

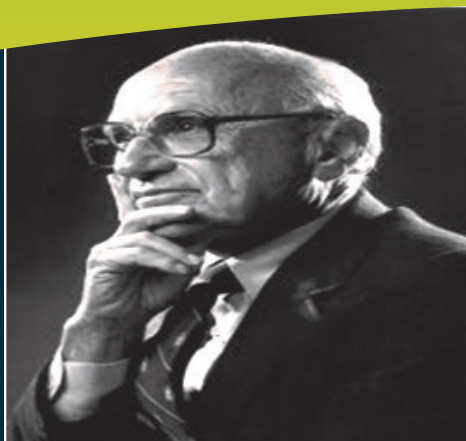


Old Henry

Old Henry Ford the first,
now dead
Reputedly, while living,
said
American should never
lack
Their model Ts, so long
as black
This way of acting still
persists
Professionals are reduc-
tionists
And bureaucrats embrace
the norm
The programmes should
be uniform
The poor are look-alikes
and weak
We know their needs,
they need not speak
Our mass production sure
to please
Let's make our pro-
grammes model Ts

Provided By:
Sanjeev Mehta,
Professor of Economics

**(From my note book
and do not know who
is the author)**



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Know an Economist:

‘Positively Yours’: Milton Friedman (1912-2006)

Milton Friedman a US ‘**Positive**’ economist, was awarded Nobel Prize in Economics in 1979 for his contributions in the areas of consumption analysis, monetary theory and stabilisation policy. His contribution are so immense that Karl Burton commented-“*attempting to portray the work of Milton Friedman is like trying to catch the Niagara Falls in a pint pot.*” Friedman and a group of Chicago economists came to be known as Chicago school. This group believed that within competitive market structure price system works to allocate resources efficiently and led to what is commonly known as neo classical revolution. Friedman always held that public policies should operate on the basis of rule and they should not be discretionary, which provided strong support for the independence of central Bank from legislatives controls. Friedman became a monetarist in mid 1950s. He established that equation exchange ($MV=PT$) was not merely a tautology but ‘an engine of analysis. He held this opinion at a time when experts, at that time, considered equation of exchange an intellectual vestige. Friedman helped to revive the quantity theory of money and offer it as an alternative (or, may be a superior alternative) to Keynesian analysis. He emphasized that money supply affects price behaviour, a notion that is well reflected by his famous quote-“*Inflation is always and everywhere a monetary phenomenon*”.

He approached the problem of inflation and unemployment relationship (known as Phillips curve) from a different perspective and maintained that changes in unemployment rate is not related to variation in inflation rate but to the difference between inflation and expected inflation. He asserted that monetary policy can play a key role in affecting inflationary expectation and thereby the rate of unemployment. Using this tool he was also able to explain stagflation in USA in 1970s. He also used expectation augmented Phillips curve to describe the natural rate hypothesis- inability of monetary policy to affect real variables (such as employment, real interest and real GDP) in the long run. His theoretical analysis got strengthened by the work of his Chicago colleague Robert Lucas on rational expectations. Rational expectation hypothesis enabled Friedman and Edmond Phelps to explain independence of unemployment rate from the rate of inflation (concept of vertical Philips curve). Friedman’s views on economic policies were not accepted by contemporary economists till 1970s. Further, Friedman also contributed in the field of consumption theory by providing logical explanation to the long term stability of average propensity to consume. He used analytical framework developed by Irving Fischer to explain inter-temporal allocation of consumption which smoothens the profile of consumption expenditure of an individual over the period of time. Analytical framework of Friedman’s philosophy was so powerful that it was bound to overcome stiff challenge from ‘*Keynesians*’ and be generally accepted. So powerful is the intellectual legacy of Friedman that his death anniversary is officially celebrated as ‘**Milton Friedman Day**’ in universities and other institutes so to pay homage to this giant by conducting special academic events. ‘

Some of his noted work are- ‘**Essays in Positive Economics**’, ‘**Capitalism and Freedom**’, ‘**A Monetary History of the United States 1867-1960**’, and, ‘**Free to choose**’.

It appears, I fruitlessly tried to catch Niagra Falls in a pint pot but at least you have some ‘holy water’ to drink.

-Sanjeev Mehta

Professor of Economics 1

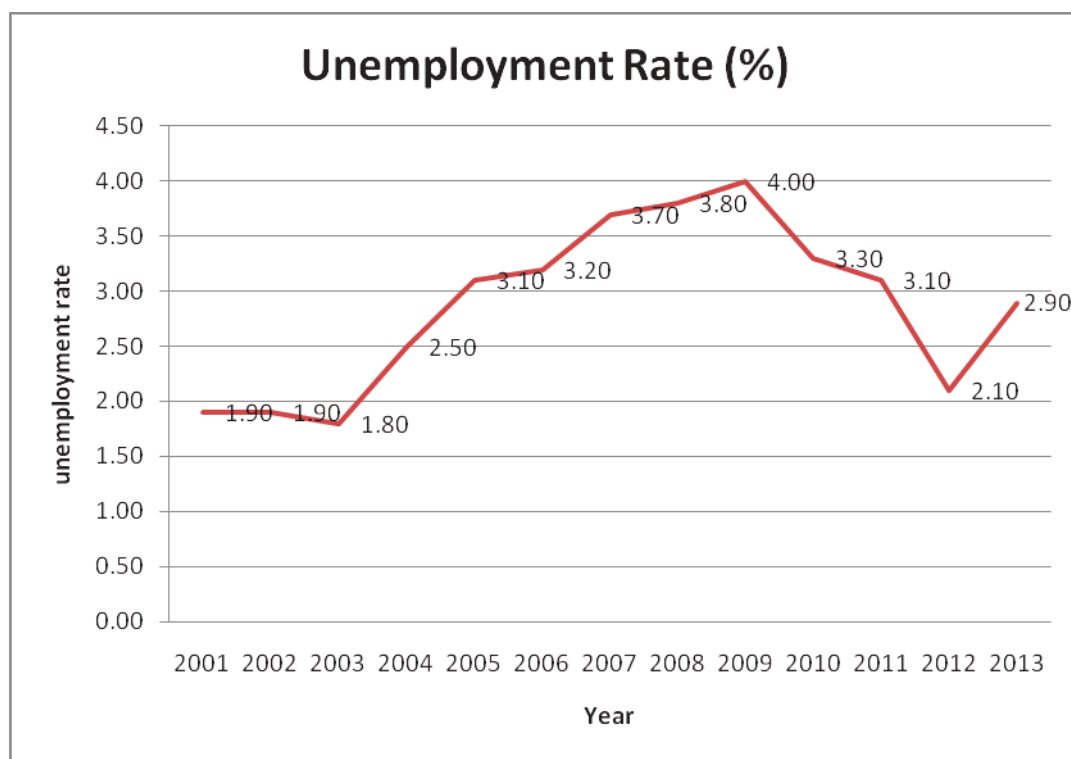
INFLATION AND UNEMPLOYMENT RELATION IN BHUTAN

— Kinley Zangmo, Kinga Choden and Tshering Buthri

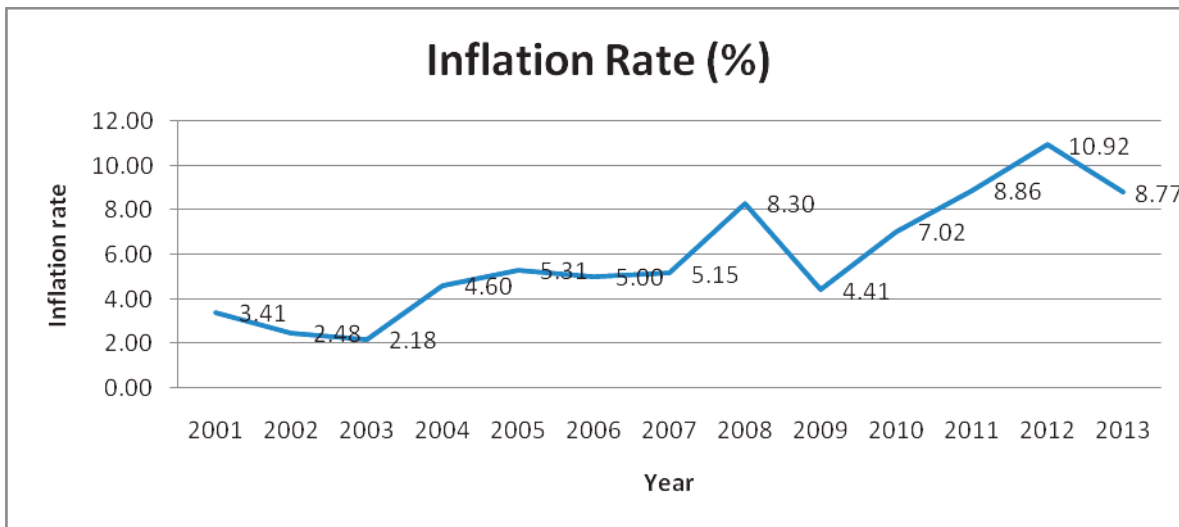
2nd year

Unemployment which counts the people who are jobless and actively looking for a job is one of the major macroeconomic indicators. Inflation is another major macroeconomic indicator. Relation between inflation and unemployment is studied using the tool of Phillips' curve. Initial version of Phillips curve shows trade-off between inflation and unemployment. Phillip's curve was first put forward Sir Arthur Phillips, which showed that as price increases (inflation), the real wages falls, and the demand for labour rises there by reducing the level of unemployment. Stickiness of the nominal wages provides logical framework for this relationship. Later, Milton Friedman and Edmond Phelps used rational expectations model to show that in long run the inflation rate becomes independent of the level of unemployment.

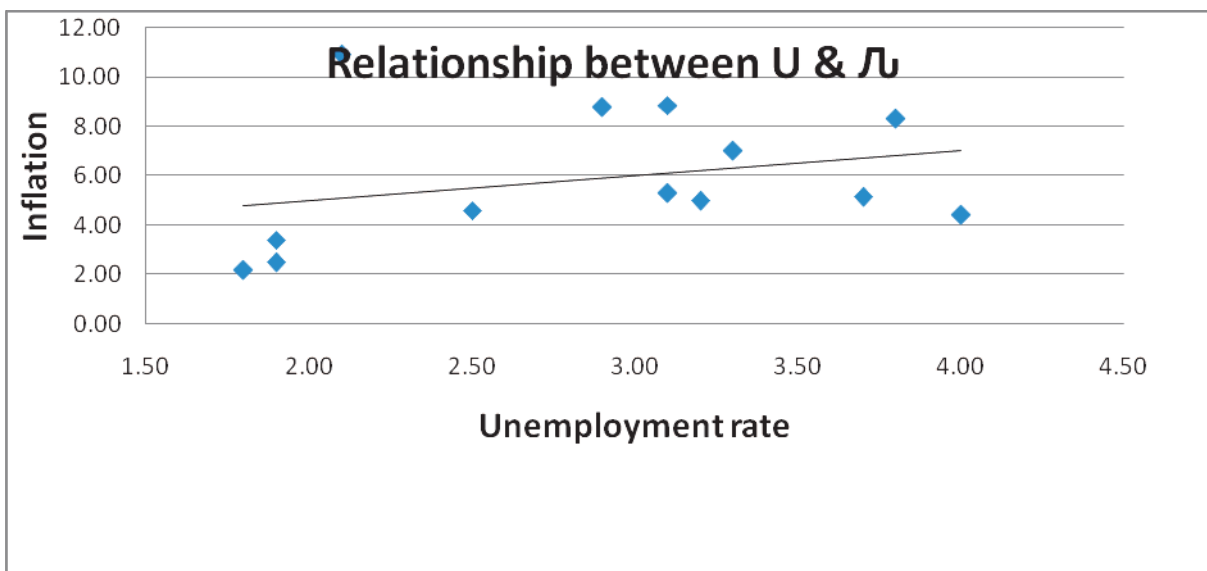
In this paper, we aim to trace the type of relationship between inflation and unemployment in Bhutan. We have used 13years data (2001-13) to study the relation between inflation and unemployment in Bhutan. Unemployment and inflation rate data is obtained from the Statistical Year Book of Bhutan for different years.



Unemployment rate in Bhutan almost doubled from 1.9% to 4% in the first 9 years and there after declined continuously to 2.1% in 2012 and rises again to 2.9% in 2013. The increase in the rate of unemployment is mainly associated with rising rate of youth unemployment. Preference for the white color job, mismatch between demand and supply of skills that the worker possess and the employers want and limited growth of private sector are major reasons of rising unemployment in Bhutan. Government initiatives taken for reduction of unemployment like providing apprenticeship, training program, job fair, establishment of new technical institutes.



Time series data, also reflects that inflation rate increases continuously since 2001. From 3.4% to almost 9% in the recent years. Increase in the global prices of food and fuel were the major factors behind this inflationary trend. Rising food prices tends to have greater impact on the overall price level in Bhutan as food products are given 48% weight in the price index in Bhutan. Inflation in Bhutan is closely related to the inflation in India and the inflation rate in Bhutan is a mirror image of the inflation rate in India as most of the products in Bhutan are imported from India.



The relationship between inflation and unemployment in Bhutan is found to be positive. Rising food and fuel prices act as exogenous supply shock which tend to generate stagflation. Stagflation is a situation when unemployment and inflation rise together. As inflation rate in Bhutan is greatly induced by inflation rate in India, the shape of Philips' curve in Bhutan is purely accidental.

Source

Royal Monetary Authority

National Statistical Bureau

STATUS OF BALANCE PAYMENT IN **BHUTAN**

- Pema Chogyal.

RTC Graduate

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Bhutan is the small country with well preserved culture, tradition and pristine environment. GNH is the main development philosophy of country. Despite Country growing on average rate of 7.43% over past few decades, its balance of payment problem remained as the threat to the development of the country (Trading economics, n.d). Therefore, in following paragraph I would like to mainly talk about the main causes of balance of payment problem in Bhutan and some of the ways that can reduce the severity of BOP problem in Bhutan.

The main cause of BOP problem in Bhutan is due to its huge import of goods and services from our neighboring countries. According to World Bank, (2011) Bhutan's import was almost 77% from India followed by Bangladesh, Nepal and Hong Kong. According to World Bank (2011) the overall external debt would likely to grow in future due to robust capital inflow. According to Royal Monetary Authority (2012), overall import has increased by 36.5% to Nu 53.7 billion driven by huge increase in import from India. The import from India has increase from Nu 28.53 billion in financial year 2009/2010 to Nu 40.6 billion in financial year 2013/2014.

Import of non essential Commodities is another cause of increase in the import of Bhutan over the past decades. According to the Royal Government of Bhutan (2013) the GDP growth of Bhutan was high over the past few years, due to that it increased the confidence of Bhutanese public and increased "consumerism" in Bhutan thereby increasing the problem of balance of payment. Thus trade deficit of Bhutan over the past decade remained high.

Knowing cause and effect relation is the begging to solution. There are many solutions to reduce trade deficit or balance of payment problem in Bhutan. Restricting the import of food grains and promoting agriculture sector in Bhutan would help in reducing the balance of payment problem of Bhutan. According to RMA (2013), Bhutan's trade deficit increased steadily over the year. Food sufficiency remained as major issue for country. Bhutan's total food trade deficit has increased to Nu 5.2 billion in 2013 from Nu 4.2 billion in 2012 (RMA,2013).

Therefore, if Bhutan government could increase tax on import of food grains and provides subsidies to the farmers to promote agriculture, it would reduce the BOP problem and improve the food sufficiency in country.

Promoting both hydro power sector and tourism sector in Bhutan would further help in reducing trade deficit in Bhutan. According to National Statistical Bureau, (2013) tourism and hydro power sector was the significant contributor to overall economy of country. Therefore, further promotion of hydro power sector and tourism would reduce the trade deficit of Bhutan.

The other ways to reduce the balance of payment problem in Bhutan would be the government making the appropriate target subsidies in the setting of the domestic electricity tariffs to reflect the actual cost of supply to reach electricity to the customers. Substituting imports by local goods and services by promoting local industries/ businesses without compromising quality and pricing would further Balance the payments of Bhutan.

Therefore, knowing the causes and effect relation of any economic problems in the country would help in reducing or completely eliminating problems in the country. There are many causes and methods to overcome the problem of balance of payment system in Bhutan. Thus I would like to invite future writer to comment on already mention causes and strategies that I have mentioned in this short essay to reduce trade deficit in Bhutan.

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..... Is like a journey, till dusk!

~Purna.B.Subba
1st year

Nature, the storehouse of
All ideas and the mother
Of all inspirational resources.
The beauty, the wisdom and
The ingenuity has inspired
Poets, authors, musicians
And even the scientists. . .

In the lifecycle of a butterfly
And even in a tiny seed
Nature has message of inspira-
tion:
Root and shoot of a germinat-
ing
Seed burst upon the seed coat
And break through the hardest
ground-
To begin its life.

Each time a tiny seedling
pushes
Its way through the soil, the
Inspiration nature sends us is:
The root of success are formed
Through hard work.

The most inspiring phenome-
non
In the nature, the transforma-
tion of
A caterpillar to a beautiful
butterfly.

Transformation of a tiny insect
that
Once crawled to a brilliantly
Colored that can fly, nature
Gently unfolds the message:
Good thing admires to those
who wait
And inspire us to persevere.

Old Traditions New Influence

It was another auspicious day at Tashichodzong and the long queue of devotees stretched far back along the roads leading to this majestic building that dominates the valley.

An elderly man, grumbling behind me, caught my attention and I couldn't help but over-hear his complaint. He was not happy about the state of his daughter's attire. She was wearing a half-kira - even though she looked respectable enough - like most of the girls in the queue.

His observation made me reflect upon the whole transformation of the Bhutanese wardrobe over the past few decades. Under the benevolent reign and foresight of the Wang-chuk dynasty, Bhutan has undergone a rapid modernization in recent years that has transformed Bhutanese lives immeasurably for the better. This can be clearly noticed from the huge change in the way we dress ourselves - especially among the youth. As the kingdom's doors have opened to the outside world through the advent of television and the internet, western fashion ideas have spread their influence throughout many parts of the country. In many cases, the young have taken to it excited by the choices - much to the mild annoyance of the older generations. This influence and impact can not only be seen from the preferences and dominance of the western styles, but also from the transformation and alterations to our own traditional garments.

The change to how women wore the kira began in the late '80s by some women living in the warmer regions of the South who cut their kiras at the waist to beat the heat. Gradually, the popularity of the half-kira spread to other areas because of the practical convenience, comfort and affordability that the style created.

Today, the kira has been further transformed into a 'belt-skirt' style, in which kiras are stitched into two parts; the top being stitched like a sleeveless shirt and the bottom resembling a skirt that can be either buttoned or hooked.

Even the tegos now are stitched in a jacket style, while wongjus pieces are attached to the sleeves and collars for convenience giving a sense of personal style and expression. The rhetorical question here is if all these transformation in the name of convenience and affordability is worth risking our culture.

The youth of today are not going to change their habit over night and we can't expect them to. We need to know that regardless of all these merit of transformation, we need to realize the importance of unique culture. As cliché as it seems, our very own rich culture and tradition has been acting like a shining armor and an identity. Despite being one of the smallest countries in the world, we managed to stay strong, not being colonized by gigantic countries elsewhere. It is also one of the pillars of Gross National Happiness. As a youth and as a Bhutanese, the least we can do for our country is to uphold the identity and preserve the culture.

Sonam Peday
1st year

MY FRIEND

~Pelden Choiden
Pema Lhamo
1st Year

My friend is like a god
Who is as precious as gold
We grew up together
And became friend forever

Thoughts and feelings we
never confide
Left with nothing to hide
Dear, you are so lovely
Who never makes me feel
lonely

We still listen to each other
and share
Giving each other the ut-
most care

Contract Farming: An Answer or a Problem

10th Five Year Plan recognizes the fact that poverty is a central issue to be addressed. One of the strategies to raise the rural income is the introduction of contract farming. The plan document highlights the importance of contract farming in following words- “the Royal Government will permit and facilitate the introduction of contract farming mechanisms.This is intended to help protect small holder farmers overcome existing market constraints, minimize transaction costs and enhance market access.” It is an important policy framework which has the potential to affect the condition of farmers, especially of the small farmers. In the wake of globalization and liberalization there is a greater danger that small farmers would be further marginalized and contractual farming is considered to be one of the elements of providing greater opportunities to them. So far, there is hardly any empirical evidence that such efforts have been fruitful. My intention is to initiate a general debate, especially amongst the major stakeholders about the suitability of the contractual farming to the typical Bhutanese conditions. National newspapers are most effective source of dissemination of the information and should become the platform for such debate.

To assess the suitability of contract farming in Bhutan we need to know the ground realities. Only if certain preconditions are met the contractual farming can bring desired benefits to the small farmers. For many of the readers who are not aware of what is contractual farming, I will begin with a brief description of contract farming. Contract farming is not a new concept but rather it is in existence for many years as a means of organizing the commercial agriculture especially for small-scale farmers. Contract farming is an agreement between farmers and firms for the supply of agricultural products under forward agreement, at a predetermined price. The basis of such arrangement is a commitment on the part of the farmer to provide a specific commodity at pre-specified volume, quality and price to the contractors at a particular point of time. It is a kind of partnership between agribusiness and farmers.

It brings some advantages to the farmers in form of assured supply of inputs, diffusion of technology, assured price and market access. But there are hidden dangers too, they include- increased vulnerability to endogenous supply shocks, exposure to exploitation by the monopsonic firms/middlemen.

My worry is about the capabilities of the small farmers to benefit from such arrangements. According to the World Bank (Country Assessment 2006) about 13.7% of the house holds in Bhutan own less than 1 acre land and their collective holding amounts to just 1.4% of the operational land. About 47% of the households own less than 3 acres land constituting about 16% of total operational holding. This 47% of the households belong to the category of small farmers. Ability of the small farmers to benefit from contractual arrangements mainly depends on two conditions- 1) Incentives of the new system relative to the traditional one. 2) Capacity of the contracting firms to undertake needed investment.

The primary disincentive for the firms to undertake contractual arrangements with the small farmers is related to the diseconomies of scale of dealing with large number of small farmers that raises the transaction cost

The usual incentive associated with cheap labour is absent in Bhutan. It raises the fundamental issue whether contractual farming is possible even if it is desirable. The contracting firms are most likely to tie up with big farmers rather than the small farmers.

Another angle of looking at this issue is whether this system provides relatively large benefits to the small farmers over the traditional one.

Assured prices for their product is definitely a major incentive as it reduces the uncertainty. Contract farming is basically an antithesis of free market forces. Need for contractual farming arises because of imperfections in the market that prevent normal price signals to regulate supply. Contract farming is basically an antithesis of free market forces. Need for contractual farming arises because of imperfections in the market that prevent normal price signals to regulate supply. Generally, the farmers would not produce the crop unless they were under contract in a vertically integrated market. This system is a case of market monopsony (a market situation representing one buyer and many sellers) and it is the only way to ensure that firms can secure return on their money. This is not applicable with the usual crops which are relatively easy to produce and market independently. Hence contract farming is more likely to operate for the production of unconventional crops. But small farmer's ability to benefit from contractual arrangement would depend on ability to take risk in terms of producing the crops for which they do not have adequate experience. It reminds me of John Kenneth Galbraith who asserted that small and subsistence farmers are risk averters as any risk involved in a new system means risking the existence. Thousand of small and subsistence farmers in Bhutan are not likely to behave differently.

One should also bear in mind that firms are in better position to have access to information than the small farmers. Using this advantageous position they have an incentive to set a price which is lower than the expected market price at the time of harvesting. If price expectations are rational the firms would net all the benefits without sharing the gains with the small farmers. It is, therefore, an extension of capitalistic mode of production for exploitation. Such contractual arrangements, if undertaken, would call for farm level technological change. The cost of acquisition of new technology is generally higher as one has to pay rent for the new intellectual property. The present experience with Bhutanese industries does not provide any evidence of their technological readiness and there is no reason to believe that they will act differently to transfer new techniques to the farmers. If government provides subsidized inputs to the small farmers, firms would have incentive to create linkages with the small farmers in order to benefit from input subsidy. Finally, a greater part of the benefit of the input subsidy would go into the pockets of firms.

Promoting agriculture through contracts is also a cultural issue. In countries like Bhutan where custom and tradition play an important role, difficulties may arise when farming innovations are introduced. Besides this discriminatory buying, late payments by the firms, inefficient extension services, poor quality of agronomic advice and unreliable transportation are usual discontent of the small farmers with the contractual arrangement. Finally, it is also an issue of loss of sovereign rights of the farmers over their land. It has more emotional content than any logic but most of our decisions are based on emotional considerations rather than the logic.

The second condition for the success of contractual farming relates to the capacity of the firms to undertake the needed investment to develop the capacity of the small farmers. Contractual farming by small farmers to produce unusual crops is likely to be rated as a highly risky business endeavour which may not be attractive for equity finance hence loan finance becomes the only option. In Bhutan's context, even the financial institutions with the lesson learnt from the present financial crisis would be hesitant to put their money into risky ventures. There would be limited options for borrowing combined with higher cost.

Most of these ventures are then likely to have high debt-equity ratio that would expose such projects to high vulnerability and financial risk. Under such circumstances, it would be common belief that government will be under political pressure to provide subsidized credit to the small farmers if contractual farming has to be promoted and thus the firms would expect to shift the financial burden to the government or to other donor agencies. Such measures results into cross subsidization. Investment capacity of the firms is also limited by their lack of commitment for any long term relationship with the contracted farmer. The problem is more serious when the cost of switching is very low. There are other problems too. The contractual farming leads to mono cropping which is potentially bad for soil fertility and also adversely affects the bio-diversity. How the government would align the impact of contractual farming with the objective of the protection of environment? At one hand the contracting firms have the ability and incentive to break the rules of the game, but the small farmers, on the other, do not have the capabilities even if they have incentives. In the absence of a cheap and quick dispute settlement mechanism the exposure to threat is always greater. Is Bhutan ready with all the preconditions for its success? This is the basic question that needs to be answered before contractual farming is introduced. It is quite apparent that given the unequal power relationship between the firms and small farmers, the later would be subjected to exploitation.

**Sanjeev Mehta,
Professor of Economics**

RIDDLE

1. What has four legs, a head and leaves?
2. What has holes but holds water?
3. What has no beginning, end or middle?
4. What has to be broken before it can be used?
5. What is harder to catch the faster you run?
6. What is higher without the head than with it?
7. What is in the middle of nowhere?

ANSWER FOR LAST ISSUED RIDDLE

1. A Shoe
2. A Window
3. Stocking
4. A Piano
5. A Post Office
6. A Cowboy riding his horse
7. A mouse on Vacation
8. 3 (half of 2 =1, and then 1+2=3)

***** Anyone can mail the answer and get a treat from us for right answer or wait until the next issue*****

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