Internationalisation of Rupee

India, which has the **third-largest purchasing power parity** and the **fifth-largest nominal GDP** in the world, uses the rupee as its official currency. Some of India's neighbours, like Bhutan and Nepal, also accept the rupee as legal money. It bodes well for the rupee's gradual internationalisation since Sri Lanka recently decided to legally incorporate it as a designated foreign currency.

But with a very small proportion in both commercial transactions and the worldwide foreign exchange market, the rupee is far from being a truly global currency. To make Rupee an international currency, RBI created Inter-Departmental Group (IDG), headed by RBI Executive Director **Radha Shyam Ratho.**

What is the meaning of Internationalisation of Rupee?

Internationalisation of the rupee is a process that involves increasing use of the local currency in cross-border transactions.

What are the important point of the Inter-Departmental Group?

The IDG claimed that because India is one of the nations with the greatest rates of economic growth and has displayed amazing fortitude even in the face of significant obstacles, the rupee has the potential to become an international currency.

According to the report, increasing the rupee's use in capital account transactions, foreign trade settlement, and invoices will give the home currency a stronger international presence.

Under which act, cross border trade transactions in INR is formulated ?

The broad framework for cross border trade transactions in INR under Foreign Exchange Management Act, 1999 (FEMA). It is as delineated below:

1. Invoicing: All exports and imports under this arrangement may be denominated and invoiced in Rupee (INR).
2. Exchange Rate: Exchange rate between the currencies of the two trading partner countries may be market determined.
3. Settlement: The settlement of trade transactions under this arrangement shall take place in INR in accordance with the procedure laid down by RBI

What are the ways for Internationalisation of Rupee given by IDG?

To internationalize the rupee, it was advised to make advantage of the existing bilateral and multilateral payment and settlement structures, such as ACU (Asian Clearing Union).

The ability to open accounts outside of the country where the currency is used is a fundamental component of a currency's internationalization, it was stated, thus non-residents should be permitted to create rupee accounts.

What are the advantages of internationalisation of rupee?

Some of the advantage are fairly obvious, as explained below:

i. Use of Rupee in cross-border transactions mitigates currency risk for Indian business. Protection from currency volatility not only reduces cost of doing business, it also enables better growth of business, improving the chances for Indian business to grow globally.

ii. It reduces the need for holding foreign exchange reserves. While reserves help manage exchange rate volatility and project external stability, they impose a cost on the economy. For example, there is a general agreement that India's reserves are borrowed funds. Banks and corporate incur external debt at market rates which are then invested in Government securities issued by advanced economies (AEs). The rate at which external debt is incurred is substantially higher than the return on reserves,. Assuming an interest differential of 2%, on a Reserve base of say USD 600 billion, the cost of reserves would work out to USD 12 billion, annually. This cost represents a transfer of income from India to AEs. Reducing the requirement of reserves would save some of this this loss of income. I

iii. Reducing dependence on foreign currency makes India less vulnerable to external shocks. For example, during phases of monetary tightening in US and strengthening dollar, excessive foreign currency liabilities of domestic business results in a de facto domestic tightening. The 'Taper Tantrum' episode in 2013 and the currency volatility experienced by most emerging market economies (EMEs) in recent months exemplify such risks. Reduced exposure to currency risk would substantially mitigate the pain of reversal of capital flows.
iv. As the use of Rupee becomes significant, the bargaining power of Indian business would improve adding weight to the Indian economy, enhancing India's global stature and respect.

What are the risks of internationalisation of Rupee?

i. India is a capital deficient country, and hence needs foreign capital to fund its growth. If a substantial portion of its trade is in Rupee, non-residents would hold Rupee balances in India which would be used to acquire Indian assets. Large holdings of such financial assets could heighten vulnerability to external shocks, managing which would necessitate more effective policy tools.

ii. A reduced role for convertible currencies in external transactions could lead to reduced reserve accretion. At the same time, 11 however, the need for reserves would also reduce to the extent the trade deficit is funded in Rupees.

iii. Non-resident holdings of Rupees could exacerbate pass-through of external stimulus to domestic financial markets, increasing volatility. For instance, a global risk-off phase could lead nonresidents to convert their Rupee holdings and move out of India.

These risks are real, but they are unavoidable if India is to progress to be an economic superpower. Macroeconomic policy would need to measure up to such risks. Internationalisation would make domestic monetary policy more challenging but the alternative of compromising on growth by playing it safe is clearly not an optimal choice. We need to calibrate our moves to the evolving size of our economy, particularly the size of the external sector and to our appetite for risk in framing policy for external trade and capital flows. But the direction is clear.

Note:
Last year in July, the RBI put in place a mechanism to settle international trade in rupees in order to promote growth of global trade with emphasis on exports from India and to support the increasing interest of the global trading community in the rupee.