



Globalising the Indian Rupee

This editorial is based on "[Perils of Trading Globally in Re](#)" which was published in The Hindu Business Line on 07/05/2023. It talks about the Government of India's efforts to internationalise Indian rupee and the corresponding challenges.

For Prelims: [Vostro Account](#), [India's Foreign Trade Policy 2023](#)

For Mains: [De-dollarisation](#) - need for alternate international payment methods, [Indian currency in cross border trade](#), [RBI allows Trade Settlements in Rupee](#), [Internationalisation of Indian rupee](#) - significance and challenges

Currently, global trade and the economy are going through difficult times, especially after the **Covid-19 inflicted recession** and the **renewed geopolitical tensions in Eastern Europe**. Many developing countries in Asia, Africa and Latin America are on the verge of currency crises with **severe foreign exchange shortages and volatility**.

Even if not for all the crisis, the **US often weaponising the US Dollar against its adversaries** by imposing sanctions on them (Iran, Russia etc.) has led to [countries across the globe look for alternate means of trade and payment settlements](#).

At this juncture, an alternative arrangement to the USD-based settlement system with one using **INR could be a win-win to both India and the countries facing sanctions** by the US. **RBI's decision to promote Indian rupee for cross-border trade** is undoubtedly a step in the right direction, however, such internationalisation requires a number of short-term and long-term actions.

What is Understood by Internationalisation of Rupee?

▪ International Currency:

- An international currency is one that is **used instead of the national currencies of the parties directly involved** in an international transaction, whether the transaction in question involves a purchase of goods, services or financial assets.
- As of July 2022, **USD accounts for about 88% of global foreign exchange market turnover, followed by the Euro**, Japanese Yen and Pound Sterling. **The Indian rupee accounts for a mere 1.7%.**

▪ Internationalisation of Indian Rupee:

- It refers to the **process of increased cross-border transactions** of Indian currency, **especially in import-export trades** followed by other **current account transactions** and then **capital account transactions**.
- This would enable the international settlement of trade in Indian rupees in foreign trades, as opposed to other currencies including USD.

Note: Current account is used to deal in export and import of goods and services, whereas, capital account is made up of capital through cross-border transactions in the form of investment and loans.

▪ **Driving Factor:**

- The [removal of seven Russian banks from SWIFT arrangement](#) as part of the **Ukraine-induced economic sanctions against Russia** was the trigger.
- This payment arrangement assumed greater importance in 2022-23 as [India increased its dependence on discounted Russian oil](#), making it the **second largest source of crude oil**.

▪ **India's Efforts:**

- In July 2022, the RBI issued a circular on ["International Trade Settlement in Indian Rupees"](#), which underlined the terms not only for trade settlement but also for **cross-border transactions in Rupees**.
 - An important component of this arrangement is that Rupee surplus balance can be used for capital and current account transactions in accordance with mutual agreement.
 - Thus, **foreign entities holding Rupee balances are allowed to invest in assets in India**.
- More recently in March 2023, the RBI put in place the mechanism for **rupee trade settlement with as many as 18 countries**.
 - Banks from these countries have been allowed to open [Special Vostro Rupee Accounts \(SVRAs\)](#) for settling payments in Indian Rupees.
 - In April 2023, [India and Malaysia agreed to settle trade in Indian rupees](#).
- As part of its [Foreign Trade Policy 2023](#), the government intends to **encourage the use of the Indian currency in cross-border trade**, aided by a new payment settlement framework that RBI introduced in July 2022.

▪ **Significance:**

- The most important advantage of internationalising Rupee is to **reduce dependency on the USD for foreign trade**.
 - It would further **increase the bargaining power of India** in international business.
- Expanding the use of rupee for international trade will **reduce currency risk for Indian businesses** by **eliminating their exposure to currency volatility**.
 - This can **reduce the cost of doing business** and can hence help in **making exports more competitive in the global market**.
- Additionally, the need to maintain forex reserves can drastically reduce if a sizable share of India's trade can be settled in terms of the domestic currency.

Is the US Dollar Still the International Currency?

- The [International Monetary Fund's \(IMF\)](#) data on holdings of forex reserves shows that after the Ukraine conflict, the **USD's share has not really changed and remains close to 60%, followed by the euro, at 20%**.
 - The yen and British pound come next. The renminbi has a lower share than the Swiss franc and Australian dollar.
- Along with [general](#) acceptability as a medium of exchange for international trade, the **US dollar is also in demand because of demand for dollar-denominated assets** worldwide.
 - The debt issued by the US government is bought by many countries across the world as a **hedge against currency fluctuations affecting valuation of reserves**.
- Thus, the run of the US dollar as an international reserve currency is far from over.

What are the Major Roadblocks to Internationalisation of Rupee?

▪ **Rupee-Trade Arrangements Not Easy to Implement:**

- This was also the **main reason why India and Russia have suspended efforts to**

settle bilateral trade in rupees, after months of negotiations failed to convince the latter to keep rupees in its coffers.

- The **rupee is not fully convertible**; India's **share of global exports of goods is just about 2%** and these factors reduce the necessity for other countries to hold rupees.
 - Consequently, **Russia wanted the trade to be done in Chinese Yuan, UAE Dirham** or other currencies.

▪ **India's Trade Deficit with Major Trade Partners:**

- India has a trade deficit with its major trading partners including China, UAE, Saudi and Russia.
- Infact, **India's large trade deficit vis-a-vis Russia**, which implies that the latter would be saddled with **large Rupee balances**, was also why it has been **reluctant for Rupee-Rouble trade**.

▪ **Balancing Exchange Rate Stability & Domestic Monetary Policy:**

- As the Rupee becomes more internationalised, it is **likely to become more vulnerable to external economic shocks**, such as changes in global interest rates or fluctuations in commodity prices.
 - This could make it **more difficult for the central bank (RBI) to maintain both exchange rate stability and a domestically oriented monetary policy**.

▪ **Lesser Control on Money Supply:**

- When a currency is internationalised, **both residents and non-residents can buy and sell domestic currency**-denominated financial instruments such as stocks, bonds, and other securities.
 - This means that the demand and supply of the **country's currency can be influenced not just by domestic but also external factors** (outside the country).
- If so happens in the case of Rupee, the **RBI will have limited control over the money supply** within its own borders, which could make it **difficult to maintain stable interest rates** that are in line with the requirements of the domestic economy.

▪ **Risks from Full Convertibility of Rupee:**

- For rupee to be effectively internationalised, the government will have to **remove restrictions on any entity** (domestic/foreign) from buying/selling rupee; this implies no restrictions **on the flow of capital in and out of the country**, which would require full convertibility on the capital account.
- However, **successive Indian governments have avoided full convertibility** on the capital account to prevent the Indian economy from being exposed to the risks of external financial shocks.

What Measures can be Taken to Facilitate Rupee Internationalisation?

▪ **Emulating China:**

- Among the emerging economies, China is the only country that has been able to steadily internationalise its currency, while maintaining controls on its capital account. It has done so by:
 - **Finalising currency swap agreements** between central banks of China and 43 such countries, which **assure the markets that there would not be oversupply of the renminbi**.
 - Creating an offshore market for its domestic currency that allows **foreign entities to sell renminbi for dollars**.
- However, it must not be forgotten that **China also has its trade surplus with most of the other countries**.
 - This is one of the areas that India is currently working on via the [Atma-Nirbhar Bharat initiative](#) and also needs to give it further impetus by means of **funding and research & development** so that it can reduce its reliance on imports.

▪ **Better Planning:**

- It would require India to have considerable thinking and planning to make rupee-internationalisation function in a manner that **does not adversely affect the economy's fundamentals**.
 - The government must **carefully balance the benefits with the potential risks** and take appropriate measures to **ensure the stability of the economy**.

- It also requires India to have a **large and deep domestic financial market to be better equipped to handle external shocks** and make it easier for the RBI to manage its monetary policy.
- **Focussing of Enhancing Exports:**
 - India has made a modest attempt at facilitating rupee trade, the idea will take time to gain acceptance. For the time being, the rupee's acceptance will potentially be limited to **countries that have a deficit with India.**
 - India will **need to enrol other trade partners** that would be able to use their rupees to buy goods from India.
 - The US and European Union are the major export destinations for India and the others would be **oil exporting nations.** Getting the latter into our fold sounds plausible.
- **Other Concerted Steps that Government can Take:**
 - **Removal of restrictions** on buying and selling of domestic currency in both the spot and forward markets.
 - **Domestic firms being able to invoice exports and imports** in their own currency.
 - Foreign firms, financial institutions, govt institutions and individuals being able to **hold the country's currency and financial instruments.**

Drishti Mains Question

“Amid the ongoing geopolitical instabilities across the world and the increasing frequency of the US weaponising the US Dollar to impose sanctions against countries, the world is now looking for more suitable alternate means of payment settlement. Internationalisation of Indian Rupee offers a prudent way ahead”. Comment.

UPSC Civil Services Examination, Previous Year Questions (PYQs)

Prelims:

Q1. 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)

Q2. 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)

PDF Refernece URL: <https://www.drishtiias.com/printpdf/globalising-the-indian-rupee>

