Discussion Papers

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Abstract: Random movements in national exchange rates particularly against major global invoicing currencies such as US dollar, euro, pound sterling, etc. cause uncertainty in export proceeds and import payments. Along with other hedging instruments, trade in local currency instead of global invoicing currencies could mitigate the adverse impacts of exchange rate volatility in the developing countries. Countries have explored the use of national currencies through various arrangements including currency swap arrangements and bilateral trade arrangements. India's rupee trade with Russia, East European countries, Nepal, Iran and other countries in the past is one such example. This scheme, which was actually conceived as a trade policy instrument in the 1950s through 1980s during the times when India faced severe foreign exchange constraint, is now being considered as a generalized policy option for mitigating exchange rate-related risks in trade. Against this backdrop, this paper examines the features of rupee trade arrangements with Nepal, Russia and Iran and its possible extension for a number of identified oil-exporting countries.

Keywords: Trade, exchange rate, currency swap.

1. Introduction

Countries consider trade in local currency as a solution to minimize the impact of exchange rate fluctuations on exports and imports and to popularize their own currencies for invoicing. India had experimented trade in local currency (called rupee trade) with Russia, Nepal, Bangladesh, Iran and East European countries such as Hungary, Rumania,

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Bulgaria, Poland, Czechoslovakia, East Germany, Yugoslavia in the past in its limited form.[1] The utility of this scheme was reflected in higher exports and imports between India and these countries. Although rupee trade with Iran is the most recent, with other countries especially Russia and East European countries India had rupee trade arrangements in the 1950s through 1980s. The experience of rupee trade in terms of realized exports and imports has been mixed and case-specific than overwhelming. In fact, the literature on this subject in the 1960s and 1970s suggested discontinuation of the scheme on the grounds of higher opportunity cost of trading in rupee trade area than in the convertible currency area.

In view of fresh sanctions on Russia and Iran by the United States in 2018 which disrupted India's oil payments in dollar and aggressive steps by China to internationalize renminbi, India has put emphasis on promoting greater use of rupee in international transactions in the recent years. Further, due to virtual closure of international payments and clearance in dollar, Iran and Russia wish to revive rupee trade with India so as to avoid any abrupt disruption in bilateral trade. While there is no definitive official position by India on the issues of reviving rupee trade yet, there is enough indication of considering the merit of this scheme at this juncture. In order to examine the pertinent issues relating to rupee trade, the Ministry of Commerce and Industry, Government of India constituted a Task Force in 2012. The Task Force Report favoured the idea of extending rupee trade to some oil-exporting countries such as Angola, Algeria, Nigeria, Oman, Iraq, Venezuela, Qatar, Yemen and Saudi Arabia.

Although it is hard to characterize the past regimes of rupee trade as a conscious strategy by India to promote local currency trade, the lessons from those countries provide valuable insights about the scope and mechanisms of any such scheme in the future. Moreover, it is not an exaggeration to view rupee trade scheme as a trade promotion strategy with an aim to exploit the geo-political environment (as in case of Iran). On the other hand, 'rupee trade' in its limited way has served as an instrument of cordial trade relations between India and the partner countries.

In that perspective, this paper attempts to highlight the essential features of non-dollar trade globally and regionally with exclusive focus on India's limited version of rupee trade. Further, the paper would examine the merits of continuing rupee trade and the feasibility of this scheme as a generalized policy instrument for export promotion.

2. Trends in Global Non-Dollar Trade

The US dollar (henceforth dollar or USD) enjoyed an unchallenged status of global invoicing and reserve currency until the introduction of euro (EUR) as a common currency for the European Union in 1999. Although the volume of trade invoiced in EUR, sterling (GBP), yen (YEN) and other currencies has increased in the 2000s, USD continues to remain the preferred currency for global trade and financial transactions. The growing perception of EUR as an alternative global reserve currency in the 2000s has not really affected the dominance of USD in global transactions. By and large, two currencies such as USD and EUR continue to maintain a near duopoly in trade settlements, invoicing and other financial transactions. However, over the years, there have been remarkable changes in the pattern of global currency use especially for emerging markets currencies, e.g. renminbi (RMB) for trade invoicing.

As per the Triennial Bank Survey of 2016 of the Bank of International Settlements (BIS), the percentage share of dollar-denominated trade in 2016 was 87.6 per cent of total world trade (out of 200 per cent[2]), followed by euro at 31.4 per cent. Interestingly, trade invoicing in other major currencies such as the Deutsche Mark/Euro, Yen, Pound Sterling, Franc, Australian Dollar and Swiss Franc witnessed an increase over time. The survey also hints at the significant elevation in the global status of a number of emerging market currencies. For instance, RMB became the most actively traded emerging market currency overtaking the Mexican peso to become the world's eighth most actively traded currency.

Several other emerging market currencies, particularly from the Asia-Pacific region, gained market share in the recent years. Korean won, Indian rupee and Thai baht were among the currencies whose rankings advanced by two or three places. In contrast, the turnover of some other currencies such as Mexican peso and Russian rouble which peaked in 2013 has exhibited decline in subsequent years. Both USD and EUR experienced fall in their global shares. The share of USD in global foreign exchange turnover has gone down from 89.9 per cent in 2001 to 87.6 per cent in 2016. Likewise, the share of EUR fell from 39.7 per cent in 2001 to 31.4 per cent in 2016. On the other hand, other currencies like, Australian dollar and Indian Rupee witnessed a rise in this period. Notably, the share of 'other currencies'[3] increased from 25.4 per cent in 2001 to 29 per cent in 2016 which possibly indicated the emergence of a multi-currency global financial market in the future (Table 1).

Among emerging market currencies, renminbi and Indian rupee have the potential to be considered as natural contenders for international currency status on account of the increasing economic competency of these two countries and their ability to withstand the adverse impact of the global financial crisis with relatively greater ease (Ranjan and Prakash, 2010). China has promulgated provisional rules governing the issuance of renminbi-denominated bonds by international development institutions which will allow non-residents to issue 'panda bonds' in Chinese markets. Further, the People's Bank of China (PBC) has entered into a series of bilateral currency swap agreements whereby the PBC and other central banks have agreed to exchange renminbi (not the dollar) with the respective counterparty currencies, mainly for supporting trade between these countries. In addition, Hong Kong is increasingly becoming an offshore renminbi trading center and the Chinese government is giving full support to its emergence as the global financial centre.

While Chinese authorities are taking numerous steps to facilitate internationalization of renminbi which is visible in transactions with its neighboring economies, India's approach in this context is gradual as current account is fully convertible but a calibrated approach is envisioned for the capital account. While foreign investment flows, especially direct investment, are encouraged, debt flows in the form of external commercial borrowings are generally subject to certain ceilings and with some end-

Table 1: Currency Distribution of OTC Foreign Exchange Turnover

(Per cent)

Currency	2001		2007		2010		2013		2016	
	Share	Rank	Share	Rank	Share	Rank	Share	Rank	Share	Rank
US Dollar	89.9	1	85.6	1	84.9	1	87.0	1	87.6	1
Euro	37.9	2	37.0	2	39.0	2	33.4	2	31.4	2
Japanese Yen	23.5	3	17.2	3	19.0	3	23.0	3	21.6	3
Pound Sterling	13.0	4	14.9	4	12.9	4	11.8	4	12.8	4
Australian Dollar	4.3	7	6.6	6	7.6	5	8.6	5	6.9	5
Swiss Franc	6.0	5	6.8	5	6.3	6	5.2	6	4.8	7
Indian Rupees	0.2	21	0.7	19	0.9	20	1.0	20	1.1	18
Chinese Renminbi	0.0	35	0.5	20	0.9	17	2.2	9	4.8	7
Other Currencies	25.2	-	30.7	-	28.5	-	27.8	-	29.0	-

Source: Compiled from BIS (2016).

use restrictions. India has some lessons to learn from the ways in which Chinese have pushed for internationalization of RMB and its subsequent inclusion as the first emerging market currency in IMF's Special Drawing Rights (SDRs) basket currencies.

Table 2: Shares of Home and Major Currencies for Export Invoicing in Europe and Asia-Oceania

Country	Home Currency		Foreign/International Currency					
			USD		Euro		Yen	
Europe	**1995**	**2012**	**1995**	**2012**	**1995**	**2012**	**1995**	**2012**
Germany	74.7	64.6	-	25.6	74.7	64.6	0.9	-
Belgium	-	56.6	-	-	-	56.6	-	-
Denmark	-	18.3	-	33.7	-	22.3	-	-
France	51.7	48.4	18.6	38.5	10.5	48.4	1.0	-
Italy	40.0	72.6	21.0	24.3	18.0	72.6	0.6	-
Netherlands	43.8	56.4	20.6	37.6	18.5	56.4	0.6	-
UK	61.6	51.1	23.1	28.8	4.0	3.1	1.1	0.4
Asia-Oceania	-	-	-	-	-	-	-	-
Japan	37.6	39.4	51.5	50.3	2.4	5.4	37.6	39.4
Australia	-	13.7	-	84.0	-	1.0	-	1.9
New Zealand	-	22.0	-	59.0	-	5.4	-	1.9
India	1.8	-	80.9	88.4	5.4	7.0	0.5	0.1
Indonesia	-	0.8	94.3	93.3	0.5	1.3	1.5	1.4
Korea	0.1	2.2	88.0	85.1	2.4	5.5	7.3	4.3
Thailand	2.4	10.0	91.0	79.7	0.5	2.2	4.1	5.9

Source: Auboin (2012).

Interestingly, a stylized pattern has been observed in the currency use pattern. Developed economies have used their home currencies for export invoicing whereas developing economies in the Asia-Oceania region have relied heavily upon dollar and to a significant extent on euro and yen for export invoicing (Table 2). However, among the developed countries (European countries here) the use of home currency has declined slightly whereas the use of dollar and euro has increased considerably from 1995 to 2012. Among the countries in the Asia-Oceania region, although countries like Japan, Australia, New Zealand, India, Indonesia, Korea and Thailand have started using more of their home currency for export invoicing, the share of USD still remained high.

Table 3: Currency-wise Invoicing Pattern of India's Exports and Imports

Currency	2009-10	2010-11	2011-12	2012-13	2013-14
Exports					
Pound Sterling	2.81	2.47	2.31	2.31	2.43
US Dollar	84.75	86.41	87.01	88.41	86.58
Japanese Yen	0.35	0.22	0.26	0.15	0.10
Euro	10.13	8.88	8.14	6.97	7.41
Other Currencies	1.96	2.02	2.28	2.16	3.48
Imports					
Pound Sterling	0.66	0.71	0.50	0.42	0.53
US Dollar	83.91	85.38	88.67	86.06	86.28
Japanese Yen	1.98	1.73	1.41	1.47	1.10
Euro	12.61	11.13	8.29	9.44	8.78
Other Currencies	0.84	1.05	1.13	2.61	3.31

Source: RBI (2014).

The invoicing pattern of India's exports and imports has not changed over the years. Dollar still account for more than 85 per cent of country's total exports and imports. As per 2013-14 data, the share of dollar was 86.58 per cent in India's export invoicing followed by euro (7.41 per cent), other currencies (3.48 per cent) and pound sterling (2.43 per cent). Despite modest rise or fall in-between the proportion of export invoicing in dollar has gone up from 84.75 per cent in 2009-10 whereas the share of euro has fallen from 10.13 per cent in 2009-10 to 7.41 per cent in 2013-14. It is interesting to note the elevation of other currencies in country's export invoicing from 1.96 per cent in 2009-10 to 3.48 per cent in 2013-14. The structure of invoicing is more or less similar for Indian imports (Table 3).

3. India's Bilateral Trade with Rupee Trade Partners

As mentioned above, India has implemented rupee trade with a number of countries including Nepal, Russia and Iran. This section highlights the current trends in India's exports and imports with these three countries with an aim to identify any discernible patterns which would help formulate any decision of continuing or reviving rupee trade with them. Being a small country, Nepal accounts for minuscule proportion of India's total exports and imports. In 2017, exports to and imports from Nepal constituted 1.9 per cent and 0.1 per cent of India's total exports and imports (Table 4). In comparison, India's share in Nepal's global exports stood at 56.6 per cent at the end of 2016. It was as high as 67.9 per cent in 2006. India's share in Nepal's imports, too, increased from 36.6 per cent in 2000 to 70.1 per cent in 2016 while Nepal's share in India's imports has declined from 0.5 per cent in 2000 to 0.1 per cent in 2016.

Table 4: India's Trade with Nepal, Iran and Russia

($ Million)

Year	Nepal		Iran		Russia	
	Exports	**Imports**	**Exports**	**Imports**	**Exports**	**Imports**
2003	605.1 (1.02)	291.5 (0.40)	893.0 (1.50)	267.7 (0.37)	696.3 (1.17)	784.9 (1.08)
2010	1904.9 (0.86)	505.7 (0.14)	2509.3 (1.14)	11078.3 (3.16)	1393.2 (0.63)	3591.6 (1.03)
2015	3195.1 (1.21)	489.6 (0.12)	3126.9 (1.18)	6225.3 (1.59)	1611.9 (0.61)	4527.1 (1.16)
2016	4526.2 (1.74)	385.3 (0.11)	2412.5 (0.93)	8253.7 (2.31)	1813.9 (0.70)	4782.0 (1.34)
2017	5518.0 (1.87)	413.6 (0.09)	2596.8 (0.88)	11089.4 (2.50)	2139.0 (0.73)	7980.6 (1.80)

Source: UN-COMTRADE accessed on January 24, 2019.

Note: Figures in parentheses represent share in India's world total.

In case of Iran, one would expect a dramatic turnaround in India's exports and imports following imposition of sanctions on Iran by the United States in 2012 as India offered Iran the provision of rupee payments. Rupee trade has resulted in some increase in India's exports and imports but not to an extent that significantly alters Iran's position in India's global trade. Similarly, the magnitude of India's exports to and imports from Russia in the 2000s has increased without significantly altering Russia's share in India's global trade. It is also hard to decipher the impact of rupee trade facility with Russia as it was implemented long back. However, the recent trends in exports and imports with these countries may indicate the possible revival of rupee trade. It may also provide clue to formulate a broad-based rupee trade arrangement with other trade partners which has implications for rupee internalization as well.

4. Features, Efficacy and Lessons from Rupee Trade

There is a growing body of literature that argues in favour of local currency use for trade and financial settlements. It would not only help countries to minimize the risks associated with exchange rate fluctuations but also contribute to building trust and acceptability of local currencies in domestic and regional financial markets. Chaturvedi (2014) highlights the growing interest among the developing countries for mutually-beneficial currency swap arrangements as a modality of promoting South-South cooperation. Based on the objectives, design and implementation of rupee trade in the past, Dash (2018) underscores the importance of using this mechanism as an instrument of furthering cooperation among the Southern countries. India has a history of accepting and providing payments in rupee in connection with trade. India had rupee trade with a number of countries including Russia, Nepal, Iran, Bangladesh and a few East European economies. Presently, Indian rupee is officially accepted in Nepal and Bhutan as a means of settlement of payments. Furthermore, as per RBI (2010)[4], there is some evidence that Indian rupee is accepted in Malaysia, Singapore, Hong Kong, Indonesia, UK and Sri Lanka. The need for trade settlement mechanism in Indian rupee is to increase bilateral trade ties between India and trade partners and to strengthen home currency for optimum benefit to the exporters/importers (Mishra, 2013).

As part of the recommendations provided by the Task Force, India aims to target South Asian economies for promoting rupee trade as India is the largest trade partner in the region and is in a strategic position to manage such an arrangement. Hence it would be beneficial for India to do trade in rupees with its neighboring countries like Pakistan, Myanmar, Sri Lanka, Bangladesh, and Nepal. The Task Force also recommends engaging in trade in local currencies with developed countries like Australia, Japan, Korea, Canada, etc. India has been exploring this option with major trading partners, including Singapore and Japan. Furthermore, India also considers oil-exporting countries such as Angola, Algeria, Nigeria, Oman, Iraq, Venezuela, Qatar, Yemen and Saudi Arabia and some non-oil exporting countries for establishing rupee payment arrangement. China has shown keenness to start a yuan-rupee trade, and India is hopeful that Japan may also show interest in accepting rupee payments.[5] Additionally, the government of India has also signed/extended Currency Swap arrangements with a number of countries including Japan, Sri Lanka, Bhutan and SAARC nations. The RBI also signed an MoU to consider a currency swap agreement with the central bank of United Arab Emirates (UAE). The proposed agreement aims to further strengthen the close economic relationship between India and UAE.

In that perspective, this section briefly describes the rupee trade arrangements India had implemented with Nepal, Russia and Iran, and assesses effectiveness of rupee trade in expanding India's exports and imports.

Nepal

India has a strong trade linkage with Nepal which is governed by Treaties of Trade and Transit and Agreement of Cooperation to Control Unauthorized Trade signed in 1971, 1978, 1996, 2002 and 2009. Under the treaties of trade with India, Nepalese manufactured products are allowed on non-reciprocal basis to India free of basic customs duty on the basis of Certificate of Origin issued by the Government of Nepal designated authority, FNCCI. India renewed its treaty of trade with Nepal in 2009 and one of the most important feature of the renewed treaty was that: “Both Contracting Parties shall make provisions so that no discrimination will be made in respect of tax, including central excise, rebate and other benefits to exports merely on the basis of payment modality and currency of payment of trade.” This would be made effective from the date to be mutually agreed to, after which the Protocol to Article III would become redundant” (This change has come into effect from 1st March 2012). As a result, imports from India are normally paid in Indian Rupees, since the currency is fully convertible in Nepal except for some specified products as laid down by the Government of Nepal, the imports of which are permitted only on payment in hard currency. The excise duty levied on goods imported from India and paid in Indian currency is refunded to the Government of Nepal.[6]

Indian exporters can avail benefit of export promotion schemes prevailing in India, making these products more competitive in Nepal either for sale or for further value addition. Furthermore, there is no restriction on invoicing of export contracts in rupees. Export proceeds may also be realized in rupees, provided it is through a freely convertible Vostro account. Free foreign exchange remitted by the buyer to its non-resident bank (after deducting bank service charges) on account of this transaction would be taken as export realization under export promotion schemes envisaged in the Foreign Trade Policy 2015-2020 (Govt. of India, 2015). There is no bar on realization of export proceeds in conformity with the above provisions under the excise laws or for payment of drawback. At present, there is not much information at our disposal to assess the effectiveness of rupee trade with Nepal.

Russia

India and Russia (then USSR) signed the Rupee Trade Agreement in 1953 which enabled both countries to settle bilateral trade transactions in respective local currencies. As per the arrangement, both parties were supposed to settle their payments in rupee based on a pre-determined exchange rate. It was believed that this rupee-rouble clearing arrangement had contributed to growth in bilateral trade between India and Russia during 1951-1990 (Maitra, 1986). For instance, India’s exports to USSR and East European countries increased from less than one per cent of total exports in 1950s to 24 per cent in 1972-73. Likewise, imports to India from these countries increased from less than one per cent of country's total imports to 12.4 per cent in 1972-73 (Patil, 1977).

This arrangement collapsed in 1991 with the disintegration of the USSR. The formal announcement of termination of this arrangement was made during the visit of the Secretary of State of the Russian Federation, Gennady Burbulis to India in May 1992 (Gidadhubli, 1992).[7] The reasons for discontinuation of India-Russia rupee trade by both the countries include Russia's foreign policy shift towards the hard currency area especially Finland and Germany, demand for hard currency payment for defence exports by the Russian enterprises, loss of complementarity, refusal of Letter of Credit by India to Russia, outflow of dollar to Russia as part of the hard currency component of the rupee trade agreement, artificially high exchange rate between India and Russia, among others. In subsequent years, bilateral trade fell drastically due to several domestic factors in Russia along with multiplicity of trade channels such as Debt Repayment Account, Hard Currency Account and so on. Since then trade between the two countries were invoiced in global currencies as per the market exchange rates.

After more than two decades of trade in convertible currencies, both the countries now increasingly recognize the need for reviving the rupee trade agreement. India and Russia has been discussing the possibility of trade in national currencies and formulating the specific mechanisms associated with it for the past few years (Kuzmin, 2014; Mallick, 2015). This was reiterated by the Russian Economic Minister during his visit to India in October 2018. To quote him, "Our country is looking at an investment protection and avoidance of double taxation agreement with India....We are also looking at trade in national currencies and a strategy for economic cooperation" (Business Line, 2018). The Minister cites the rationale in view of the sanctions by the United States on Russia which disrupt bilateral trade in dollar. While India is considering rupee payment arrangement with some oil-exporting countries, the possibility of reviving rupee trade with Russia is being discussed. Although there is no indication whether the proposed arrangement is likely to be considered or not, the Commerce and Industry Minister of India has appreciated Russia's proposal as a positive step as long as it does not affect the country's balance of payments position and highlighted the possibility of a mutually beneficial trade in diamonds. Since India is a hub for cutting and polishing of diamonds and Russia has huge reserves of diamond, the rupee trade scheme may be a win-win case for both the countries.

Following announcement of US sanctions, billions of India's defence payments to Russia was affected in 2018. The issue of rupee-rouble trade was discussed in the 24th meeting of Indo-Russian working group on banking and financial matters held in August 2018 in the Russian city of Tula which inspired a meeting later between Indian and Russian banks operating in India including Vnesheconombank, Sberbank and VTB (Kondratieva, 2018). At the same time, there is the fear of Russia accumulating huge stock of rupees which may affect trade and currency valuation in the future (The Telegraph, 2018).

The success of the India-Russia rupee trade has to be evaluated from diverse angles than just the rise in exports and imports over a four-decade long period. Both India and Russia did benefit from this agreement during the planning era when foreign trade policy was regulated and the state trading organizations in both the countries ensured the implementation of the agreed basket of goods for exchange in annual trade plans. It also insulated the country from global competition and provided a protected market especially in an era when foreign exchange reserves were not very high to adequately cover import payments in hard currency. However, rupee trade had several shortcomings which were mostly exposed when both India and Russia introduced reforms in their domestic economies by embracing market economy and massive privatization and liberalization. It was observed that trade complementarity between the two countries, which was the basis for rupee trade in the 1950s and 1960s, was lost in subsequent years due to structural changes in domestic economies and global competition. The complexity of managing surplus rupee by Russia or servicing debt to Russia by India had also surfaced as a key determinant of the continuation of rupee trade in that period.

Iran

The motivation for rupee trade arrangement with Iran was to facilitate continuous supply of oil imports to India in view of the US sanctions on Iran in 2012. On the Iranian side, the need for this arrangement was equally important as the settlement of international payments in dollar by Iranian banks was closed. As per this arrangement, India was entitled to make import payments in rupees up to 45 per cent of the total import bill and Iran had the option of using its export proceeds in rupee for purchase of goods and services from India. Since February 2013, Iran had started making payments in rupees to Indian exporters; India too, has been paying 45 per cent of its Iran Oil bill in Indian rupees through UCO Bank branch in Kolkata. The balance was paid in Euros in Turkey. As per Article 2.53 of the Foreign Trade Policy (2015-2020) "Export proceeds realized in Indian rupees against exports to Iran are permitted to avail export benefits/incentives under the Foreign Trade Policy (2015-20) at par with export proceeds realize in freely convertible currency." Although trade between India and Iran grew following the implementation of the scheme, it was difficult to assess whether the rise in trade can be entirely attributed to the effectiveness of rupee trade arrangement. Regardless of the experience of this phase of rupee trade, Iran is willing to initiate rupee trade with India after fresh sanctions were imposed on Iran in 2018.

Table 5: Factors Determining Success of India's Rupee Trade

Factors	Concerns	Rupee Trade Arrangement
Balanced Trade	Positive trade balance of India with rupee trade partners is not healthy as surpluses cannot be set off against deficits and debt servicing obligations elsewhere. Likewise, deficits would require India to export more to the rupee trade partners.	• India-East European countries in the 1960s • India-Russia in the 1960s • India-Bangladesh in 1975

Table 5 continued...

Table 5 continued...

Provision of Letter of Credit	As exports from India may not exactly match imports from a single rupee trade partner at various points of time, the need for letter of credit frequently arises.	• India-Russia • India-East European Countries
Annual Trade Plan	Target volume and value of each commodity to be exported and imported during a year. Although the actual trade may differ, it would help the country prepare accordingly.	• India-Russia
Participation of Private Enterprises	Centralised planning and state monopoly over foreign trade in Russia and Eastern European countries before 1991, and India's regulated trade regime through quotas, controls and licences ensured success of rupee trade. Private enterprises may not oblige to this type of payment arrangement.	• India-Russia • India-East European Countries
Trade Complementarity	India and rupee trade partners should continue to trade in similar goods as agreed under the agreement. Otherwise, loss of complementarity would lead to random accumulation of surpluses and deficits by either party and become irrelevant for country's development.	• All rupee trade arrangements
Risk of Higher or lower Unit Prices of Traded Goods/ Supply of Inferior Quality Goods	As per the agreement, India may end up exporting goods at a low price or import at a higher price compared to prices in the currency convertibility area. India may import inferior quality goods from rupee trade partners in exchange of its exports.	• All rupee trade arrangements
Switch Trade	Goods exported from India are diverted to third countries for earning foreign exchange.	• India-East European countries

Source: Compiled from Economic and Political Weekly (1978, 1975, 1971, 1969, 1968, 1966). Gidadhubli (1999,1992,1990); Patil (1977).

With respect to contribution of rupee trade to India's trade expansion, the evidence is mixed even though the rationale has been pretty strong at different points of time of its introduction. The primary motivation behind rupee trade in the 1950s was to ensure healthy growth of trade particularly imports of capital goods. From that angle, rupee trade with Russia and East European countries was quite unique and effective in developing basic industrial sectors including power, iron and steel, mining and heavy engineering (Gidadhubli, 1992). However, the rupee trade with Iran was entirely different as it appeared as a temporary solution to the disruption in dollar payment channel. With Nepal, rupee trade was more or less a facilitating mechanism for trade given the historical relations with the kingdom. Some of the factors that explained the success of rupee trade in the past are listed in Table 5. For instance, in a couple of instances, there was a need for letter of credit to adjust the surpluses or deficits accumulated due to inability of a party in fulfilling the matching volume of exports or imports. In that sense, balanced trade was the necessary condition for smoothing operation of rupee trade between India and other countries. Another angle to the success of rupee trade during planning era was the complementarity of goods that India and its rupee trade partners had traded among them. Since rupee trade was a special trade arrangement between two countries, the goods chosen for this purpose were carefully identified taking into account the development priorities of the two countries. In the 1980s, Russian exports to India were not really in the interests of India as other global competitors acquired an edge over Russian competitiveness in those products. The allegations of trade in inferior goods in rupee trade area compared to free convertible currency area were not entirely baseless as the global market conditions made those goods cheaper in subsequent years unlike the 1950s and 1960s. In that case, the effectiveness of rupee trade in promoting India's trade was country-specific and mixed.

5. Extension of Rupee Trade

Besides Nepal, Russia and Iran, the Government of India is considering similar payment arrangements with a number of oil-exporting countries. While huge trade deficits with these oil-exporting countries is the prime trigger for forming a rupee trade arrangement, it is imperative to examine holistically this move based on historical experience as well as future developmental imperatives. Sen (2016) analyses the historical context in case of rupee trade with Russia during the Soviet era and identifies the conditions for implementing the scheme now. In this context, the trends in India's trade with the existing and prospective rupee trade partners are presented in Tables 6 and 7.

Table 6: Trends in India's Trade with Existing and Potential Rupee Trade Partners

Country	Export Growth (2003-07)	Import Growth (2003-07)	Export Growth (2008-17)	Import Growth (2008-17)	Exports (2017) ($ Mn)	Imports (2017) ($ Mn)	Trade Balance ($ Mn)
Oil-Exporting							
Angola	38.3	995.5*	-3.8	13.8	233.4	4118.3	-3884.9
Iraq	27.2	1794.9*	14.2	5.4	1257.8	15310.0	-14052.2
Nigeria	15.3	199.7	4.7	-2.1	2063.6	8343.0	-6279.4
Qatar	40.9	89.8	6.4	10.1	1181.7	8099.7	-6918.0
Saudi Arabia	33.3	121.6	-0.3	-0.9	5217.5	21086.8	-15869.3
Venezuela	55.5	309.8	-6.1	4.1	81.7	5898.1	-5816.4
Non-Oil Exporting							
Nepal	19.6	12.7	14.0	-4.6	5518.0	413.6	5104.4
Bhutan	-4.4	39.9	15.9	2.9	401.7	207.0	194.7

Source: Analysis based on data from UN-COMTRADE accessed on January 24, 2019.

Note: Export and import growth rates are compound annual growth rates.

It is observed from Tables 6 and 7 that India has a huge trade deficit with the oil-exporting countries. In 2017, trade deficit reached approximately $53 billion which constitute substantial portion of India's overall trade deficit. The value of total imports from these countries together accounts for 14 per cent of country's global imports. Since oil and petroleum products dominate trade with those countries, it would be appropriate to examine the trends in these categories of products. In terms of trade in minerals fuels (HS27), trade deficit hovered around $56 billion in 2017, out of which crude oil contributed 84 per cent ($47 billion). It indicates the amount of foreign exchange required to service trade deficits and provides the rationale to push for rupee trade as India is net oil-importing country. In recent years, even though India's trade deficit with these six oil-exporting countries has declined due to an overall fall in imports, low petroleum and commodity prices, and subdued global demand, the deficit still remains sufficiently high especially with countries like Iraq, Saudi Arabia and Venezuela. Saudi Arabia is India's fourth largest trading partner and is a major source of energy supply as India imports around 19 per cent of its crude oil requirement from the Kingdom. Moreover, India's imports from Saudi Arabia, which are mostly oil imports, constituted over 13.7 per cent of India's total stock of foreign exchange (only dollars) in 2013 whereas imports from Iraq, Venezuela, Qatar, Nigeria and Angola constituted 7.5 per cent, 5.6 per cent, 5.5 per cent, 4.9 per cent and 2.3 per cent of foreign exchange reserves respectively. From this angle, the oil-exporting countries are natural contenders for India's rupee trade or currency swaps arrangements.

Table 7: India's Trade in Oil and Petroleum Products with Potential Rupee Trade Partners

($ Million)

Country	Mineral Fuels (HS 27)					Crude Oil (HS 270900)		
	X (2017)	M (2017)	TB	CAGR (%) (2013-2017) (X)	CAGR (%) (2013-2017) (M)	M (2017)	TB	CAGR (%) (2013-2017) (M)
Angola	0.51	3525.1	-3524.6	167.2	-14.9	3130.7	-3130.7	-17.4
Iraq	164.2	15241.5	-15077.3	264.5	-6.7	15241.4	-15241.4	-6.6
Nigeria	33.1	8154.4	-8121.3	-2.7	-12.0	7249.3	-7249.3	-13.8
Qatar	51.9	7025.1	-6973.2	-1.2	-15.0	1345.2	-1345.2	-23.6
Saudi Arabia	426.5	16806.8	-16380.3	-50.1	-15.5	14344.6	-14344.6	-17.7
Venezuela	-	5891.3	-5891.3	0	-20.8	5891.3	-5891.3	-20.8
Total (Six Countries)	676.2	56644.2	-55968			47202.5	-47202.5	

Source: Analysis based on data from UN-COMTRADE accessed on January 24, 2019.

Note: During 2014-16, exports of mineral fuels have not changed much. India has not exported crude oil (HS 270900) to these six countries during 2013-17 except to Saudi Arabia in 2014.

6. Chinese Approach of Local Currency Trade and Renminbi Internalization

China has moved far ahead of other countries in internationalizing its currency at the global level. Although China's increased trade with rest of the world contributed to the smooth elevation of renminbi in that direction, the Chinese government has embarked upon an aggressive policy of popularizing its currency at the international level. Some of these measures warrant attention by other countries including India. The China-Russia example is one such measure. Usage of rouble and renminbi by Russia and China for trade has been to enhance trade, reduce the role of dollar and to improve cooperation among the banks. Earlier, renminbi was not even a partially convertible currency; same was the case with rouble. At that time, trade between the two countries was performed in dollar equivalent which comes with an additional cost of conversion and risk of change in rate of the currency intermediary.

In 2002 an agreement was signed between Central Bank of Russia and the People's Bank of China on interbank settlements in trade in border areas. It was an agreement on direct settlement in rouble and renminbi leading to an extension of the scope of convertibility of the rouble and renminbi in foreign exchange transactions. The government authorized Chinese banks and firms to accept payments from Russian partners in their national currency. Later in 2005, cash as well as non-cash transactions in renminbi was allowed to be carried out by all banks located in the specific territories of Russia; similar is the case of rouble in China. In 2010 the former was expanded to the whole of China and Russia. This scheme expanded the volume of settlement in local currency. As a result, both countries experienced large reductions in trade costs, which in turn helped both China and Russia. China's continued liberalization of exchange regulation removing all regional restrictions in the use of renminbi in foreign trade operations of their companies made it possible. In 2011, the agreement lifted almost all limitations on national currencies in trade and economic relations between the countries, and extended their use to pay for services and implementation of inter-bank transfers by citizens.

This cooperation was strengthened by the increased presence of Russian and Chinese financial institutions in each other's markets.

Renminbi-Rouble currency pair exchange trade was started in Shanghai in 2010 via China Foreign Exchange Trade System (CFETS) and also in Russia at Moscow Interbank Currency Exchange (MICEX). It was an important development for promotion of rouble and renminbi in international settlements. Not just this, settlements in renminbi reduce the cost of conversion thus escalating the number of Chinese businesses that are ready to work with Russian companies on foreign trade contracts. Also, Russian exporters have diversified currency structure and have amplified cash flows in the Chinese currency. Shifting of trade contracts in renminbi reduces currency risks for Chinese exporters, which can lower prices for Chinese products for Russian importers. It also eliminates some internal technical problems, for example, the VAT refund for Chinese exporters.

All this has been possible with the joint efforts by Russian and Chinese authorities, participating banks and integrated financial infrastructure of both countries and various measures taken by them. Some of which are:

- In 2009, China launched a pilot programme with an intention towards internationalizing renminbi that allowed imports and exports in Yuan.[8]
- In 2011, permission was given to open special accounts in China for Russian bidders of Renminbi/Rouble operations on MICEX-RTS.
- In 2012, China allowed all local firms to import and export in Renminbi in order to make it international currency.
- Russian banks authorised that bidders can open special accounts in Chinese banks to carry out non-cash exchange operations, to credit renminbi to special accounts in China without the provision of trade contracts and open deposits. In addition, Russian banks have opportunities to invest in the Chinese bonds and derivatives market mediated by Chinese banks-agents.

- Industrial and Commercial Bank of China (ICBC) Moscow branch will serve as the renminbi clearing bank.[9]
- Introduction of Chinese initiatives on renminbi settlement, renminbi swap lines (bilateral currency swap agreements help enable trade settlement in renminbi with the added benefits of improving operational efficiency, lowering transaction costs, and ensuring market confidence)[10] and renminbi-denominated bonds that aim to establish the renminbi as an international currency.[11]

In addition, China has now an elaborate network of currency swap arrangements which spread across countries in all regions of the world. Currency swap arrangements are part of China's conscious strategy of renminbi internalisation. Table 8 presents the list of existing currency arrangements undertaken by China. It is apparently clear that China has signed more currency swap arrangements than India and other countries in Asia.

Table 8: List of China's Currency Swap Arrangements

Country	Signing Date	Swap Amount (RMB billion)	Trade Volume (RMB billion)	Imports by China (RMB billion)	% Share of Swap Amount to imports by China	Imports by China ($ Mn)		
						2013	2014	2015
Belarus	May-15	7	8.9	6.3	111.2	580.8	738.8	1010.5
Malaysia	Apr-15	180	652.7	331.5	54.3	60053.9	55770.9	53226.9
South Africa	Apr-15	30	401.2	95.6	31.4	48314.0	44669.7	15354.3
Australia	Apr-15	200	839.8	405.7	49.3	91558.2	90132.2	65141.4
Armenia	Mar-15	1	1.2	1.4	73.2	76.8	170.1	219.2
Suriname	Mar-15	1	1.2	0.3	316.1	28.0	52.6	50.8
Pakistan	Dec-14	10	87.5	17.0	59.0	3207.1	2760.4	2478.7
Thailand	Dec-14	70	438.3	234.7	29.8	38107.1	38209.0	37212.7
Kazakhstan	Dec-14	7	175.9	59.6	11.7	16023.9	9698.5	5840.0

Table 8 continued...

Table 8 continued...

Hong Kong	Nov-14	400	2465.2	79.4	503.9	16225.3	12920.2	8161.5
Canada	Nov-14	200	335.0	129.8	154.0	24132.1	21133.5	18549.2
Qatar	Nov-14	35	62.6	51.1	68.5	8426.2	8311.6	4594.7
Russia	Oct-14	150	549.1	255.3	58.7	39565.2	41558.1	33144.8
South Korea	Oct-14	360	1687.2	1169.0	30.8	182882.0	190286.0	174289.0
Sri Lanka	Sep-14	10	22.3	1.5	654.4	182.3	248.7	259.2
Mongolia	Aug-14	15	36.7	31.2	48.1	3497.5	5071.6	3752.8
Switzerland	Jul-14	150	367.4	249.5	60.1	56125.0	40616.8	9147.0
Argentina	Jul-14	70	91.3	32.3	216.7	6096.0	5258.1	5714.1
New Zealand	Apr-14	25	76.2	58.4	42.81	8251.5	9504.7	6583.3
EU	Oct-13	350	N.A.	1360.9	25.7	219726.0	243875.0	209011.0
Iceland	Sep-13	3.5	1.4	0.5	745.4	75.8	59.4	66.0
Albania	Sep-13	2	3.4	1.5	133.1	242.5	190.3	128.7
Hungary	Sep-13	10	51.7	16.8	59.5	2715.2	3260.0	2873.3
UK	Jun-13	200	430.8	117.6	170.1	18983.2	23550.5	18880.7
Brazil	Jun-13	190	554.9	332.4	57.2	53666.1	51975.6	44380.4
Singapore	Mar-13	300	466.9	184.9	162.2	29861.8	30534.5	26021.7
Ukraine	Jun-12	15	68.4	19.0	78.8	3275.2	3513.1	3555.2
Turkey	Feb-12	10	136.8	22.2	45.0	4495.1	3715.2	2953.9
UAE	Jan-12	35	284.4	68.3	51.2	12724.5	15560.3	11280.4
Uzbekistan	Apr-11	0.7	28.0	5.2	13.4	1918.5	1596.2	1266.8
Indonesia	Mar-09	100	420.5	92.5	108.1	31478.4	24589.0	19815.5
Total	–	3137.2	10747.2					

Source: Authors' compilation from various sources.

7. Internalization of Rupee as Foundation for Enhanced Rupee Trade

Internationalization of currency would facilitate non-dollar trade or trade in local currency. India has taken a number of policy measures to promote the acceptability of rupee in international trade and financial transactions.

Some of those policy initiatives are mentioned below:

- RBI in consultation with the Government of India has put in place a framework for issuance of rupee-denominated bonds overseas by Indian corporates. The Government of India approved an off-shore rupee-linked bond issuance by IFC for an amount of $1 billion (INR 62 billion) in October 2013.
- Masala Bonds: IFC issued a 10-year, 10 billion Indian rupee bonds (equivalent to $163 million) on November 8, 2014. The "Masala bonds" marked the first rupee bonds to be listed on the London Stock Exchange.
- Non-residents are permitted to hedge rupee risk of their exports and imports to and from India and loans denominated in Indian rupees with Indian authorised dealer bank onshore.[12]
- The capital account is being progressively liberalized in accordance with the evolving macro-economic conditions and requirements of the Indian industries, individuals and financial sectors.
- In March 2012, the finance ministry, Govt. of India had issued a notification on exempting 45 per cent of payments made to Iran in rupee from any local tax.
- RBI permits eligible offshore entities to invest in rupee debt outside India through the INR ECB and rupee-denominated bonds through overseas route.
- RBI is considering allowing a centralised hedging facility for Indian subsidiaries of non-resident companies. If these guidelines come into force, a multinational company based offshore entity could deal directly with authorised dealer (AD) banks onshore to hedge the currency risk of its subsidiary and would prove to be a positive step towards rupee internationalisation.
- India has signed currency swap arrangements with a number of countries which enable India and its trading partners settle their claims against each other under a centrally organized arrangement and at a pre-determined periodicity in Indian rupees (Ramdas, 2013).

Conclusion

In the quest for devising alternative means of minimizing external vulnerability, a wave of de-dollarization is observed in recent years in many countries of the world. Moreover, there is greater willingness among developing countries especially the crisis-affected economies to delink from dollar-based payment systems so as to minimize the burden of holding higher amounts of hard currency, and to avoid unwanted exacerbation of foreign payment liabilities due to random and uncertain fluctuations of their currencies against dollar and other major invoicing currencies. The fall in share of dollar and the rise in use of emerging market currencies such as rupee and renminbi in global trade invoicing and financial transactions are reflective of this evolving trend. At the same time, it is hard for small developing economies and least developed countries to accumulate optimum level of foreign currency reserves due to their narrow export basket and shallow foreign exchange market. This growing tendency towards de-dollarization has prompted developing countries to build financial safety nets by securing bilateral currency swap arrangements and promoting trade in national currencies. Local currency use for trade is being viewed as a means to address exchange rate risks along with other ways of hedging. In this spirit, 'rupee trade' scheme of India, which is a limited version of local currency use in trade, is one of the many policy tools available for export promotion.

Given the dependence for oil and petroleum imports, rupee trade may prove more effective for India's trade with the oil-exporting countries. However, a generalized approach of rupee trade can also be visualized for all trade partners as the evolving global trade scenario appears to be more complex and competitive. As regards using 'rupee trade' as a foundation to internalization of rupee, it would certainly require more ground-level assessment of its effectiveness. At present, due to data limitations, it is not easy to assess the sole contribution of rupee trade facility to export and import growth even though it has happened in the past. Our analysis suggests that rupee trade had worked reasonably well with Russia, Iran and Nepal even though the prevailing conditions favoured its success in those years. On the issue of establishing new rupee trade arrangement with select oil-exporting countries, there is merit in considering this proposal as India runs significant magnitude of trade deficits with these countries.

The acceptability of Indian rupee in global currency and financial markets needs more proactive measures. The Government and the Reserve Bank of India have taken notable steps to widen the use of rupee in country and financial transactions. The issuance of rupee-denominated and masala bonds in offshore markets would pave the way for greater use of rupee in international financial markets. At the same time, India has introduced a slew of measures on capital account liberalization over the past few years which would probably deepen and diversify local capital markets with considerable transactions in rupee and rupee-denominated assets. One major challenge in this respect is the absence of organised exchange trading of Indian currency as in case of other emerging market currencies like Chinese renminbi. Another important issue for this transition to rupee-based systems is that rupee is not yet a fully convertible currency. There is no direct quotation for various currencies with respect to rupee like in case of rupee-rouble pair. Insignificant presence of Indian banks and financial institutions in other countries is also hailed as a main barrier for making rupee an international currency.

Endnotes

1 We call it 'limited form' because rupee trade in those years were mostly targeted at certain countries; not a broad-based strategy of using rupee as an invoicing currency for all trade partners.

2 Since two currencies are involved in every transaction, the sum of percentage shares of individual currencies equal to 200 per cent.

3 Other Currencies is a term used to define the currencies of the rest of the 29 countries including Canadian dollar, rouble, etc

4 See Ranjan and Prakash (2010).

5 Government of India had made a proposal to provide a two year extension with

amendments to the Framework on Currency Swap Agreement for SAARC member countries up to November 14, 2017 and extension thereafter if necessary.

6 Embassy of Nepal in New Delhi (https://in.nepalembassy.gov.np/trade-and-commerce/).

7 Gidadhubli (1992) mentions that the process of termination of rupee trade has already happened in the Soviet Union and East European countries including Germany, Poland and Czechoslovakia in the late 1980s and early 1990s.

8 See Alvi and Kamal (2012).

9 See Russian Insider (2017).

10 See Li (2015).

11 See Balasubramaniam, Patnaik and Shah (2011).

12 The Economic Times (2015).

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