



Local Currency Trade between India-Indonesia

For Prelims: [Reserve Bank of India](#), [Look East Policy](#), [Non-Aligned Movement](#), [G20](#), [East Asia Summit](#)

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

Source: [BL](#)

Why in News?

The [Reserve Bank of India \(RBI\)](#) and the [Bank Indonesia \(BI\)](#) signed a Memorandum of Understanding (MoU) for establishing a framework to promote the use of **local currencies (the Indian Rupee (INR) and the Indonesian Rupiah (IDR)) for cross-border transactions.**

- Earlier in 2023 [India and Malaysia](#) announced that they will settle trade in **INR** in addition to other currencies.



What are the Key Highlights of the MoU between RBI and Bank Indonesia?

- The primary objective of the MoU is to facilitate **bilateral transactions in INR and IDR**, covering **all current account transactions, permissible capital account transactions**, and other economic and financial transactions as mutually agreed upon by both countries.
- The framework enables **exporters and importers to invoice and pay in their respective domestic currencies**, thereby fostering the development of an INR-IDR foreign exchange market. This approach optimizes costs and settlement time for transactions.
 - It is expected to **promote trade between India and Indonesia**, deepen financial integration, and enhance the historical, cultural, and economic relations between the two nations.

INTERNATIONALISATION OF RUPEE

- MEANING**
 - Increasing the use of Indian rupee in **cross-border transactions**
- INVOLVES**
 - Rupee for **import and export**
 - Rupee for **current and capital account transactions**

Indian Rupee is fully convertible in current account, but partially in capital account (BoP)
- NEED**
 - Weaponisation of USD by US (for **sanctions**)
 - Wave of **de-dollarisation**
 - Increasing **internationalisation of Chinese Renminbi**
 - India's **minimal share in global forex market turnover (1.7%)**
- RBI'S EFFORTS**
 - Indian currency in cross-border trade – key component in **Foreign Trade Policy 2023**
 - Mechanism introduced for **rupee trade settlement with 18 countries**
 - » Banks from these countries allowed to open **Special Vostro Rupee Accounts (SVRAs)**
 - Circular on **"International Trade Settlement in Indian Rupees"** (2022)
 - External **commercial borrowings in INR** enabled
- SIGNIFICANCE**
 - **Reduced dependency on USD**
 - **Lesser need for holding forex reserves**
 - **Better bargaining power** of Indian business
 - **Less exposure to currency volatility**
- CHALLENGES**
 - Rupee not fully convertible
 - **Less need for other countries to hold INR;**
India's low share in global exports
 - Rupee may become **more vulnerable to external shocks**
 - **India's lesser control on Rupee supply**
- STEPS THAT CAN BE TAKEN**
 - **More liberalised settlements in INR** (in India and overseas)
 - India to **expand its reach** in the global financial market
 - **Transition to an export-oriented economy to reduce trade deficit**

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India-Indonesia Relations

- **Commercial Relations:**
 - Indonesia has emerged as the **second largest trading partner of India in the ASEAN region**.
 - Bilateral trade has increased from USD 4.3 billion in 2005-06 to USD 38.84 billion in 2022-23.
- **Political Relations:**
 - Both countries were chief **supporters of independence for Asian and African countries**, leading to the **Bandung Conference of 1955** and the formation of the **Non-Aligned Movement in 1961**.
 - Since India adopted the **'Look East Policy' in 1991**, there has been rapid development in bilateral relations.
 - Both countries are members of **G20, East Asia Summit** and the **United Nations**.
- **Cultural Relations:**
 - The **Hindu, Buddhist and later Muslim faiths** travelled to Indonesia from the shores of

India. The stories from the great epics of **Ramayana and Mahabharata** form a source of Indonesian folk art and dramas.

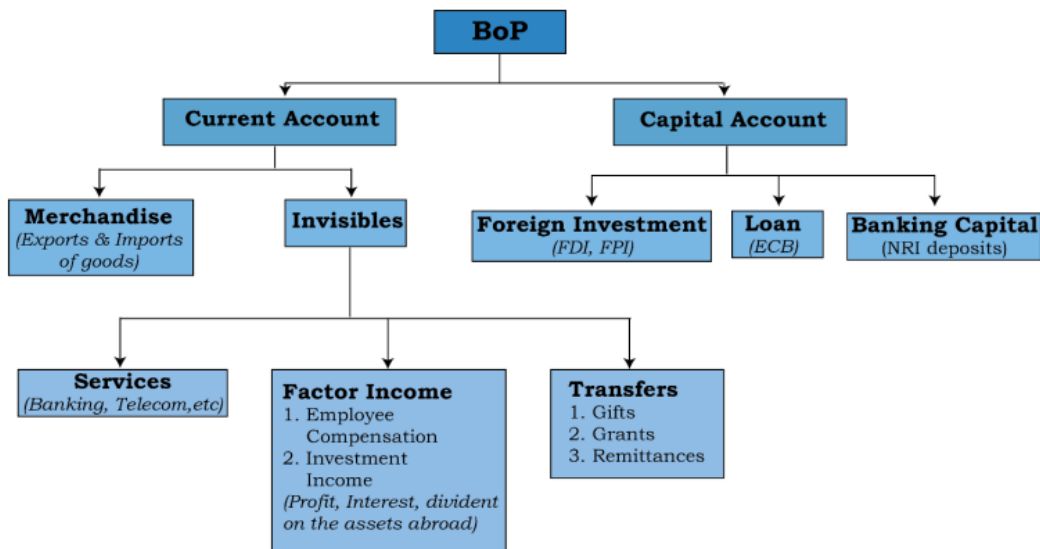
- There are approximately 100,000 people of Indian origin in Indonesia, mainly located in Greater Jakarta, Medan, Surabaya, and Bandung.

What are Efforts for the Internationalisation of the Rupee?

- **Liberalisation of Capital Markets:**
 - India increased the availability of rupee-denominated financial instruments, such as **bonds (Masala Bond) 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, **Sri Lanka and Mauritius have adopted UPI.**
- **Special Vostro Rupee Accounts (SVRAs):**
 - India permitted **authorized banks from 18 countries (Ex. Russia and Malaysia) to open Special Vostro Rupee Accounts (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.
- **Currency Swap Agreements:**
 - Signed by the RBI with several countries (Ex. **Japan, Sri Lanka** and **SAARC members**) enables the exchange of rupee and foreign currency between respective central banks, bolstering the international usage of the rupee.
- **Bilateral Trade Agreements:**
 - The government's signing of bilateral trade agreements with other countries has facilitated greater cross-border trade and investment, promoting the use of the rupee in international transactions.

Balance of Payments (BoP)

- The **Balance of Payments (BoP)** is a crucial indicator of a country's economic health, summarising its international transactions with the rest of the world.
 - Those transactions that **happen between Indian residents and Foreigners or nonresident Indians (NRIs)** are recorded in India's balance of payment.
- **Structure:** The BoP is broadly divided into two main accounts:
 - **Current Account:** This account reflects the **flow of goods, services, income, and current transfers.**
 - It deals with **transactions that do not change the overall assets or liabilities of Indian residents** abroad or foreign residents in India. It includes:
 - Exports and Imports of goods and services
 - Investment income (interest, dividends) and compensation of employees
 - Current transfers (gifts, aid, Remittances)
 - **Capital Account:** This account captures transactions involving **capital assets.**
 - It records transactions that **directly impact a country's foreign assets** and liabilities.
 - Acquisition or disposal of non-produced non-financial assets (land, intellectual property)
 - Includes **Foreign Direct Investment (FDI), Foreign Portfolio Investment (FPI),** Investing in businesses abroad, borrowing from foreign entities, and deposits made by **NRIs in Indian banks** are examples of capital account transactions.



▪ Forex Reserves:

- Indian forex reserves are vital assets held by the **RBI in foreign currencies.**
 - They serve as a financial cushion, ensuring liquidity to meet external obligations and stabilize the nation's currency and economy.
- **Components of Indian Forex Reserves:**
 - **Foreign Currencies:**
 - The Indian forex reserves mainly consist of foreign currencies such as the US Dollar, Euro, and British Pound. These currencies provide liquidity and facilitate international trade transactions.
 - **Gold Reserves:**
 - It is an essential hedge against inflation and a safety net during economic uncertainties.
 - **India has 800.78 tonnes of gold reserves.**
 - **Special Drawing Rights (SDRs):**
 - **SDRs** are international reserve assets the IMF has created. They supplement the foreign exchange reserves of the member countries.
 - The SDR is based on a basket of international currencies comprising the USD, Japanese yen, euro, pound sterling and Chinese Renminbi.
 - **Reserve Portion in IMF:**
 - The reserve portion in the IMF represents India's quota in the **International Monetary Fund**. It reflects India's position and voting power within this global financial institution.
 - Impact on Indian Forex Reserves: Strengthens international standing.

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)

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