



Rise of the Indian Rupee

This editorial is based on [Will rupee trade gain currency globally?](#) which was published in The Hindu Businessline on 23/07/2023. It talks about the de-dollarization and internationalization of Indian rupee.

For Prelims: [De-dollarisation](#), [Currency Swap Agreements](#), [Capital Account Convertibility](#), [SWIFT](#), [International Financial Services Centre](#), [Unified Payments Interface](#), [Special Vostro Rupee Accounts](#), [Reserve Bank of India](#)

For Mains: Benefits and Challenges of De-dollarization

In the realm of global trade, the **US dollar has long reigned supreme**, acting as the dominant currency **for foreign exchange transactions**, trade invoicing, and **reserve holdings**.

India's ongoing efforts to promote the **use of the rupee in international trade** represent a step towards [de-dollarisation](#) and **currency diversification**. While challenges remain, the **combination of export growth**, [capital account convertibility](#), and **sustained economic development** may pave the way for the rupee to gain currency globally.

The journey to reduce dollar dominance **requires concerted efforts, and success will depend on India's resilience and adaptability** in a rapidly evolving global economic landscape.

However, an increasing number of countries are recognizing the **inherent risks that come with an overreliance on the dollar**, including exposure to **US politics, sanctions, and exchange rate volatility**. As a response to these concerns, many emerging economies are actively pursuing efforts to de-dollarize their trade and diversify their currency usage.

What are the Trends in Currency Usage?

- **Use of Local Currencies in International Payments:**
 - [SWIFT](#) data indicates a rise in the usage of local currencies in international transactions between 2013 and 2019.
- **Non-Dollar-Denominated Trade on the Rise:**
 - The **Triennial Bank Survey of 2022** shows a marginal increase in the share of dollars in daily turnover, but emerging economies are increasingly engaging in non-dollar-denominated trade.
- **Rise of the Chinese Renminbi:**
 - In 2022, the **Chinese renminbi became the fifth most traded currency globally**, with over 70% of China-Russia trade settled in yuan and roubles.
- **Growth of Local Currency Bond Markets:**
 - Emerging market **local currency bond markets** expanded significantly from **2015 to**

2021, presenting an alternative to dollar-denominated assets.

What are India's Efforts to Strengthen the Rupee?

- **Establishment of the International Financial Services Centre (IFSC):**
 - India's first IFSC in **GIFT City, Gujarat**, aimed to promote the use of the rupee in **international financial transactions**.
- **Liberalization of Capital Markets:**
 - India increased the availability of rupee-denominated financial instruments, such as **bonds and derivatives, to enhance the rupee's appeal**.
- **Promotion of Digital Payment Systems:**
 - Initiatives like the **Unified Payments Interface (UPI)** have facilitated digital transactions in rupees.
 - Recently, France and Singapore have adopted UPI.
- **Introduction of Special Vostro Rupee Accounts (SVRAs):**
 - India permitted **authorized banks from 18 countries to open SVRAs** for settling payments in rupees at market-determined exchange rates.
 - Objectives of the Mechanism are lower transaction costs, greater price transparency, faster settlement time, and overall promotion of international trade.

What are the Opportunities for the Rupee's Global Standing?

- **Export Growth as a Catalyst:**
 - India's ambitious **export target of \$2 trillion by 2030** could contribute to improving the rupee's international standing.
- **Full Capital Account Convertibility:**
 - Achieving **full convertibility of the rupee would enhance its attractiveness** for international trade and investments.
- **Sustained Economic Growth:**
 - Higher and sustained **economic growth would strengthen India's position** in the global trade market.
- **Reducing US monetary Policy Influence:**
 - By reducing the use of the US dollar, countries **can reduce the influence of US monetary policy** on their own economies.
- **Improved Monetary Policy Effectiveness:**
 - Internationalisation **can enhance the effectiveness of India's monetary policy**.
 - With a broader international reach, the **Reserve Bank of India (RBI)** can use the exchange rate as a tool to manage inflation and stimulate economic growth.
 - It provides greater **flexibility in managing monetary conditions** and responding to economic challenges.

What are the Challenges and Limitations of Trade in Rupee?

- **High Dependency on Dollar Invoicing:**
 - Despite efforts, a **significant portion (86%) of India's imports is still dollar invoiced**, limiting the impact of de-dollarisation.
- **Non-Convertible Currency Concerns:**
 - Partner **countries may hesitate to engage in local currency trade** due to the rupee's lack of convertibility, leading to potential trade challenges.
- **Ballooning Rupee Reserves:**
 - Accumulation of rupees in partner countries' **reserves without adequate avenues** for its use may pose issues.
- **Exchange Rate Volatility:**
 - Internationalising the rupee exposes it to greater **exchange rate volatility**.
 - Fluctuations in the value of the rupee **can impact trade competitiveness, foreign investment flows**, and financial market stability.
 - Managing exchange rate risks becomes crucial in order to mitigate potential adverse effects.

▪ **Capital Flight and Financial Stability:**

- Opening up the rupee to international markets may lead to capital flight if **investors lose confidence in the currency or anticipate unfavourable** economic conditions.
- This can strain the country's foreign exchange reserves, impact financial stability, and create challenges for monetary policy management.

▪ **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 rupee to be used widely as an international currency.

▪ **Competing Currencies:**

- The rupee faces competition from established international currencies like the **US dollar, euro, and yen**, which enjoy widespread acceptance and liquidity.
- Gaining market share and displacing these dominant currencies **can be a significant challenge**.

What Should be the Way Forward?

▪ **Strengthening Currency Convertibility:**

- India should **focus on achieving full capital account convertibility** for the rupee.
- This will **enhance its attractiveness** as a viable currency for international trade and investments.
- Efforts to **liberalize capital flows and ease foreign exchange** controls are crucial in this regard.

▪ **Encouraging Bilateral Currency Arrangements:**

- India can explore **bilateral [currency swap agreements](#)** with partner countries to promote the use of the rupee in trade settlements.
- Such arrangements **can reduce dependence on the dollar** and foster stronger economic ties with other nations.

▪ **Leveraging Regional Initiatives:**

- India can collaborate with other countries in the region to **promote regional trade settlements** in local currencies.
- Participating in initiatives like the **Chiang Mai Initiative Multilateralization (CMIM)** can strengthen the use of Asian currencies in trade and reduce reliance on the dollar.

▪ **Diversifying Trade Partnerships:**

- India should **diversify its trade partnerships to reduce the concentration of imports** and exports with specific countries.
- Engaging with a broader range of trading partners will create opportunities for increased usage of the rupee in global trade.

▪ **Building Trust in Currency Stability:**

- Demonstrating prudent fiscal and monetary policies and maintaining currency stability will **instil confidence in the rupee as a reliable and stable currency** for international trade.

Drishti Mains Question:

How can India enhance the role of the rupee in global trade and reduce its dependency on the US dollar?

UPSC Civil Services Examination Previous Year's Question (PYQs)

Prelims:

Q. Recently, which one of the following currencies has been proposed to be added to the basket of IMF's SDR? (2016)

- (a) Rouble
- (b) Rand
- (c) Indian Rupee
- (d) Renminbi

Ans: (d)

Q. Consider the following statements: (2019)

1. Purchasing Power Parity (PPP) exchange rates are calculated by comparing the prices of the same basket of goods and services in different countries.
2. In terms of PPP dollars, India is the sixth largest economy in the world.

Which of the statements given above is/are correct?

- (a) 1 only
- (b) 2 only
- (c) Both 1 and 2
- (d) Neither 1 nor 2

Ans: (a)

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