



Internationalisation of Indian Currency

For Prelims: [Internationalization of Indian Currency](#), Capital account transactions, [Special Vostro Rupee Accounts \(SVRAs\)](#), [International Trade Settlement in Indian Rupees](#), External commercial borrowings in Rupees

For Mains: Internationalization of Indian Currency, Bilateral, regional and global groupings and agreements involving India and/or affecting India's interests.

[Source:TH](#)

Why in News?

Recently, India has made first-ever payment in rupees for crude oil purchased from the UAE, paving the way for the Internationalization of Indian Currency.

- In July 2023, an agreement with the UAE facilitated **Indian Oil Corporation's (IOC) rupee payment** for a million barrels of crude from ADNOC (Abu Dhabi National Oil Company). Similarly, some Russian oil imports were settled in rupees.
- India, heavily reliant on oil imports (over 85%), employs a strategy centered on sourcing the most cost-effective oil while diversifying suppliers without breaching international obligations, notably amidst the Russian oil controversy post-Ukraine conflict.

What is Internationalisation of Rupee?

- **About:**
 - Internationalization of rupees 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](#).
- **Historical Context:**
 - In the 1950s, the Indian rupee was widely used as [legal tender](#) in the United Arab Emirates, Kuwait, Bahrain, Oman, and Qatar.
 - However, the devaluation of India's currency by 1966 led to the introduction of sovereign currencies in these countries to reduce reliance on the Indian rupee.
- **Benefits of Internationalisation of Rupee:**
 - **Appreciate Currency Value:** It will improve the demand for the rupee in international trade.
 - This can lead to increased convenience and reduced transaction costs for businesses and individuals dealing with India.
 - **Reduced Exchange Rate Volatility:** When a currency is internationalized, its exchange rate tends to stabilize.
 - The increased demand for the currency in global markets can help reduce volatility, making it more predictable and reliable for international transactions.
 - **Geopolitical Advantages:** Internationalizing the Rupee can enhance India's geopolitical

influence.

- It can strengthen economic ties with other countries, facilitate bilateral trade agreements, and promote diplomatic relations.
- **Fortify Indian Economy:** Diversifying settlement currencies can reduce dollar demand and **fortify India's economy against global currency shocks.**
- **Challenges:**
 - **Triffin Dilemma:** The Triffin dilemma could manifest as **a conflict between maintaining stability in India's domestic economy and meeting the global demand for the Rupee.** Balancing these conflicting demands presents a challenge in the process of making the Rupee an international currency without adversely impacting the country's economic stability.
 - It describes the **conflict between a country's domestic monetary policy goals and its role as an international reserve currency issuer.**
 - **Exchange Rate Volatility:**
 - Opening up the currency to international markets can increase volatility in its exchange rate, especially in the initial stages. Fluctuations can impact trade and investments, affecting economic stability.
 - **Impact on Import Costs:** If the Rupee's internationalisation leads to increased demand for the currency in global markets, it might strengthen the Rupee against other currencies. A stronger Rupee **could potentially reduce the cost of imports from countries like China and Russia,** potentially impacting trade balances.
 - **Limited International Demand:** The daily average share for the rupee in the global forex market is only around 1.6%, while India's share of global goods trade is ~2%.
 - **Convertibility Concern:** The **INR is not fully convertible**, meaning there are restrictions on its convertibility for certain purposes such as capital transactions. This restricts its widespread use in international trade and finance.
 - **Demonetization Impact:** The **demonetization** exercise in 2016, along with the recent withdrawal of the Rs 2,000 note, has affected confidence in the rupee, particularly in neighboring countries like Bhutan and Nepal.
 - **Challenges in Trade Settlement:** While efforts have been made to trade with around 18 countries in rupees, transactions have remained limited.
 - Also, negotiations with Russia to settle trade in rupees have been slow, hampered by currency depreciation concerns and inadequate awareness among traders.
- **Steps Towards Internationalisation:**
 - **Developments in the GIFT City**
 - **Asian Clearing Union (ACU):**
 - The ACU is a regional payment arrangement. It facilitates the settlement of trade transactions among its member countries on a multilateral basis. It was established in 1974 by ten central banks of Asia. The ACU currently has 13 member countries. India is a member of ACU.
 - 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 July 2022, the RBI issued a circular on **"International Trade Settlement in Indian Rupees"**.
 - RBI enabled **external commercial borrowings in Rupees (especially Masala Bonds).**

What are the Reforms that India Can Pursue to Internationalise the Rupee?

- **Make the Rupee More Freely Convertible:**
 - With a goal of full convertibility by 2060, letting financial investments move freely between India and abroad.
 - This would allow foreign investors to easily buy and sell the rupee, enhancing its liquidity and making it more attractive.
- **Reforms Suggested by Tarapore Committee:**
 - **Strong Fiscal Management:** Such as reducing **fiscal deficits** lower than 3.5%, reducing gross **Inflation** rate to 3%-5%, and reducing gross banking **non-performing assets** to less than 5%.

- **Liberalised Scheme for Personal Remittance:** The introduction of a more liberal scheme for personal remittances to facilitate easier transactions for individuals dealing with foreign exchange.
- **Removal of Restrictive Clauses for Employee Stock Options:** The removal of restrictive clauses related to issuing Employees' Stock Options at concessional rates, allowing for smoother transactions and operations concerning stock options.
- **Name Change and Reorientation of Department:** The committee suggested changing the name and reorienting the department responsible for handling the implementation of the [Foreign Exchange Management Act, 1999](#), from the Exchange Control Department to the Foreign Exchange Department, emphasizing a leaner and more strategic task force approach.
- **Pursue a Deeper Bond Market:**
 - Enabling foreign investors and Indian trade partners to have more investment options in rupees, enabling its international use.
- **Encourage Exporters/Importers for Transactions in Rupee:**
 - Optimising the trade settlement formalities for rupee import/export transactions would go a long way.
- **Sign Additional [Currency Swap Agreements](#):**
 - As with Sri Lanka, to allow India to settle trade and investment transactions in rupees, without resorting to a reserve currency such as the dollar.
 - India currently has a bilateral swap arrangement (BSA) with Japan for up to USD 75 billion as a backstop line of support in case of any balance-of-payments issues.
- **Ensure Currency Management Stability and Improve the Exchange Rate Regime:**
 - Avoid sudden or drastic changes such as devaluation or demonetisation that can impact confidence.
 - Ensure consistent and predictable issuance/retrieval of notes and coins.

Conclusion

The Tarapore Committee's recommendations (in 1997 and 2006), including reducing fiscal deficits, inflation rates, and banking non-performing assets, should be pursued as a primary step towards internationalisation of rupee. Also, advocating for the rupee to become an official currency in international organizations would raise its profile and acceptance.

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)

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