

# Composition of Internal and External sources in Bhutan

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## ABSTRACT

Until the inception of planned development in the 1960s, the Bhutanese economy was not monetized and economic transactions were limited to the barter system e-government in the 1950s. However, planned development commenced in Bhutan with the launching of the First Five Year Plan in 1961, modern public finance practices came in force much latter. The first tentative steps towards setting up a modern public finance system in Bhutan were taken in the early 1970s with the launching of the Third Five Year Plan. Bhutanese economy as more funds are spent on various economic activities to boost overall development.

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## INTRODUCTION

Until the inception of planned development in the 1960s, the Bhutanese economy was not monetised and economic transactions were limited to the barter system. Bhutan did not have a national currency, though a series of coins had been issued by the government in the 1950s. Trade continued to be conducted through barter, while government taxes were also collected in kind. Royal government of Bhutan has brought about revolutionary change in the course of time. Bhutanese economy was declared to be planned economy right after the initiation of five year plans in 1961. As the development responsibilities of the Royal Government had increased with the planning era, there was a need of huge funds to execute spectrum of economic activities. Bhutan faced persistent crises in managing the required fund to support its five year plans. However, planned development commenced in Bhutan with the launching of the First Five Year Plan in 1961, modern public finance practices came in force much latter. The first tentative steps towards setting up a modern public finance system in Bhutan were taken in the early 1970s with the launching of the Third Five Year Plan<sup>1</sup>. The budgetary expenditure in Bhutanese economy was virtually dependent on Indian grants, supplemented by royalties from the use of forest resources until third five year plan. The taxation system was rudimentary, still emerging from the feudal era of taxation in kind. An important landmark in the development of public finance in Bhutan was the introduction of a corporation income tax in 1982, which marked the beginning of new era in which domestic revenue became an increasingly important source in financing the budget.

This trend was further strengthened with the commissioning of the Chukha hydropower project in 1986, as the dividends and taxes extracted from the project became the single most important source of domestic revenue.<sup>2</sup> Since Royal government of Bhutan is committed to expedite the developmental programmes, largely for increasing the welfare of the society, huge funds are being invested to build a strong infrastructural network. Consequently, the public expenditure has always remained higher than public revenue in Bhutanese economy as more funds are spent on various economic activities to boost overall development. The fiscal measures are taken to procure money in order to meet the public revenue and expenditure lags. The fiscal measures of financing public expenditure come under the preview of fiscal policy and budgetary management. Fiscal management got serious attention since 1980s and the fiscal year of Bhutan was also changed from April–March to July–June, in 1987/88, heralding the modern era of public finance. The sourcing of funds for public expenditure managed either from internal resources or grants from the developmental partners.

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<sup>1</sup>Macroeconomics of Poverty Reduction: The Case Study of Bhutan P-53

<sup>2</sup>In the second half of the 1980s, dividends yielded by the Chukha project contributed some 38 percent of all domestic revenue.

**Structure of Tax Revenue and Non Tax Revenue**

The main source of the domestic financing for the expenditure was the tax revenue in the beginning of development programme. The public sector enterprises were very less in order to generate sufficient funds for financing of developmental programmes. It was after the commissioning of Chukha Hydro Project, on –tax revenue started increasing. The non –tax revenue thereupon, has increased continuously. Non tax revenues comprises of administrative fees and charges, dividends, revenue from government’s departments, transfer of profits, interest on loan from corporations and capital revenues.

**Figure 1**

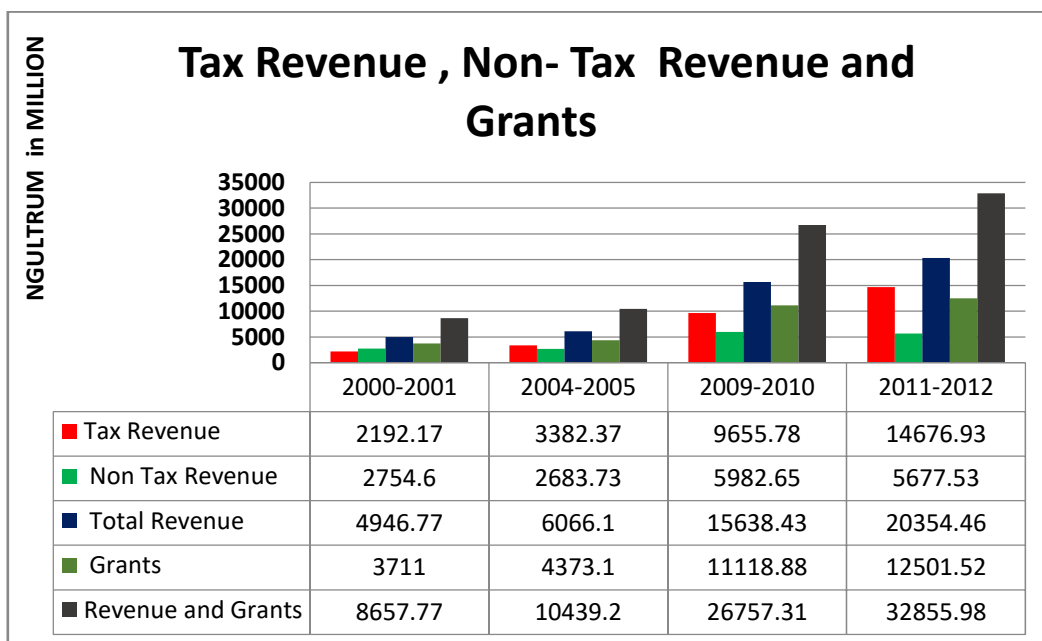


Figure 1 shows a picture of absolute form of tax revenue, non tax revenue and grants .It reflects that tax revenue’s share has been higher than non revenue tax in total income receipts of the government since 2004 -2005. It manifests the nascent manifestation and small size of the public sector’s enterprises and corporations. They have not developed enough to generate adequate revenue for financing the planned expenditure of government. Consequently, government levies more taxes on people to have funds for financing the new and on –going projects.

**Figure 2**

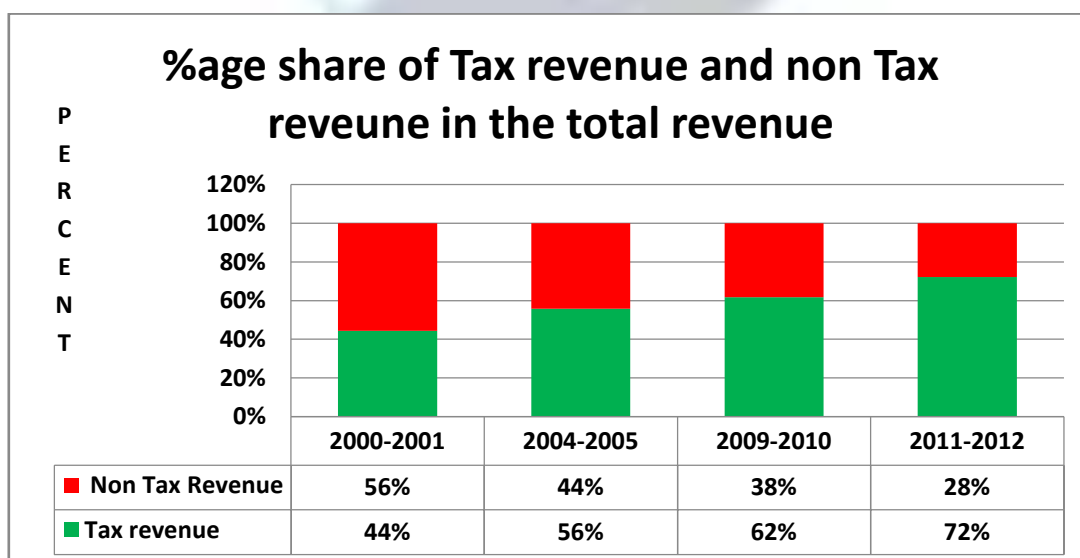
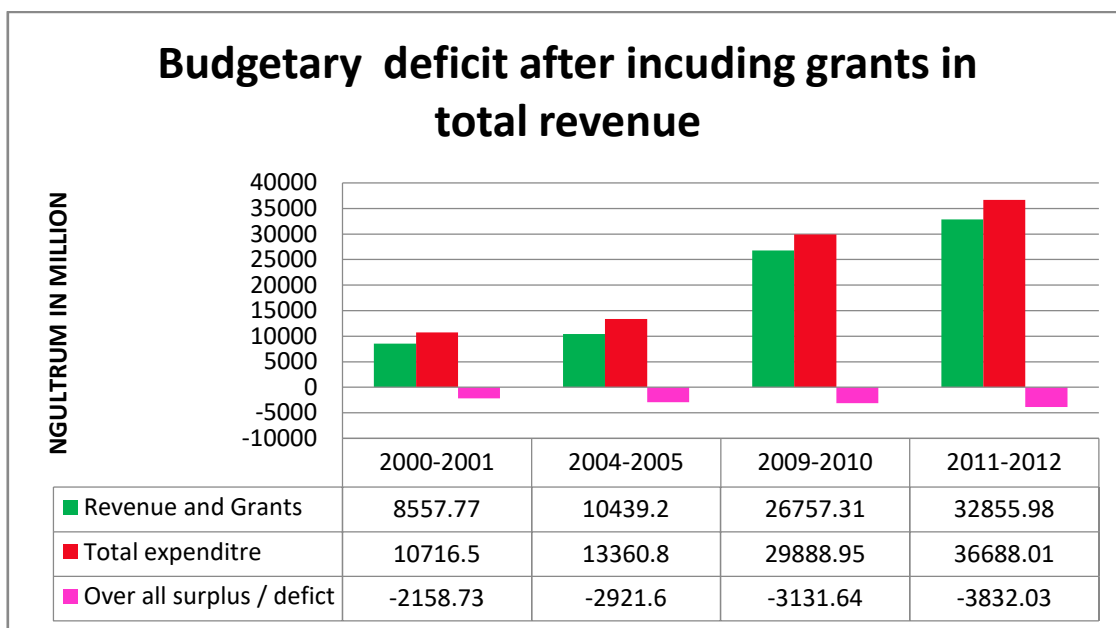


Figure two illustrates percentage share of tax and non tax revenue. The non –tax revenue in 2000-2001 was 56 percent while tax revenue was 44 percent. However, the share of tax revenue superseded the former in successive period. This may be accredited to the improved paying capacity of the working class and enlargement of the corporative houses to pay more corporate taxes.

**Trends of budgetary surplus and deficit**

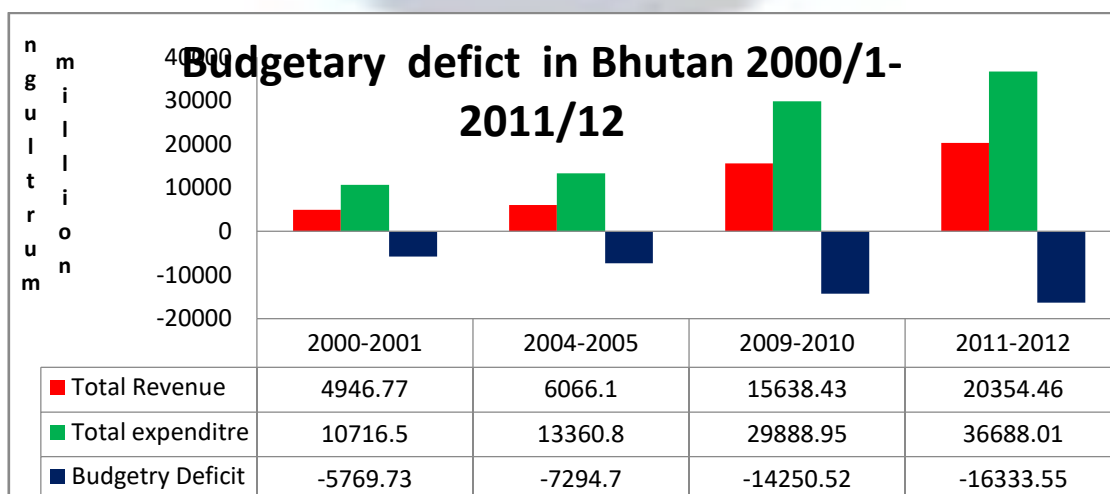
Figure 3 gives account of the budgetary deficit and surplus without grants from 2000-1 to 2011-12. Had the developmental partners not given grants, it would suffer extremely with budgetary deficit. The budgetary deficit remained in the range of 2158.73 in 2000-1 to 3832.03 in 2011-2012. It reflects that that size of fiscal operations is exceptionally larger than other south Asian and developing countries. Given the low level of development of the private sector, the government has been traditionally playing an important role in the Bhutanese economy. It has not been only providing infrastructure and social services but also in producing economic goods and services since the beginning of development plans.

**Figure 3**



The expenditure on hydro projects has not included in total budgetary expenditures, however the dividends and taxes earn from the projects are included in the revenue side of the budget. Royal Government has always remained visionary and committed to the development of county as a result of that expenditures superseded the income over the time.

**Figure 4**



An essential component of development planning relates to its financing. Having projected the resource –availability in terms of domestic saving and foreign exchange for computing the size of plan, the one important job is to provide for the mobilization of financial resources in the aggregate to match the provision of the plans. This involves the choice of suitable means or techniques to be used for this purpose. The selection of means like taxes, borrowings, deficit financing etc., and the extent to which these are used are important because these have close bearing on the pattern of distribution of the burden of development as among classes of people, the general price level and the balance of payments.

The sources of financing economic development mobilize through various channels. Finance refers to a mobilization of funds from surplus unit to deficit unit for the productive investment in the country. The budding economy of the world needs funds for capital formation and expansion of prerequisites necessary for industrialization and overall economic development. Generally, the relating expenditure on productive activities exceeds their income receipts. Thus, they need to mobilize funds either from internal sources or external sources. Royal government of Bhutan has followed double pronged fiscal strategy to finance their upcoming and ongoing plans. It is determined to use internal sources for recurrent expenditures - payment of overheads, salaries, miscellaneous expenses, travelling, and entertainment, food, and lubricate its capital expenditures- creating, constructing, improving or transforming an asset, infrastructure or buildings, with external sources.

### **Internal sources of finance**

Royal government of Bhutan has been putting maximum efforts to reduce its dependence on foreign resources since the beginning of planned era. It has always tried to increase its domestic resources for financing its developmental expenditures. The importance of increasing own resources has become even more critical as developmental partner sought to substitute loans for grants. The ability of earning hard currency of Bhutanese economy is very limited. Therefore, repayment and servicing of hard currency loans seems to be difficult for the Royal Government of Bhutan. It makes essential to increase and mobilize domestic resources to finance developmental expenditures. However, increasing expenditures in successive five year plans were unlikely to be met with the internal sources. Consequently, Government resorted to external sources to execute its developmental activities. The internal and external sources have been discussed below:

This section is intended to provide an introduction to the different sources of finance available to the government, an overview of the advantages and disadvantages of the different sources of funds, and an understanding of the factors governing the choice between internal and external sources of funds.

### **CONCLUSION**

The large government budget is financed by foreign assistance and major share of them comes from India. The fiscal stance of the government of Bhutan has been prudent in the sense that the budget deficit was kept within control most of the time. This has been achieved by consciously adopting a two-pronged fiscal strategy that (a) tries to finance current expenditure almost entirely from domestic revenue and (b) adjusts capital expenditure in accordance with the availability of foreign resources. In recent years, Bhutan has made great strides in enhancing development management for sustainable and inclusive growth. Especially notable are the deepening of the financial sector and strengthening of the regulatory environment. Yet much remains to be done. Foremost on the list are legislative reforms to enhance judicial efficiency and the availability of credit and regulatory reforms to further improve regulation of the financial sector. On the legislative front, reforms to allow bankers to price—and ration—credit; to pay of" government contractors on a more timely basis; to enhance the ability of creditors to seize collateral; to deepen the government bond market; and to reform restrictions on agriculture remain as outstanding tasks for legal reform. On the regulatory front, a move from compliance-based to risk-based regulation; development and implementation of expanded stress tests for financial institutions; and expansion of early warning indicators to cover the real estate and non-financial corporate sectors remain important outstanding tasks.

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