: Author's calculations based on UNCTAD-WITS data

**Table A2: Top 10 Commodities with Export Potential at HS-6 (2018)**

HS Code	Product Description	India's Imports from Bhutan (in US\$ million)	India's Additional Import Potential from Bhutan (in US\$ million)
720221	Ferro-alloys; ferro-silicon, containing by weight more than 55% of silicon	158.1	26.6
880240	Aeroplanes and other aircraft, of	0.0	8.2
330210	Of a kind used in the food or drink industries	0.0	5.7
292910	Isocyanates	0.0	3.5
720229	Other	3.0	1.9
870323	Of a cylinder capacity exceeding	0.0	1.9
870810	Bumpers and parts thereof	0.0	1.3
390720	Other polyethers	0.0	0.8
720299	Other	1.9	0.6
720230	Ferro-silico-manganese	0.0	0.3

Source: Author's calculations based on UNCTAD-WITS data

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