



## 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)**

PDF Refernece URL: <https://www.drishtias.com/printpdf/internationalisation-of-indian-currency-1>

