Promoting Internationalization of Rupee

This editorial is based on **“Rupee invoicing of foreign trade has many positives”** which was published in the Hindu BusinessLine on 06/04/2023. It discusses the Potential and Challenges of India's Push for Rupee Invoicing in International Trade.

For Prelims: RBI, Internationalisation of Rupee, Monetary Policy, Foreign Trade Policy, Reserve Bank of India, Cross-Border Trade, Foreign Reserve, Inflation

For Mains: Internationalisation of Rupee and Related Issues, Growth & Development

India's push for rupee invoicing in international trade has gained momentum with the recent **Foreign Trade Policy (FTP) 2023**, which proposes invoicing, payment, and settlement of trade in Indian rupees.

This move is **expected to lower transaction costs, promote international trade, and reduce hedging expenses**, among other benefits. While the **rupee currently accounts for a mere 2% of global currency market turnover**, the framework could be particularly beneficial for trade partners such as Russia, Saudi Arabia, Nigeria, and the UAE.

However, the effectiveness of this policy ultimately depends on factors such as India's net trade deficit/surplus and the extent of trading in rupees in comparison to the total bilateral trade.

Overall, promoting the Internationalization of the Indian Rupee will **require a concerted effort by the government,** the **Reserve Bank of India,** and other stakeholders to increase the demand for the Indian Rupee in international transactions.

What are the Benefits of the Internationalization of Rupee?

- **Lowering of Transaction Costs**:
  - The internationalization of the Rupee can **reduce the need for currency conversion, thereby lowering transaction costs for businesses** and individuals conducting international trade.
  - This can make it **more attractive for foreign investors to do business in India** and make India's exports more competitive in global markets.
- **Greater Degree of Price Transparency:**
  - When the Rupee is widely used in international transactions, it can **lead to a greater degree of price transparency**. This can **enable Indian businesses to better understand global market conditions** and adjust their pricing strategies accordingly.
- **Quick Settlement Time:**
  - The internationalization of the Rupee can **facilitate faster and more efficient settlement times** for international transactions. This can benefit Indian businesses by

reducing the time and costs associated with cross-border payments.

- **Promoting International Trade:**
    - An internationalized Rupee can **promote international trade by making it easier and cheaper for Indian businesses to transact with their global counterparts.** This can lead to increased exports and economic growth for the country.
- **Reduction in Hedging Expenses:**
    - As the Rupee becomes more widely accepted and used in international transactions, the **need for hedging against currency fluctuations may reduce.** This can lead to cost savings for businesses and investors.
- **Reduced Cost of Holding Foreign Reserve by the RBI:**
    - An internationalized Rupee can reduce the **cost of holding** foreign reserve **by the** Reserve Bank of India (RBI). When the Rupee is widely used and accepted in international transactions, the RBI may not need to hold as much foreign currency to conduct its operations, thereby reducing costs.

What are the Challenges with the Internationalization of Rupee?

- **Capital Controls:**
    - India still has **capital controls in place that limit the ability of foreigners to invest** and trade in Indian markets. These restrictions make it difficult for the INR to be used widely as an international currency.
- **Exchange Rate Volatility:**
    - The INR has a **history of volatility,** which makes it unattractive for use as an international currency. Currency exchange rate stability is a key requirement for a currency to be used as a global reserve currency.
- **Financial Market Development:**
    - The **development of deep and liquid financial markets is a prerequisite for the Internationalization of a currency.** The Indian financial market is still in the process of developing, and it needs to become more integrated with global financial markets.
- **Regulatory Environment:**
    - The regulatory environment in India **needs to be conducive to the use of the INR as an international currency.** This **requires the government to implement policies that support the growth** of the financial sector, improve market transparency and reduce red tape.
- **Lack of Internationalization Efforts:**
    - India **needs to take more active steps to promote the use of the INR** as an international currency. This **includes establishing offshore INR trading centers**, entering into currency swap agreements with other countries, and promoting the use of the INR in trade settlements.
- **Low Inflation:**
    - **Inflation** rate is an **important consideration when it comes to the Internationalization of a currency.** The Reserve Bank of India has been successful in keeping inflation under control, but low inflation rates can make a currency less attractive to foreign investors.
- **Geopolitical Factors:**
    - Geopolitical factors such as **political instability, wars, and sanctions can have a significant impact on the Internationalization of a currency.** India needs to have stable relations with other countries and avoid getting caught in geopolitical conflicts that could impact the use of the INR as an international currency.

What Should be the Way Forward?

- **Encourage Cross-Border Trade in Indian Rupee:**
    - Government should **encourage cross-border trade with other countries,** especially neighboring countries like Nepal, Bhutan, and Bangladesh, in Indian Rupee instead of other currencies.
    - This will **increase the demand for the Indian Rupee in these countries,** thereby promoting its Internationalization.
- **Promote Financial Market Development:**

    - India could **promote the development of its financial markets,** especially the bond market, to attract foreign investors.
    - This will **increase the demand for Indian Rupee-denominated bonds** and promote its use in international transactions.
- **Liberalize Capital Account Transactions:**
    - Government should **further liberalize capital account transactions to attract foreign investment,** which will increase the demand for the Indian Rupee in international transactions.
- **Expand the Use of the Indian Rupee in International Transactions:**
    - Government should **encourage its trading partners to use the Indian Rupee in international transactions** by signing bilateral currency swap agreements. It could also explore the possibility of creating an Indian Rupee-based trading bloc with its neighboring countries.
- **Strengthen the Indian Economy:**
    - A strong and stable Indian economy will increase the confidence of foreign investors in the Indian Rupee and promote its Internationalization.

Drishti Mains Question

What are the challenges faced in the process of Internationalization of the Indian Rupee and how can they be addressed?

UPSC Civil Services Examination, Previous Year Question (PYQ)

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)

- Convertibility of rupee means freely permitting the conversion of rupee to other currencies and vice versa.
- Indian currency is fully convertible in the Current Account and partially convertible in the Capital Account.
- Current Account convertibility means freedom to convert domestic currency into foreign currency and vice-versa, for trade in goods and services. On the other hand, Capital Account convertibility means freedom of currency conversion related to capital inflows and outflows.
- Therefore, option (c) is the correct answer.

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)

- The Balance of Payments (BoP) is composed of two main aspects: Current Account and Capital Account.
- The Current Account of BoP measures the inflow and outflow of goods, services, investment incomes and transfer payments. Trade in services (invisibles); trade in goods (visibles); unilateral transfers; remittances from abroad; and international aid are some of the main components of the Current Account. When all the goods and services are combined, together they make up the Balance of Trade (BoT) of a country.
- Hence, 1 and 3 are correct.
- Capital Account of BoP records all those transactions, between the residents of a country and the rest of the world, which cause a change in the assets or liabilities of the residents of the country or its government.
- Loans and borrowing by private or public sectors; investments; and changes in the forex reserves are some of the examples of the components of the Capital Account. Hence, 2 and 4 are not correct.
- Therefore, option (c) is the correct answer.
