The Internationalization of the Rupee

Why in news?

The Reserve Bank of India (RBI) has put in place the mechanism for rupee trade settlement with as many as 18 countries.

What is internationalization of Rupee?

- **Internationalization of the Rupee –** It is the process of increased cross-border transactions involving the Indian currency.
- It corresponds to trade especially in import-export, current account transactions, and capital account transactions.
- **International settlement -** This would enable the international settlement of trade in Indian rupees in foreign trades, as opposed to other currency including US dollars.
- The goal of internationalizing the rupee is to make it a more widely accepted currency in international trade and investment.

What are the benefits of internationalizing rupee?

- **Mitigate exchange rate risk** - Internationalization of the INR can lower transaction costs of cross-border trade and investment operations by mitigating exchange rate risk.
- **Reduce risk** – Eliminates the risk of exposure to currency volatility faced by Indian businesses.
- **Exports becoming competitive** - Reducing currency risk can reduce the cost of doing business and can hence help in making exports more competitive in the global market.
- **Increased financial integration** - Help to integrate the Indian financial system with the global financial system.
- This could lead to increased investment and economic growth.
- **Reduced need for foreign exchange reserves** - The need to maintain foreign exchange reserves can reduce if a sizeable share of India's trade can be settled in terms of the domestic currency.

What are the challenges to internationalize rupee?

- **Process being complex** - Rupee-trade arrangements have not been easy to implement.
- Tarde arrangement with Russia is not yet fully operational even after a year-long engagement between the two partner countries.
- **Large trade deficit** - With Russia would saddle Russia since with large rupee balances, it would have to find a way to use or invest.

- **Small market** - The Indian economy is not as large as some other economies, so there is less demand for the rupee in the global financial markets.
- **Too much regulation** - The Indian government has a number of controls on the rupee and these controls make it difficult for the rupee to be used as a global currency.
- **Lack of liquidity** - The Indian rupee is not as liquid as some other currencies, so it can be difficult to buy and sell large amounts of rupees.

What is the way forward?

- India should learn from China's Experience of China's success in internationalizing the renminbi (RMB) and it also had trade surplus across the world.
- Currency swap agreements and creation of offshore market should be enhanced.
- Considerable thinking and planning would be required to make it function in a manner that does not adversely affect the economy’s fundamentals.
- Allow the settlement of foreign trade in rupees.
- Create special rupee-denominated bonds.
- Promote the use of the rupee in international payments.

References

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