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De-Dollarisation, Still A Far-Fetched Dream For India

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Modi government through various policies is aiming to make India more resilient to external shocks and strengthen its negotiating capabilities in international trade

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In a stunning revolution, Russia's Foreign Minister Sergey Lavrov in the Shanghai Cooperation Organisation (SCO) meeting said that it has accumulated billions of rupees in Indian banks, which it can't use.

"This is a problem," Lavrov said during the SCO meeting which took place in Goa and added that to utilise this money, these rupees need to be transferred in another currency and this is being discussed now.

It majorly started in 2022 when Vladimir Putin-led Russia invaded Ukraine. Several Russian banks opened Vostro accounts in rupees with authorised dealer banks in India. This initiative aimed to facilitate rupee trade between the two countries.

However, due to the rupee's limited convertibility, establishing a market-driven exchange rate for the rupee-rouble pair has proven challenging. Consequently, billions of rupees have accumulated in Indian bank accounts.

According to a Bloomberg report, an uneven trade relationship with India is forcing Russia to assemble up to USD one billion every month in Indian rupee assets that remain stranded outside the country, swelling the stockpile of capital it's amassed abroad since the Ukraine war.

Since the invasion, Russia became the biggest supplier of oil to India. As Europe reduced its purchases amid the war, Russia settled for a lesser share of trade in domestic currencies and redirected its shipments towards the east.

In April, the visit of the Deputy Governor of Moscow, Ekaterina Zinoveva region concluded with discussions on expanding the utilisation of national currencies. It was emphasised that payments can now be made in rupee and ruble, both within the territory of Russia.

The leading bank in Russia has a branch in India, which extends full cooperation to Indian investors, fostering bilateral relations. Additionally, officials from both nations are engaged in talks to explore avenues for boosting exports to Russia, particularly in sectors like electronics.

"Discussions are underway with Russian counterparts to explore options for converting the accumulated rupees into another currency. Trade between India and Russia has persisted despite the presence of sanctions and payment issues. Moreover, ongoing negotiations with Russia seek to address the obstacles arising from currency-related trade issues," said Saket Dalmia, President, PHD Chamber of Commerce and Industry (PHDCCI).

In pursuit of resolving these challenges, India is also working towards the launch of a SWIFT-like system. This system aims to facilitate paperless transactions for cross-border trade, providing a more efficient and streamlined process.

In order to promote the growth of global trade with emphasis on exports from India, the Reserve Bank of India (RBI) in July 2022 decided to put in place an additional arrangement for invoicing, payment and settlement of exports and imports in the Indian rupee.

The central bank last year stated that all exports and imports under this arrangement will be denominated and invoiced in rupees. The exchange rate between the currencies of the two trading partner countries is to be market-determined.

India has recently launched its new Foreign Trade Policy for 2023 (FTP) with an aim to position itself as a reliable and trustworthy trading partner. The primary objective behind this policy is to increase India's share in the global supply chain for exports. The Modi government has implemented several measures within the new FTP to enhance the ease of doing business in India, which is expected to have a positive impact on the country's exports in the years to come.

One of the key focuses of the FTP 2023 is trade facilitation through the use of technology and digitisation. The policy aims to promote e-commerce and introduces various schemes and measures to facilitate exports. In addition, the FTP 2023 places significant emphasis on the inclusion and empowerment of local vendors, highlighting the concept of "Local goes Global." This approach aims to create new job opportunities and enhance the overall performance of the country's trade sector.

"Overall, the FTP 2023 sets out a comprehensive roadmap to position India as a prominent player in the global trade arena. By implementing trade facilitation measures, leveraging technology, and promoting local vendors, India aims to enhance its trade performance and establish itself as a key player in the global supply chain for exports," added Dalmia.

Is de-dollarisation possible

According to experts, de-dollarisation by India is possible subject to many policy interventions. For converting the rupee to an acceptable global currency for trade transactions, India must become a trade surplus or at least a current account surplus. That will generate natural demand for the rupee in the currency market and arrest the chronic depreciation of the Rupee.

"For this, 'efficiency of the economy' must improve by reducing the cost of basic inputs such as capital, energy, logistics and minerals at a globally competitive level. Let's acknowledge that; during 2002-2011, the rupee was almost stable," said RP Gupta, Author and Economist.

Gupta added that for converting the rupee into an acceptable 'reserve currency', Indian institutions must improve transparency and win global trust that has been compromised in recent years.

"More so, 'net International liability' must be reduced and India should become a nation with 'surplus international assets'. That needs a viable financial innovation such as the modified gold-deposit scheme, a game changer," added the economist.

Dalmia also said that though the internationalisation of the rupee would involve major strategic moves by India's policymakers, India's new FTA 2023 extends all benefits for payments conducted in the Indian rupee, facilitated through special vostro accounts established as per the RBI guidelines.

Vijay Kalantri, Chairman, MVIRDC World Trade Center Mumbai said, "India is not entirely ready for de-dollarisation as there is no proven alternative mechanism globally to replace dollars in cross-border trade settlement."

He added that as a long-term step to reduce India's reliance on dollars and promote local currency, India has taken a few steps in the recent past. Many foreign banks have opened Vostro accounts with Indian banks to enable trade settlement in local currency in the recent past.

A challenging road ahead

Talking about the challenges on the road to de-dollarisation, the dollar continues to have a major share of 42 per cent in international payment and settlements, followed by Euro (32 per cent) and Chinese Yuan (3.51 per cent), as per SWIFT data.

Kalantri added, "If a country has to promote its currency in international payments and settlements as an alternative to the USD dollar, its currency should be freely convertible in the world forex market, with minimal transaction cost. In other words, there should be an active and liquid forex market for that currency.

He explained that a country should have a stable economy and open its financial market completely to foreign investors and allow unrestricted outflow of capital to foreign countries. Not many countries satisfy all these conditions together to promote their currency as an alternative to the US dollar.

Currently, the central banks across the world hold 58 per cent of their reserves in dollars, 20 per cent in Euros and 2.69 per cent in Chinese renminbi, according to the IMF COFER Database 2022. As the dollar continues to be a predominant reserve currency for most central banks, it is more liquid and hence more acceptable in the global forex market.

A lesson from the history

In 1944, about 44 leading nations signed the "Bretton-Woods Agreement" and accepted the US dollar (USD) as the global currency. During that period, the American central bank was holding the most extensive stock of gold and agreed to convert USD into gold on-demand basis. Subsequently, oil trading in dollars facilitated the wider acceptance of USD among other nations. However, due to the fluctuating price of gold, this agreement couldn't survive after 1971.

Interestingly, by that time, the USA had already demonstrated its economic strength, fire-power and space technology. It became the largest economy and a large energy producer, leading to innovation and research. More so, vibrant democracy and a free economy facilitated its wider acceptance.

Lately, other currencies such as Euro, British pound, Japanese Yen, China RMB/Yuan, Germany Mark, Swiss franc etc., were also accepted. Currently, about 80 to 90 per cent of trade transactions and about 60 to 65 per cent of forex reserves held in the world are in USD only. About 40 to 45 per cent of debt transactions are also in USD.

In about 2009, China attempted to develop a reserve currency. Despite being the second largest economy, it couldn't succeed much due to a lack of transparency, absence of democracy and global trust. However, in 2016, the Chinese RMB became one of the world's reserve currencies.

"It must improve global competitiveness and convert India into a trade Surplus and investment-friendly nation. India is holding the largest stock of private gold that can replace international liability with domestic liability through a tax-friendly gold-deposit scheme," Gupta added.

Utilising India's strength

According to the experts, India is a large democratic nation which enjoys global trust. It has a hidden growth potential that must be unlocked.

However, India's currency is not freely convertible as it has restrictions on capital account convertibility and the country's financial market is not completely open to foreign investors. Hence, it will take many years to make India's currency acceptable as a medium of exchange in the global market, as per the experts.

"In the near future, India may take the lead to revitalize and expand the Asian Clearing Union (ACU), which was launched in 1975 jointly by Nepal, India, Sri Lanka and other Asian countries to promote settlement of cross-border transactions in local currencies," Kalantri asserted.

India has a large workforce of talented youth and those must be gainfully deployed. If these strengths are rightly leveraged, the Indian rupee can be certainly recognised as a dominant global and reserve currency in future years and replace USD to a large extent. That will also improve diplomatic relations," added Gupta.

Meanwhile, small steps such as the opening of Vostro accounts are a decent beginning, however, there is a long way to go with well-established policy initiatives and structural reforms for India to achieve this far-fetched dream.