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IMPACT OF WAR IN UKRAINE

Perspective from Bhutan


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ANALYSIS

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Abstract

Russia invaded Ukraine in late February 2022 with President Vladimir Putin anticipating a swift and decisive “special military operation”. Past a year, Russia’s war in Ukraine continues with a mounting human toll, damage to personal and public property and global uncertainty. International sanctions on Russia and supply chain disruptions have resulted in a steep rise in fuel and food prices around the world, with the conflict breaking the supply of wheat, corn and oil from Ukraine and Russia. Countries around the world are grappling with soaring food inflation, and people in developing countries are sinking into poverty.

The war has impacted countries around the globe and Bhutan is no exception. Bhutan’s ambassador to the UN, Ms. Dolma Tshering, speaking at the emergency meeting of the United Nations General Assembly (UNGA), stated that the impact of the war could be felt by the small Himalayan nation some thousands of miles away from Ukraine (South Asian Monitor, 2022).

Its economic lifeline dependent on India, Bhutan is vulnerable to any repercussion the war has on its immediate neighbour. The shortage of fuel was the first of these repercussions, causing long lines of motor vehicles to form at fuel stations even as the government sought to allay public concerns. India’s announcement of halting its wheat exports created fear of a potential shortage of food. At the same time, Bhutan’s close relations with India and the latter’s strategic relations with Russia made for a delicate situation. Eventually, Bhutan learned some invaluable lessons.

First, Bhutan broke ranks with India at the UNGA and denounced the Russian invasion of Ukraine. This was unprecedented given that on most occasions the two countries had chosen to voice similar concerns at the UN. Second, the shortage of fuel in Bhutan was an almost immediate impact of the war. While most sectors of Bhutan’s economy remained unscathed by the war, it was the transportation sector that bore the brunt. Bhutan imports all its fossil fuel from India, and the cost of diesel and petrol increased sharply by mid-March.

This was a domino effect given that India itself imports almost 80% of its crude from the Middle East, Africa, the US and Russia (Ghosh, 2022).

A direct result of the rise in fuel prices was the concomitant rise in food prices (owing to the increase in transportation costs). The National Statistics Bureau of Bhutan reported that the price of consumer goods and services increased by 6.05% in September 2022. It identified transport as the main driver of inflation with a 14.92% increase, contributing an alarming 37% to overall inflation (National Statistics Bureau, 2022).

If the war and supply chain disruptions continue, global food prices could rise further. This could be a serious issue for a net importer country like Bhutan, given that the country's central bank—the Royal Monetary Authority—has warned that the inflationary pressure on food items is expected to remain elevated in the short- and medium-term. This implies that the middle- and lower-income groups will be affected the most (Royal Monetary Authority, 2021).

Forecasts by multilateral agencies like the World Bank present an uncertain economic outlook for Bhutan in the short- and medium-term. The COVID-19 pandemic left greater devastation in its wake than did the Russo-Ukrainian war. A significant contributor to Bhutan's GDP, the tourism sector came to a halt for over two years as Bhutan closed its international borders. The World Bank predicts a slow economic recovery for Bhutan, primarily because of lower public investments and delays in hydropower projects.

Bhutan faces numerous vulnerabilities, including its location between India and China, Asia's rival giants, which presents both opportunities and threats. The country often finds itself embroiled in economic and political rivalries. As a result, even as Bhutan confronts hard choices at home, it must continue to delicately navigate regional geopolitics. Bhutan sees Ukraine's vulnerability directly mirrored in its own geopolitical dilemma.

1 Introduction

Russia's invasion of Ukraine began in late February 2022 with President Vladimir Putin announcing a special military operation aimed at "demilitarization" and "denazification" of the country. The invasion by itself was not a surprise. There were media reports of a major military build-up near the Ukraine-Russia border, despite which Russia continued to deny that it planned to invade Ukraine. However, on February 24, Russia launched a full-scale invasion, and shortly afterwards, President Putin declared war on Ukraine.

In Bhutan, a small state located between the two powers, India and China, the live events streaming on world media were a distant affair. Moreover, Bhutan does not have official diplomatic ties with the warring countries. Therefore, for most Bhutanese, the war spoke of no immediate consequences. However, as a deeply religious people, the Bhutanese sympathized with the people of Ukraine and the pain and suffering the war had brought on them.

Perhaps the only awkwardness for Bhutan as a sovereign state lay in anticipating how India would respond to the invasion. However, India's Prime Minister Narendra Modi continued to stay silent even as Russia's aggression on Ukraine escalated. Therefore, for someone new to Bhutan's foreign policy, it is important to understand the country's relation with India.

2 Bhutan's Close Bond With India

The Indo-Bhutan relation is often described as a textbook example of how two asymmetrical sovereign states can cultivate and nurture a mutually meaningful, respectful and beneficial friendship. Let's consider a couple of dichotomies, for perspective's sake. India is the world's seventh-largest country by area. At 38,394 sq. km, Bhutan is about the size of the Indian state of Kerala. The World Bank's statistics show that India's GDP in 2021 stood at US\$ 3.18 trillion; with US\$ 2.315 billion, Bhutan was ranked 172nd¹.

But the two South Asian neighbors have had a geopolitical romance of sorts. Bhutan established formal diplomatic ties with India in 1968 although India was already funding Bhutan's five-year plans when it began planned development in 1961. According to David M. Malone, a scholar-diplomat and Canada's High Commissioner to India and non-resident ambassador to Bhutan and Nepal from 2006 to 2008, "...the essential bargain between India and Bhutan involved considerable Indian assistance in exchange for Bhutanese deference to India's foreign policy and defense concerns, notable as related to China"².

However, as Bhutan began to shed its isolationist policies, Article 2 of the 1949 Indo-Bhutan Friendship Treaty came in the way of its sovereign decisions, especially when it came to expanding foreign relations. Article 2 of the Treaty, in effect till February 2007, stated: "The Government of India undertakes to exercise no interference in the internal administration of Bhutan. On its part, the Government of Bhutan agrees to be guided by the advice of the Government of India in regard to its external relations"³.

1 World Bank Group., 2022. GDP (Current US \$) - India. Available at: <https://data.worldbank.org/indicator/NY.GDP.MKTP.CD?locations=IN>

2 Malone, D. M., 2011. Does the Elephant Dance? Contemporary Indian Foreign Policy. New Delhi: Oxford University Press.

3 National Legislative Bodies/National Authorities.,1949. Treaty of friendship between India and Bhutan. Available at: <https://www.refworld.org/docid/3ae6b4d620.html>.

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In February 2007, Article 2 was revised thus: “In keeping with the abiding ties of close friendship and cooperation between Bhutan and India, the Government of the Kingdom of Bhutan and the Government of the Republic of India shall cooperate closely with each other on issues relating to their national interests. Neither Government shall allow the use of its territory for activities harmful to the national security and interest of the other”⁴.

The 2007 Indo-Bhutan Friendship Treaty restructured the relationship on a more equal footing, giving Bhutan new prospects of self-determination as a sovereign country. Soon after, Bhutan expanded diplomatic ties with scores of countries around the world. Today, Bhutan has diplomatic relations with 54 countries and the European Union. However, it must be noted that Bhutan still has no official diplomatic ties with any of the five permanent members of the UN’s Security Council, i.e., the US, France, the UK, Russia and China.

⁴ Ministry of External Affairs, Government of India. (2007). India-Bhutan Friendship Treaty. Available at: <https://mea.gov.in/Images/pdf/india-bhutan-treaty-07.pdf>.

3 Bhutan Breaks Ranks with India

At Bhutan's request, India sponsored the country's admission to the United Nations in September 1971⁵. Since then, the two countries have closely aligned their position on global issues. But with the Russian invasion of Ukraine on 24 February 2022, Bhutan asserted itself on a global platform. On 2 March, Bhutan broke ranks with India and joined the majority of countries in the United Nations General Assembly (UNGA) in calling for respecting Ukrainian sovereignty, independence and territorial integrity.

Bhutan's Permanent Representative to the UN, Ms. Doma Tshering, said Russia's invasion of Ukraine meant "core principles of the UN Charter and the rules-based international order are at stake, endangering international peace and security far beyond the borders of Ukraine and Europe"⁶. She said even Bhutan, some "1,000 miles away", could feel the tremors of the conflict.

The UNGA resolution was adopted on 2 March, condemning the invasion and demanding a full withdrawal of Russian forces from all internationally recognized Ukrainian territories including Donetsk and Luhansk. The resolution was sponsored by 96 countries and was passed with 141 voting in favor, five against and 35 abstentions.

"The threat or use of force and acts of aggression against another sovereign state can never be accepted. We cannot condone the unilateral redrawing of international borders," Ambassador Doma Tshering told the UNGA.

India, on the other hand, chose to abstain, given its close ties with Russia. On the day of the invasion, Union Minister of State for External Affairs Rajkumar Ranjan Singh said India's stand was "neu-

⁵ Tahsi, T. 2021., Natural Aspiration: The Story of Bhutan's Admission to the United Nations. 8 March. Available at: <https://kuenselonline.com/natural-aspiration/>
⁶ South Asia Monitor, 2022. Bhutan joins others in calling for respecting Ukrainian sovereignty, says deeply concerned by escalating conflict. 3 March. Available at: <https://www.southasiamonitor.org/bhutan-un-watch/bhutan-joins-others-calling-respecting-ukrainian-sovereignty-says-deeply-concerned>

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tral” and that India “hoped for a peaceful solution to the conflict”. Similarly, on the night of the UNGA resolution, India abstained from voting and instead called for “restraint on all sides”. It was only after seven months of the war that Prime Minister Modi publicly called on President Putin to end the conflict. On the sidelines of the Shanghai Cooperation Organization meeting, Prime Minister Modi told his Russian counterpart that it was not “an era of war” and that the world, particularly developing countries, worried about food, energy and fertilizer. Prime Minister Modi called for diplomacy and dialogue to end the conflict.

Bhutan’s vote for the resolution was a rare move, given that on most occasions the two countries had chosen to raise similar concerns at the UN. In South Asia, apart from Bhutan, Afghanistan, Nepal and the Maldives voted in favor of the resolution.

4 Ripples from Across the Border

Bhutan's economic vulnerabilities are clear. With the northern frontiers presenting a natural wall of snow-capped mountains, India is Bhutan's only gateway to the world, and all commerce and trade happen through India. Therefore, price volatilities in the Indian market have an immediate impact on Bhutan. The first major impact of the war was the shortage of fuel as well as the steep rise in its prices. The cost of the two most important petroleum products imported from India increased sharply in mid-March. The price of diesel rose from Nu. 83 to Nu. 100 per liter and that of petrol leapt from Nu. 84 to Nu. 95⁷.

Bhutan imports fossil fuel from India; although India produces some fossil fuel domestically, it relies largely on imports and refines the crude. Petroleum statistics indicate that India imports more than 80% of its total crude chiefly from the Middle East. Therefore, the fuel price in Bhutan is largely influenced by the production price in India as well as by the change in global prices and the rupee's strength against the US dollar.

In its 2021 annual report, the Royal Monetary Authority (RMA)—Bhutan's central bank—noted that the import of diesel and petrol consistently remained within the top 10 imports, often surpassing hydro-power exports, Bhutan's biggest export to India. In 2019, diesel and petrol constituted 14.9% of total imports. With an increasing number of motor vehicles and expanding economic activities, the import of fuel increased annually at an average of 10.9% from 2017 through 2019.

Russia's invasion of Ukraine sent global energy prices soaring overnight. The supply chain disruptions and sanctions on Russia made the situation worse. The price of a barrel of crude oil rose to USD 130 from USD 92 within weeks. Statistics from Share India Securities in-

⁷ Bhutan's Ngultrum is pegged to the Indian Rupee.

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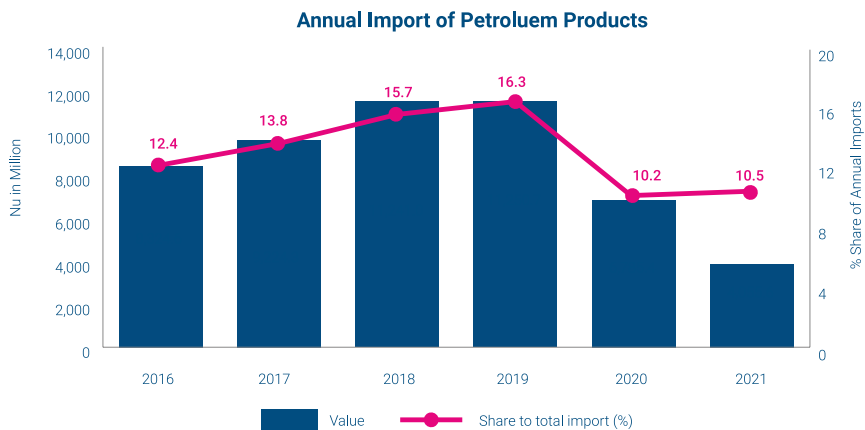
dicate that India imports about USD 1 billion worth of crude oil from Russia annually.

Global fuel price fluctuations have a significant effect on the overall price level in Bhutan. This, according to the Royal Monetary Authority, is because the increase in fuel prices worsens inflation as transportation of consumer goods becomes expensive. The Royal Monetary Authority's study of the indirect effects of fuel prices on inflation showed that a 10% increase in fuel prices results in a 4.9% increase in inflation.

The situation is a double-edged sword, termed by the central bank "the fuel price shock on inflation". As a net importer economy, the rise in fuel prices automatically leads to a rise in food prices as almost every consumer item has to be transported by land from India. For example, Bhutan imported cereals worth USD 30.35 million in 2021, the bulk of which were rice and wheat. Therefore, when India announced that it would restrict wheat exports, the news was met with dismay in Bhutan. Statistics show that Ukraine was able to export only about 1.5 to 2 million tonnes of grain a month since the war. Before the war, the figure stood at 6 million tonnes.

Bhutan imports almost all its cooking oil from India, and more than 90% of India's imported sunflower oil comes from Russia and Ukraine. Therefore, food supplies will continue to remain a major concern for Bhutan as long as the war lasts. The National Statistics Bureau of Bhutan reported that the price of consumer goods and services increased by 6.05% in September 2022. It identified transport as the main driver with a 14.92% increase, contributing a whopping 37% to the overall inflation.

The bad news is that the inflationary pressure on food items is expected to remain elevated in the short- and medium-term. According to the Royal Monetary Authority, food inflation increased to 10.1% in June 2021 from 8.9% in June 2020. Bhutan saw record inflation in meat items in the same period, from 3% in 2020 to 37.2% in June 2021. Meat remains one of the biggest contributors to food inflation. Similarly, the prices of oils and fats increased from 5.2% in June 2020 to 21.6% in June 2021.



Source: Annual Report 2021, Royal Monetary Authority of Bhutan

5 A Grim Economic Outlook

Experts, including Bhutan's government officials, have warned that the country's economic situation is currently not ideal. The economy contracted for two consecutive fiscal years because of the COVID-19 pandemic. Global supply chain disruptions as well as Bhutan's closure of its borders adversely affected the non-hydro industry and services sector. The tourism sector came to a complete halt after the government closed the country's borders in March 2020 (long before the war in Ukraine) to contain COVID-19.

The national data paint a worrisome picture. For example, apart from the record contraction of the country's economy, data show that in the last fiscal year (2021-2022), Bhutan's gross international reserves declined to USD 840 million as of June 2022 from USD 1.46 billion in April 2021. The external debt increased from USD 2.6 billion in 2018 to USD 3.2 billion in 2021, equivalent to 138.8% of the GDP⁸.

On the other hand, the economic growth for 2022 was reported at 4.6%, and the current account deficit for the fiscal year had more than doubled to 27.4% of the GDP, the fiscal deficit widening to 8.9%. India remains a major trading partner for Bhutan and this determines the overall balance of payments.

The World Bank predicts a slow economic recovery for Bhutan, mainly because of lower public investments and delays in hydropower projects. Similarly, the Royal Monetary Authority has indicated that inflation will remain elevated in the short- and medium-term because of supply disruptions and higher consumer goods prices.

⁸ Royal Monetary Authority of Bhutan., 2021. Annual Report. Available at: <https://www.rma.org.bt/RMA%20Publication/Annual%20Report/Annual%20Report%202020-2021-final.pdf>.

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Policy Recommendations

Bhutan is known for its abundance of clean energy potentials, especially hydropower. The country has already tapped into this resource through several hydropower projects built in cooperation with the Indian government. The sale of hydropower accounts for the largest share of the country's GDP and constitutes about 63% of its total exports. Therefore, there is a tremendous opportunity for the country to tap further into clean energy as an offset against ever-increasing fossil fuel imports.

To minimize the impact of fuel price shocks on inflation, the Bhutanese government should encourage its people to switch to domestically produced clean energy. (Moreover, electricity is cheaper than imported fossil fuels.) This must include the use of electricity for household purposes and replacement of the existing fleet of family-owned fuel-dependent cars with electric vehicles. The government must provide financial incentives such as import duty and green tax exemptions to encourage people to make this switch.

Bhutan imports all its motor vehicles from India and other third-world countries. The import of motor vehicles, especially for household use, has steadily been on the rise over the years. This is primarily attributed to the lack of a reliable public transport system. Thus, investing in a high-quality public transport system could minimize the import of motor vehicles. While the transportation sector will continue to depend on imported fossil fuels, the government, in the long run, could also explore green hydrogen as a potential area of investment to reduce the country's fossil fuel dependence.

Food prices in Bhutan are directly dependent on transportation costs. Thus, any fluctuation in fuel prices causes a ripple effect on food prices. As a mountainous country, its total arable land is extremely limited, making large-scale agricultural production impossible. This is the reason most Bhutanese practice subsistence farming in small

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family-owned plots. However, the country could still aim for self-sufficiency in certain essential commodities like rice, maize and vegetables. At the moment, Bhutan is self-sufficient in eggs and poultry.

Self-sufficiency in farming will require creating a conducive environment through policy interventions like the provision of subsidies to farmers, promotion of efficient farming methods and introduction of high-yielding, pest-resistant seeds for specific crops. Agriculture marketing must be strengthened and cold storage chains must be improved. Sustainable agriculture, mainly focusing on smallholder farmers and select products, could be a possible way to reduce dependence on food imports.

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Conclusion

For Bhutan, until it began planned development in 1961, isolation was considered an ideal safety valve. The country remained remote and aloof. However, as part of the rapidly flattening global village, inter-dependence is the key today. Bhutan can no longer expect to remain unaffected by distant events. This is what the war in Ukraine has proved.

If the war and supply chain disruptions continue, global food prices will rise further. This could be a serious issue for Bhutan, given that the country's central bank has warned that the inflationary pressure on food items is expected to remain elevated in the short- and medium-term. This means the middle- and lower-income groups will be affected the most.

The combined impact of the COVID-19 pandemic and the war in Ukraine spells an uncertain future for Bhutan. The road to recovery has to be faster and stronger. The prolonged war in Ukraine may not have a direct bearing on the country's economic outlook, but it will surely leave indirect scars on the lives and livelihoods of the people.

Perhaps the biggest lesson from Russia's unwarranted war could be a grim geopolitical reminder that, as a small country located between the Asian giants, the vulnerability of Ukraine is directly mirrored in Bhutan's own geopolitical dilemma.

About the Author

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Gopilal Acharya is an independent consultant and freelance journalist. He was educated in Bhutan and Sweden. He is an award-winning writer-journalist with a career spanning 20 years in the media and communication industry. He has worked in Bhutan, Nepal, Singapore, and India. He worked as Chief Editor of Bhutan's first English-language private newspaper, Bhutan Times, and later founded a weekly newspaper, The Journalist.

