

The downside to trade settlement in rupees

For this move to succeed, raising imports and exports and implementing major financial market reforms are vital

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The Reserve Bank of India's recently announced circular allows for International Trade settlements in Indian Rupees (INR).

This measure is aimed at facilitating the growth of global trade with emphasis on export from India and to support the interests of global trading community in Indian rupees.

It has also placed an additional arrangement for invoicing, payment and settlements of exports/imports in Indian rupees.

The Circular further states that exchange rate between currencies of two trading partner countries may be market determined and the entire process will be carried out using special VOSTRO account.

It is also stated that Rupee surplus balance accumulated in such account may be used for permissible capital and current account transactions in accordance with mutual agreement.

The decision to allow INR in international trade settlements is considered as an important step to facilitate trade with Russia, Iran and Sri Lanka. INR in international trade settlements is also expected to gradually contribute to the global acceptance of rupee for international trade transactions. However, this move by the RBI demands a close scrutiny considering the ever changing nature of global trade transactions.

Three issues deserve prominent

attention in the RBI decision to allow international trade settlements in rupee. First, international trade transactions to be settled in Indian rupee needs to be analysed from bilateral trade equilibrium to understand their potential scope and scale.

For example, in 2021, India's exports to Russia were at \$3.3 billion while its imports from Russia were at \$8.6 billion. This means that international trade settlement in rupee can happen up to \$3.3 billion where exports and imports are equal. Beyond this point, international trade settlement in rupee can get challenging.

However, the RBI has given the flexibilities that additional surplus generated through exports by partner country can be invested in Indian government securities and bonds without considering the fact that the rupee is not a convertible currency. Therefore, investment in government securities and bonds cannot be repatriated.

Moreover, this could potentially create macro-economic imbalances and possibly lead to a situation in the long run where India's trade deficit is financed with the surplus investment of trading partner in government securities and treasury bills.

Second, the international trade transactions that takes place between countries are shaped by various factors such as political and economic relations, availability of goods, quality and competitive pricing etc. Exchange rate happens to



Trade matters Promoting invoicing in Indian rupee will be a big challenge /ISTOCKPHOTO

be one of the factors in deciding trade. All elements have to be examined seriously which directly impact the landed cost for importers.

Currency depreciation

Depreciation of currency against US dollar and inflation play an important role. If the local currency depreciates against the dollar, it affects the pricing of imported and exported goods. Coupled with impact on custom duties the product becomes costly.

Not only this, if there is inflation then its impact is quite serious. Let us examine a few countries with which we either have a trade deficit or surplus.

The accompanying table shows that India has a trade surplus with Bangladesh, UK and Turkey while we have a trade deficit with South Korea, Thailand and South Africa.

The currencies of all these six countries have depreciated against the US Dollar by more than 10 per cent.

In Turkey, the depreciation of the local currency against dollar is al-

most 93.53 per cent. In such a situation, do we expect Turkey to import more from India even if we decide to have exchange rate fixed with Turkey (Indian Rupee and Turkish Lira without bringing US Dollar in the picture)? If the rate is to be market determined, how will Turkey respond? This problem becomes more serious if inflation is taken into account.

At the end, depreciation in local currency and inflation put together add substantial burden, which may make imports unviable even if rupee is used as a currency of invoicing.

Accepting the rupee

Third, India's efforts to promote invoicing in Indian rupee and acceptance of exchange with various countries is a herculean task. In the prevailing global trade protectionism and geopolitical rivalries, each country wants to promote exports and reduce imports.

It has another angle as well. Invoicing in Indian Rupee and not depending on US Dollar may upset India's relationship with the US.

It may also have an indirect impact on services sector for which we are dependent on developed markets like the US and Europe.

Other than this, India's share in global trade is not significant enough and our dependence for import of fossil fuels, edible oils, gold and silver etc. is quite large. It is unlikely that exporting countries will consider Indian rupee as a currency of invoicing, unless it suits their interests.

To promote rupee for international trade settlements, the first stage is that India should increase exports and imports so that rupee becomes a highly tradable currency. This should be supported by critical reforms in financial markets which include capital account convertibility, deepening financial markets coupled with large financial institutions other than the RBI to manage the large scale inflow and outflow of capital.

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Depreciation of Currency Against Dollar

Country Name	India total export (2021-22) US\$ million	India total import (2021-22) US\$ million	Currency	1-Jul-21	1-Jul-22	Depreciation in %	Inflation rate %
Bangladesh	16,129.73	1977.18	Taka	85.23	93.85	10.11	5.98
South Korea	8,085.03	17455.79	Won	1133.05	1297.27	14.49	6.00
United Kingdom	10,461.29	7017.68	Pound	0.73	0.83	13.78	9.10
South Africa	6,085.29	10965.81	Rand	14.47	16.53	14.27	5.73
Thailand	5,751.30	9332.54	Thai Baht	32.09	35.63	11.02	5.00
Turkey	8,716.13	1996.75	Turkish Lira	8.69	16.81	93.53	73.50
India	421,894.29	612607.6	Indian Rupee	74.56	79.05	6.02	6.08