Measures to arrest rupee depreciation

What is the issue?

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Indian rupee has been gradually declining and it is important to arrest its fall.

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Has rupee ever been internationalised?

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- The Indian rupee was once a multilateral currency, its usage prevalent across the Indian Ocean in places as varied as Java, Borneo, Macau, Muscat, Basra and Zanzibar.
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- The historic trade ensured that the Gulf had a familiarity with the rupee for over five centuries, with Oman utilising the ‘Gulf rupee’ till 1970.
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- The annexation of Sindh, Ceylon and Burma by the British encouraged the primacy of the rupee in these areas.
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- A number of Indian merchant communities had established themselves in such regions, aiding in its convertibility.
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- Even after Independence, Dubai and other Gulf states were using RBI-minted Gulf rupees until 1966.
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- Only after the 1965 war, devaluation of Indian rupee led to such nations switching to their own currencies.
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- Now, only Nepal and Bhutan regularly conduct bilateral trade with India in rupees.
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How has the depreciation scenario evolved?

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- The value of the rupee itself has varied over the years and it was never equal to the U.S. dollar.
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- In 1947, the rupee-dollar rate was at Rs.3.30.
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- The aforementioned devaluation in 1966 raised it to Rs.7.50, reaching Rs.32.4 by 1995.
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- This decline was precipitated by a variety of factors –
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1. Wars with Pakistan and China
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2. The adoption of Five Year Plans requiring foreign loans
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3. Political instability and the Oil Price Shock of 197
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- In recent times, the rupee has been declining due to higher oil prices and FII outflows from stocks and bonds.
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- The ongoing U.S.-China trade war, Iran sanctions and further upward movement in oil prices will continue to test the rupee's valuation.
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What are the measures needed?

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- **Increase usage** - RBI on its part should intervene in the forex market, sell non-resident Indian bonds and conduct issuance of sovereign bonds.
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- India should consider formalising the rupee payment mechanism with friendly countries such as Russia, with a focus on reducing its overall current account deficit.
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- This could pave the way for reducing rupee's dependency on the U.S. dollar.
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- Industrial growth should be a priority, so that sale of goods will necessitate

rupee swaps which will eventually lead to its institutionalisation in international markets.
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- **Black money** - The formalisation of the Indian economy by deterring black money transactions in the rupee is also much needed.
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- India’s black money strategy should consider four pillars —
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1. Encourage tax rate rationalisation
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2. Reform vulnerable sectors
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3. Support a cashless economy
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4. Create effective and credible deterrence.
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- Tax rate rationalisation, with lower tax rates as an end goal, would increase the tax base and increase compliance with tax returns.
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- Administrative agreements with countries like the U.K. and Switzerland which can offer mutual tax sharing should be encouraged.
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- **Administration** - A remittance database detailing company transfers out and NGO transfers into India could be created and all be made reported to the Financial Intelligence Unit (FIU).
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- The Direct Tax Administration’s Directorate of Criminal Investigation should be provided the right IT training, infrastructure and funding to become an effective deterrent
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- The audit cycles for income tax, service tax and excise tax departments should be aligned, helping the Large Taxpayer Unit (LTU) become more effective, increasing the scope of simultaneous scrutiny and examination.
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- **Internationalisation** - Chinese yuan is increasingly being positioned for an alternative reserve currency through a variety of multilateral trades and institutions such as the Belt and Road Initiative, the Asian Infrastructure Investment Bank etc.,
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- China campaigned hard for the inclusion of its currency in IMF’s benchmark currency basket in 2015, introducing a range of reforms to ensure that the yuan was considered as “freely usable”.
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- However, the rupee is currently not even in the top 10 traded currencies.
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- The RBI has adopted a gradualist approach, allowing companies to raise rupee debt offshore, enabling the creation of “masala bonds” and allowing foreigners to invest in rupee debt onshore.
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- The rupee has transformed from a largely non-convertible pegged currency before 1991 to a managed float.
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- However, institutional resistance against full rupee convertibility in capital account is still prevailing.
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- Hence, to restore the rupee’s multilateral nature, we must increase its usage in the international markets.
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Source: The Hindu

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