



Internationalisation of Indian Rupee

For Prelims: [Reserve Bank of India](#), [Internationalisation of the rupee](#), [Legal tender](#), [Demonetization](#), [Real-Time Gross Settlement](#), [International Monetary Fund](#).

For Mains: Benefits of Internationalisation of Rupee, Steps Towards Internationalization of Rupee

Why in News?

A [Reserve Bank of India](#)-appointed working group recommended **inclusion of the rupee in the Special Drawing Rights (SDR) basket** and **recalibration of the [foreign portfolio investor \(FPI\) regime](#)** to accelerate the pace of [internationalisation of the rupee](#).

What is Internationalisation of Rupees?

▪ About:

- Internationalisation 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.

▪ Challenges:

- **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 ₹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 Internationalization:**
 - 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 can be Done to Pace-up Internationalization of Rupee?

- **Full Convertibility and Trade Settlement:** The Rupee should aim for full Convertibility, allowing **free movement of financial investments** between India and other countries.
 - Encouraging **Indian exporters and importers to invoice transactions in rupees** would optimize trade settlement formalities.
- **Liquid Bond Market:** RBI should focus on developing a more liquid rupee bond market, providing investment options for foreign investors and trade partners.
 - Also, **there is a need to recalibrate the foreign portfolio investor (FPI) regime** in order to enhance the speed at which the rupee is internationalized.
- **Expansion of RTGS system:** The **Real-Time Gross Settlement (RTGS) system** should be **expanded to settle international transactions**.
 - Also, providing tax incentives to foreign businesses utilizing the rupee in India would promote its use.
- **Currency Swap Agreements:** Increasing currency swap agreements, **as seen with Sri Lanka, would facilitate trade and investment transactions in rupees**.
 - Consistent and predictable currency issuance and retrieval, along with a stable exchange rate regime, are essential for maintaining confidence.
- **Inclusion in the SDR basket:** Rupee should be pitched to get included in **Special Drawing Rights (SDR), which is an international reserve asset** created by the **International Monetary Fund (IMF)** based on a basket of major currencies.
 - Also, Indian Government Bonds (IGBs) can be **included in global indices, attracting foreign investments into Indian debt markets**.
- **Lessons from China's Experience:** China's approach to internationalizing the Renminbi provides valuable insights for India:
 - **Phased Approach:** China **gradually enabled the use of the Renminbi** for current account transactions and select investment transactions before progressing towards its use as a reserve currency.
 - **Offshore Markets:** The establishment of offshore markets, such as the **Dim Sum bond and offshore RMB bond market**, facilitated the internationalization process.

Note:

- **Foreign Portfolio Investment (FPI):** It consists of securities and other financial assets passively held by foreign investors.
 - It is part of a **country's capital account** and is shown on its **BOP**.
 - It does not provide the investor with direct ownership of financial assets.
 - FPI is **more liquid, volatile and therefore riskier** than FDI.
 - It is often **referred to as “hot money”**.

- Examples - Stocks, [bonds](#), [mutual funds](#), [exchange traded funds](#).
- **Special Drawing Rights:**
 - SDR serves as the unit of account of the IMF, but it is neither a currency nor a claim on the IMF.
 - The SDR basket of currencies includes the US dollar, Euro, Japanese yen, pound sterling and the Chinese renminbi (included in 2016).

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)

Balance of trade

Foreign assets

Balance of invisibles

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: TH](#)

