

## Internationalising the Indian Rupee

Vinod Rai

### Summary

*The Reserve Bank of India had set up an inter-departmental group to ascertain the feasibility of internationalising the Rupee. The group has submitted its report. It has recommended several short, medium and long-term measures to achieve the objective. While the benefits of trade settlements in the Indian Rupee are significant, the path to internationalisation has many challenges and although the size of the Indian economy would qualify for internationalising the rupee, India's trade balance is in adverse. This would pose a significant challenge.*

The Reserve Bank of India (RBI) had formed an Inter-Departmental Group (IDG) to examine the feasibility of internationalising the Indian Rupee (INR). The objective of the IDG was to review the extant position of INR as an international currency and to frame a road map for its internationalisation. The IDG recently submitted its [report](#) containing its recommendations.

The report states that the internationalisation of a currency is closely linked to the nation's economic progress, especially its prominence in global trade. The report has recommended enabling the Rupee as an additional settlement currency in multilateral mechanisms such as the [Asian Clearing Union](#). It has also encouraged the opening of Rupee accounts for non-residents in and outside India, and integrating the Indian payment system with other countries for cross-border transactions. The report, inter alia, stated that the increasing use of INR in invoicing and settlement of international trade, as well as in capital account transactions, will give the local currency an international character.

The report has detailed several measures to boost Rupee's usage in international transactions. Short-term measures include designing a template and adopting a standardised approach for dealing with bilateral and multilateral trade arrangements for invoicing, settlement and payment in Rupee and local currencies. It recommends incentivising exporters to use Indian currency for trade settlement and seamless cross-border transactions. It has also recommended integrating Indian payment systems with other countries for cross-border transactions, strengthening financial markets by fostering a global 24x5 INR market, and promoting India as the hub for INR transactions and price discovery.

The medium-term measures recommended by the committee include synchronising tax regimes of India and other financial centres, and allowing banking services in INR outside the country, while in the long run, the objective could be to include the rupee in the International Monetary Fund's (IMF) special drawing rights basket.

### Benefits

For the Indian economy, counted among the world's top five economies, the advantage of greater usage of its currency in international transactions would be substantial. The most significant advantage would be that transactions in INR would bring down the exchange rate risk for Indian exporters and importers while curtailing the demand for the United States dollar. It would also reduce the need to maintain a forex reserve to manage external vulnerabilities. Subsequently, it would make the economy less vulnerable to sudden decline and reversals of capital flows. As the Indian economy grows and its trade linkages with other countries deepen, more space will be created for using the Rupee in international transactions.

In July 2022, the RBI allowed banks to settle international trade transactions in Rupees with 18 countries. However, the volume of transactions under this facility has been small. Whilst some oil import from Russia has taken place in INR, Russia prefers currencies like the Yuan or Dirham as the medium of transaction, despite India's sharp rise in oil imports. The Russian Deputy Prime Minister, Denis Valentinovich Manturov, said, "because of a lack of imports from India, it's not enough to use the rupee". Limited acceptance of trade transactions in the Rupee would prove a challenge to its internationalisation.

Internationalisation of the rupee would require its increasing usage in cross-border transactions – between residents in India and non-residents. It would require that all import and export transactions be settled with the Rupee as the currency of settlement. It would also necessitate further opening up of the currency settlement and a strong swap and forex market. Full convertibility of the currency in the capital account (allowing free movement of local financial investment assets into foreign assets and vice-versa) and Cross-border transfer of funds without any restrictions would be a pre-requisite for internationalisation. Presently, through bilateral agreements, the INR is an accepted currency in neighbouring countries such as Nepal and Bhutan, but these nations cannot use it for trading with a third nation. The INR is used and unofficially accepted in other neighbouring nations, such as the Maldives, Bangladesh and Sri Lanka.

## **Challenges**

To internationalise the INR or any other currency as a safe asset, the size of the economy is of primary importance. Whilst the Indian economy fulfils this criteria, the country's imports are larger than its exports and suffers from the disadvantage of a trade deficit. China's efforts to make its currency, Renminbi internationally acceptable, has met with only limited success though, post the Ukraine war, as some settlements with Russia in Renminbi are taking place.

In 1994, India accepted the Articles of Agreement of the IMF, making the Indian Rupee fully convertible on the current account. India also enabled external commercial borrowings in Rupees (like masala bonds, which are rupee-denominated bonds issued by Indian entities outside India). On the other hand, the RBI exercises a very tight control over India's Capital account. To internationalise the rupee, the free flow of capital has to be allowed. Even though the value of the Rupee is determined in the open market, RBI's open market operations help maintain its stability. The financial markets of India lack the capability in

terms of the range of financial products, the volume of financial products and the volume of assets traded.

Although Rupee-based trade is being encouraged by the government and the RBI, there is no move to permit full convertibility as it may lead to the flight of capital with attendant exchange risks. Thus, while the acceptance of the INR as a global currency is gaining, its internationalisation will still require cautious steps.

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Mr Vinod Rai is a Distinguished Visiting Research Fellow at the Institute of South Asian Studies (ISAS), an autonomous research institute in the National University of Singapore (NUS). He is a former Comptroller and Auditor General of India. He can be contacted at [isasvr@nus.edu.sg](mailto:isasvr@nus.edu.sg). The author bears full responsibility for the facts cited and opinions expressed in this paper.