



Internationalisation of Rupee

For Prelims: RBI, Internationalisation of Rupee, Monetary Policy

For Mains: Internationalisation of Rupee and related issues, Growth & Development

Why in News?

A deputy governor of the [Reserve Bank of India \(RBI\)](#) recently emphasized the advantages and risks of the internationalization of the rupee.

What is Internationalisation of Rupee?

- Internationalisation of the rupee is a **process that involves increasing use of the local currency in cross-border transactions**.
- It involves **promoting the rupee for import and export trade** and then other **current account transactions** followed by its use in **capital account transactions**.
 - As far as the rupee is concerned, it is fully convertible in the current account, but partially in capital account.
 - **Current and Capital account are the two components of [Balance of payments](#)**. While the current account deals mainly with the import and export of goods and services, the capital account is made up of the cross-border movement of capital by way of investments and loans.

Why is the Need for Internationalisation of Rupee?

- The dollar accounts for **88.3% of global foreign exchange market** turnover, followed by the euro, Japanese Yen and Pound Sterling; the rupee accounts for a mere 1.7%, underlining the need for pushing the currency much farther to get an international tag.
- In the case of the dollar, which is an international currency, the 'exorbitant' privileges include immunity from Balance of Payments crises as the USA can pay for its external deficits with its own currency.

What are the Various Advantages of Internationalisation of the Rupee?

- Use of Rupee in cross-border transactions mitigates **currency risk for Indian business**. Protection from currency volatility not only reduces cost of doing business, it also enables better growth of business, improving the chances for Indian business to grow globally.
- It **reduces the need for holding foreign exchange reserves**. While reserves help manage exchange rate volatility and project external stability, they impose a cost on the economy.
- Reducing dependence on foreign currency makes India **less vulnerable to external shocks**. For example, during phases of monetary tightening in US and strengthening dollar, excessive foreign currency liabilities of domestic business results in a de facto domestic tightening. Reduced exposure to currency risk would substantially mitigate the pain of reversal of capital flows.
- As the use of Rupee becomes significant, the **bargaining power of Indian business would**

improve adding weight to the Indian economy, enhancing India's global stature and respect.

What are the Challenges in Internationalisation of Rupee?

- India is a **capital deficient country**, and hence needs **foreign capital to fund its growth**. If a substantial portion of its trade is in Rupee, non-residents would hold Rupee balances in India which would be used to acquire Indian assets. Large holdings of such financial assets could heighten vulnerability to external shocks, managing which would necessitate more effective policy tools.
- A reduced role for convertible currencies in external transactions could lead to reduced reserve accretion. At the same time, however, the need for reserves would **also reduce to the extent the trade deficit is funded in Rupees**.
- Non-resident holdings of Rupees could exacerbate pass-through of external stimulus to domestic financial markets, increasing volatility. For instance, a global risk-off phase could lead **non-residents to convert their Rupee holdings** and move out of India.

What are the Steps taken for the Internationalisation of the Rupee?

- **In July, 2022** the RBI has **introduced a [mechanism to facilitate international trade in rupees](#)**.
- Enabling **[external commercial borrowings](#)** in Rupees (especially **[Masala Bonds](#)**).
- The Asian Clearing Union is also exploring a scheme of using domestic currencies for settlement. An arrangement, bilateral or among trading blocs, which offers importers of each country the choice to pay in domestic currency is likely to be favoured by all countries, and therefore, is worth exploring.

Way Forward

- The recent initiative of invoicing trade in rupee comes from a different global requirement and order, but for true internationalisation and wider use of the rupee overseas, opening up of trade settlement in rupee alone will not suffice. Further **opening up and liberalised settlements in rupee for various financial instruments** both in India and overseas markets are more important.
- **Rupee internationalization may also require an efficient swap market** and a strong foreign exchange market.
- **Further improvement in overall economic fundamentals**, financial sector health, followed by an upward movement in sovereign ratings will also strengthen confidence in the rupee, making the currency ready for the next step in its international journey.

UPSC Civil Services Examination Previous Year Question

Q. Convertibility of rupee implies (2015)

- (a) being able to convert rupee notes into gold
- (b) allowing the value of rupee to be fixed by market forces
- (c) freely permitting the conversion of rupee to other currencies and vice versa
- (d) developing an international market for currencies in India

Ans: (c)

Q. With reference to Balance of Payments, which of the following constitutes/constitute the Current Account? (2014)

1. Balance of trade
2. Foreign assets
3. Balance of invisibles
4. Special Drawing Rights

Select the correct answer using the code given below:

- (a) 1 only
- (b) 2 and 3
- (c) 1 and 3
- (d) 1, 2 and 4

Ans: (c)

Source: [IE](#)

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