INR Settlements in the Era of Friend-Shoring

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4.1. Introduction

Recently, the concept of friend-shoring is coined in international trade by the US Treasury Secretary Janet Yellen (Condon et.al. 2022). It is to develop a trade block of countries that would be able to supply the necessary items to each other to avoid disruption of the supply chain which was recently observed globally immediately with the COVID break out. The purpose of friend-shoring is to emphasize the need for strengthening the trade relationships to shore up new global supply chains as they faced massive vulnerability in the immediate aftermath of the COVID crisis and subsequent Russia-Ukraine war. While it proved to be a necessity during the time of COVID crisis, friend-shoring has raised a concern that the wheel of globalization may reverse. For long, the main engine of globalization was based on the comparative advantage of the production house as per the availability of natural resources at a lower cost. Important determining factors for this expansion of offshore industrialization was the availability of cheap and skilled labour. Even though many countries have different segmented specializations, China showed its dominance in controlling the supply chain of global markets for both developing and developed countries. With the closure of the international border, many developed countries suddenly realized the extent of their dependence on South Asian countries, especially China. This recent distortion of trade across the border made many developed countries think about the necessity of "reshoring," or bringing key manufacturing processes back within their own country's borders. The promotion of friend-shoring may have impact on international trade. First, it might force different other trade-blocks to get generated for their sustainability; Second, with the constraint in the supply of raw materials the quality of the products might be degraded which in turn might have some severe climate impact; Third, massive disruptions in the payment system are expected. So, the sustainability of friend-shoring in international trade, without having an appropriate execution of strategic policy-making seems unrealistic.

Nonetheless, it has become important that the global economy thinks of a widespread supply chain availability through international trade. One important and best possible option is to develop a model to promote a few countries with the comparative advantage as the alternative production house. An extreme concentration of production houses inside China can be seen as the source of the vulnerable supply chain in case China closes its border even in the short run. For example, the US still depends on China for 276 types of critical goods, like certain electronics, textiles, chemicals, metals, according to a report by asset manager Allianz Group (Baschuk, 2022). So, it has become important that the emphasis is provided to develop a China plus one model for which the alternative destinations for the manufacturing units could be countries like India, Vietnam, South Korea, Malaysia, Japan and Indonesia.

In the context of increasing its share of international trade, the recent policy on promoting INR settlement with a few countries could be an important step that might benefit India in many ways. It may be noted that 'the internationalization of the Rupee is far beyond a target to achieve. However, an increase in the use of the Rupee in international trade with a target to expand India's global share in export might help India to handle its persistent trade deficit in a big way.

In this chapter, we explore the importance of INR settlement in the context of the current share of India in International trade[1]. We argue that the *China-plus-one* model may have more potential to serve the global supply chain. Moreover, we explore the share of countries export and import invoicing in the internationally dominant currencies, like USD and EUR along with the share of invoicing in the home currency of the respective county. Also, we discuss some ways forward in terms of an increase in the share of India's export with the possibility of emphasizing the INR settlement for the import.

4.2. China Plus One Model: The Potentials of a Diversified Supply Chain

Globalization in today's form is a result of free trade with a very low tariff and transportation cost. While emerging market economies have become the major destination for manufacturing production, high-value-added inputs are sourced in advanced economies. Consequently, the final products became considerably less costly. This process has not only benefited the production houses but also increased the consumption capacity of the households by making the products affordable even to the low-income group. At the same time, with the low-cost labor, the developing countries got the opportunity to move to the most sophisticated production process with a spillover of knowledge-based and skill-based production practices. These overseas investment opportunities of the capital-rich developed countries not only help in generating more employment but also helped in generating a market for selling the products manufactured in other countries. With the higher income and growing population of the countries, the market for the high value product grows. Nevertheless, over time the growing dominance of China in the export of goods raised substantial concern, (Figure 4.1). It became a threat to the whole world with the outbreak of the Covid crisis.

Though the former US, President Mr. Trump initiated a Tit-for-tat tariffs policy against China which continued during the present President Mr. Biden, it has created a ramification impact. Furthermore, Russia's invasion of Ukraine — and China's refusal to condemn it — further undid decades of globalized commerce, as did the sanctions imposed on Russia by the US, the UK, and the European Union. Most importantly two large commercial alliances led by the US and China exclude each other. For example, the *Regional Comprehensive Economic Partnership (RCEP)* led by China, which took the effect at the start of 2022, is now the world's biggest free-trade area. This is retaliation to the regional partnership, *Indo-Pacific Economic Framework (IPEF)* led by the US since 2017. Those are in addition to the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), which moved ahead after the US pulled out in 2017 from what was then called the Trans-Pacific Partnership, or TPP.

Subsequently, establishing a stronger and less concentrated supply chain has become important. Very interestingly, in *China plus One* model in addition to India, some other countries show the potential to become an important source of the future supply chain. It may be noted that Singapore and Malaysia are having exceptionally a high share of exports to their GDP. Among all other developing countries, Vietnam and Indonesia have been doing remarkably well while India shows a larger share after 2003-04, in terms of the exports as a percentage of GDP (Figure 4.2).

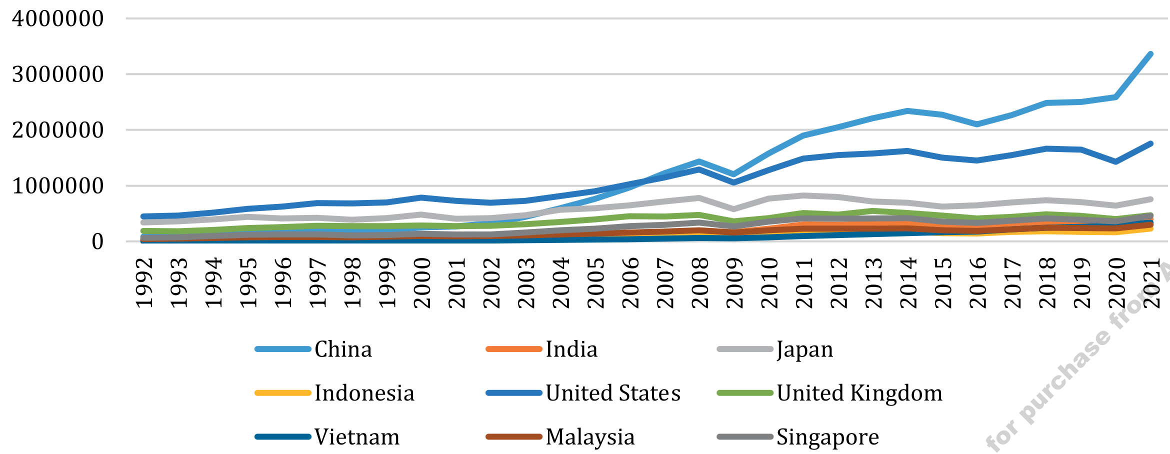
Figure 4.3 represents a few stimulating facts and figures relating to countries' international

1. It may be noted that the conclusion of this report is entirely based on international trade and the capital inflow-outflow is not discussed in this report. Although, dollar hegemony is linked to global politics, our report does not cover the same.

FIGURE 4.1

Share of Merchandise Exports for Select Countries

Merchandise Exports in Million USD



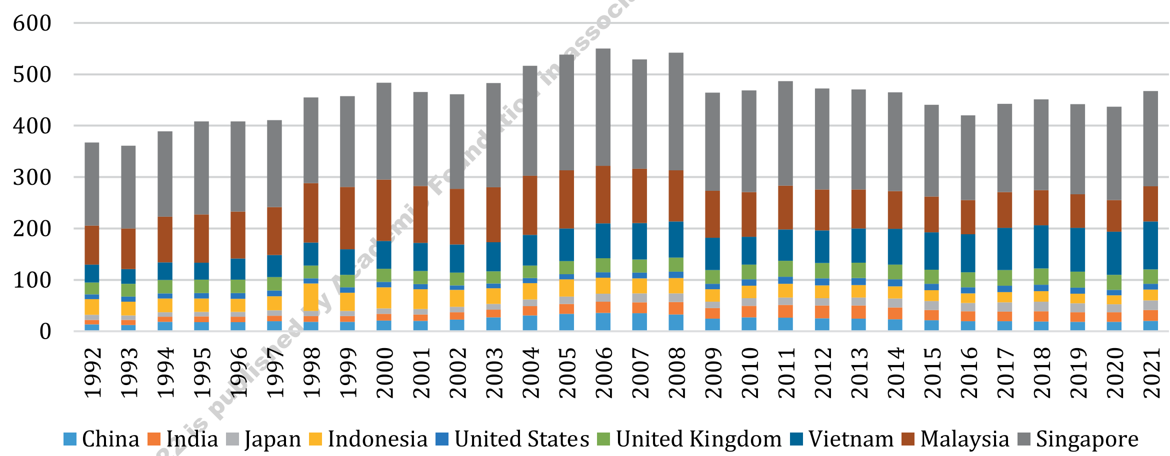
Note: Merchandise exports show the f.o.b. value of goods provided to the rest of the world valued in current U.S. dollars.

Source: World Development Indicator, Database.

FIGURE 4.2

Export Share in GDP for Select Countries

Export as a Percentage of GDP



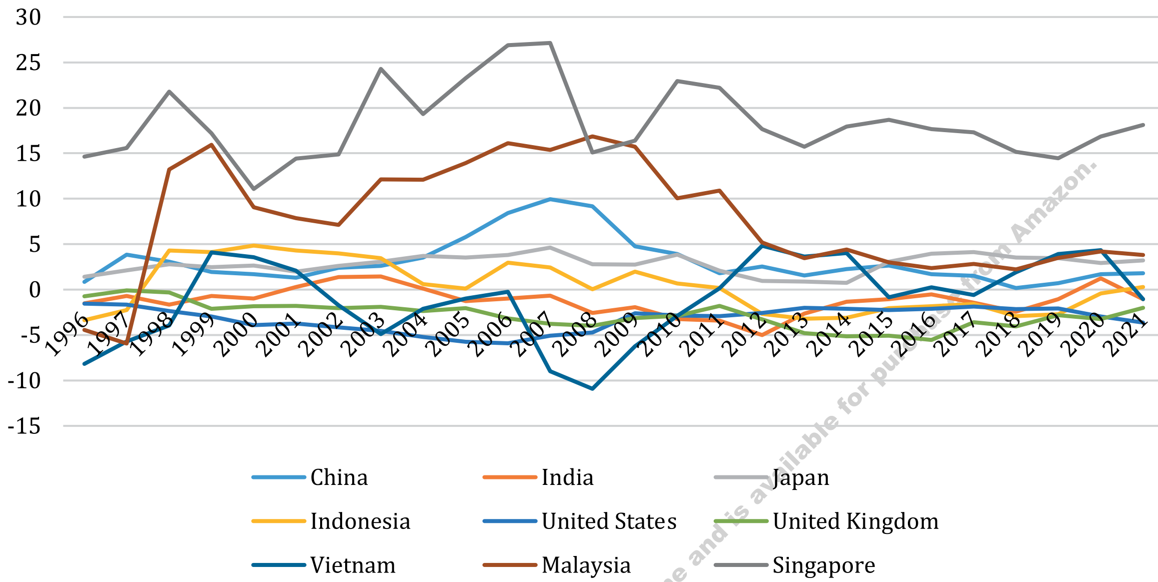
Note: Exports of goods and services represent the value of all goods and other market services provided to the rest of the world. They include the value of merchandise, freight, insurance, transport, travel, royalties, license fees, and other services, such as communication, construction, financial, information, business, personal, and government services. They exclude compensation of employees and investment income (formerly called factor services) and transfer payments. The original data source as reported in the metadata of the world development indicator is World Bank national accounts data and OECD National Accounts data files.

Source: World Development Indicator, Database.

FIGURE 4.3

International Competitiveness

Current Account Balanne as a Percentage of GDP



Note: Current account balance is the sum of net exports of goods and services, net primary income, and net secondary income. The source of data as reported by World Development Indicator metadata is the International Monetary Fund, Balance of Payments Statistics Yearbook and data files, and World Bank and OECD GDP estimate.

Source: World Development Indicator.

competitiveness. While we see Singapore and Malaysia stand out in terms of competitiveness measured by current account balance as a percentage of GDP, India and other developing countries, including Vietnam, and Indonesia is no different from their developed economy counterpart.

Also, as we rank the top 15 countries as India's export destinations (Table 4.1), we find there are four countries, for example, 1) USA, 2) UAE, 3) CHINA, and 4) HONGKONG, which are consistent in importing from India. Other than China, Hong Kong, Saudi Arabia, and UAE there are many other Asian countries, like Bangladesh, Indonesia, Malaysia, Nepal, Singapore, and Vietnam, which consistently remain important markets for India. Though UAE regularly imports from India and holds the second rank immediately after the US, Saudi Arabia also remains within the top 15 importing countries from India. Among European countries, we find Belgium, Germany, and UK are consistent within the top 15 countries which are importing from India.

As we have seen that the US, the UAE, Hong Kong, and China are four countries consistently importing from India over the years, India might emphasize the goods and services in which the demand exists. It may also be interesting to note the composition of the supply chain in other countries. The export-import data of the Department of Commerce and Ministry of Commerce and Industry, Government of India (Table 4.1) reveals that India has experienced very high growth in terms of supplying meat and edible meat offal, fish and crustaceans, mollusks, and other aquatic invertebrates, dairy products, lac; gums, resins, and other vegetable saps and extracts; the UAE imports more of live trees and other plants;

TABLE 4.1

India's Top 15 Destinations of Exports for the Last 5 Years: Rank is Made as Per the % Share

	2017-18	*2018-19*	*2019-20*	*2020-21*	*2021-22*
Australia					15
Bangladesh	8	7	9	5	4
Belgium	12	11	13	13	9
China	4	3	3	2	3
France			14		
Germany	7	8	8	8	10
Hong Kong	3	4	4	4	7
Indonesia				14	14
Italy	13	14			
Malaysia	14	13	11	11	
Nepal	10	10	10	9	11
Netherland	11	9	7	10	5
Saudi Arab	15	15	12	12	12
Singapore	5	5	5	6	6
Turkey					13
UAE	2	2	2	3	2
UK	6	6	6	7	8
USA	1	1	1	1	1
Vietnam	9	12	15	15	

Source: Department of Commerce and Ministry of Commerce and Industry, Government of India available at https://tradestat.commerce.gov.in/eidb/default.asp on January 23, 2023.

bulbs; roots and the like; cut flowers and ornamental foliage, dairy products, products of the milling industry; malt; starches; insulin; wheat gluten, etc.

Table 4.2 represents the improvement in ease of doing business in the countries under China plus one model. It may be noted that India has made substantial improvements from 2015 to 2019. Notably, Singapore and Malaysia have established themselves with better business environments or equivalent respectively compared to the US and UK. However, the countries in the discussion, including India's needs to make a piercing advance in terms of ease of doing business to become a globally established supply chain.

4.3. Invoicing Export-Import in Home Currency: Is it a New Concept

We have already discussed that the *China Plus* one model has some potential and it may be having some important contributions to make to fulfill the future requirement of the world. With its potential, if India becomes one of the supply titans to the world there may be added benefits if more and more trade transactions, especially import transactions are settled in the Indian rupee. The market sentiment needs to

TABLE 4.2

Ease of Doing Business Score (0 = Lowest Performance to 100 = Best Performance)

	2015	*2016*	*2017*	*2018*	*2019*	*2019 (Rank 1=most business-friendly regulations)*
China	62.28	63.79	64.20	73.30	77.28	32
India	54.52	55.94	60.91	67.50	71.05	62
Japan	77.53	77.94	78.01	78.04	78.00	30
Malaysia	78.61	78.27	78.77	81.34	81.47	12
Indonesia	62.11	64.66	66.87	68.18	69.58	73
Singapore	84.89	85.44	85.57	85.84	86.20	2
United States	83.59	83.59	83.59	83.57	84.00	6
United Kingdom	83.34	83.34	83.22	83.55	83.55	8
Vietnam	62.60	65.29	66.98	68.57	69.77	70

Note: The ease of doing business scores benchmark economies concerning regulatory best practices, showing the proximity to the best regulatory performance on each. The Metadata of the World Development Indicator reveals the source as World Bank, Doing Business project (http://www.doingbusiness.org/). NOTE: Doing Business has been discontinued as of 9/16/2021. The last column represents the ease of doing business rank (1=most business-friendly regulations).

Source: World Development Indicator.

be checked if the Rupee consists of an impending future in enhancing its dominance in the settlement of world trade. In this context, we discuss the potential and procedure of INR settlement in international trade transactions. It may be noted that the more liquid currencies are still a part of the large advanced economies. The demand for any currency in the international markets depends on its free convertibility, availability to non-residents, and for international trade transactions. Mostly, the internationalization of currencies is subject to the respective countries' financial markets, institutions, and regulatory policies. In this context, our purpose is not to argue for the future of INR as a truly internationalized currency or a currency equivalent to USD or EUR. Rather, in our discussion, we focus on the consequence and the process of increasing the trade settlement denominated in INR.

It may be noted that overall the idea of promoting the local currency in international trade is not at all new. Neither it is new for India's payment system, nor that other countries do not have this settlement. The IMF data on *Patterns in Invoicing Currency in Global Trade* by Boz et al. (2020) shows that for many countries maximum trade is invoiced in EUR (Table 4.3). However, USD has the maximum share in the settlement of currencies because each country has to convert its currency first into USD and then into its local currency. For example, Denmark has 46% of its export invoice settled in EUR as compared to 25% invoiced in USD. Now, if an Indian importer has to pay an exporter from Denmark in EUR then as per the Global Settlement System Indian importer has to pay an equivalent amount in INR to buy the USD first, and then the equivalent USD gets converted into EUR. Similarly, for Denmark, the import transaction invoiced in EUR is 49% while the share of USD invoices is only 28%. To any country an importer from Denmark is paying in EUR means Danish Krone (DNK) to be converted into USD first and then from USD

TABLE 4.3

Invoicing Export-Import Across Countries with EUR Dominance (in %)

	EUR	*Home Currency*	*Currencies Other than EUR and USD*
Austria	Export (93%); import (90%)		Export (3%); import (2%)
Albania	Export (82%) and import (76%)		Export (1%); import (2%)
Bahamas			Export (56%) and import (54%)
Belarus	Export (34%) and import (48%)		Export (38%) and import (30%)
Belgium	Export (71%) and import (74%)		Export (10%); import (3%)
Bosnia	Export (82%) and import (88%)	Export (10%); import (4%)	
Bulgaria	Export (65%) and import (70%)		
Croatia	Export (78%) and import (74%)		Export (2%); import (6%)
Czech Republic	Export (79%) and import (68%)		Export (8%); import (12%)
Denmark	Export (46%) and import (49%)		Export (30%); import (23%)
Estonia	Export (65%) and import (59%)		Export (22%); import (22%)
Fiji		Export (94%) and import (24%)	Import (52%)
Finland	Export (67%) and import (65%)		Export (10%); import (9%)
France	Export (72%) and import (74%)		Export (6%); import (2%)
Germany	Export (76%) and import (77%)		Export (6%); import (2%)
Hungary	Export (82%) and import (74%)		Export (8%); import (8%)
Iceland	Export (43%) and import (60%)	Export (1%); import (4%)	Export (13%); import (25%)
Italy	Export (82%) and import (71%)		Export 4(%); import (3%)
Latvia	Export (90%) and import (92%)		Export (4%) and import (2%)
Lithuania	Export (73%) and import (64%)		Export (2%) and import (1%)

Luxembourg	Export (91%) and import (88%)		Export (5%) and import (1%)
Macao		Export (35%) and import (35%)	Export (67%) and import (77%)
Macedonia	Export (93%) and import (83%)		Export (1%) and import (1%)
Malta	Export (67%) and import (86%)		Export (7%) and import (1%)
Moldova	Export (64%) and import (51%)		Export (5%) and import (5%)
Montenegro	Export (82%) and import (94%)		Export (2%) and import (4%)
Morocco	Export (64%) and import (55%)	Export (4%) and import (2%)	Export (5%) and import (3%)
Netherlands	Export (81%) and import (67%)		Export (2%) and import (1%)
Poland	Export (65%) and import (55%)		Export (17%) and import (17%)
Portugal	Export (65%) and import (55%)		Export (2%) and import (1%)
Romania	Export (81%) and import (70%)		Export (6%) and import (12%)
Senegal	Export (52%) and import (83%)	Export (26%) and import (5%)	Export (27%) and import (5%)
Serbia	Export (92%) and import (82%)	Export (1%) and import (3%)	Export (1%) and import (4%)
Slovak Republic	Export (94%) and import (86%)		Export (2%) and import (3%)
Slovenia	Export (91%) and import (77%)	Export (4%) and import (3%)	
Spain	Export (77%) and import (65%)	Export (4%) and import (2%)	
Eswatini	Export (45%) and import (65%)	Export (45%) and import (65%)	
Sweden	Export (54%) and import (63%)	Export (19%) and import (7%)	
Switzerland	Export (30%) and import (46%)	Export (39%) and import (18%)	Export (49%) and import (21%)
Tunisia	Export (78%) and import (54%)		
UEMOA	Export (76%); import (71%)	Export (16%); import (17%)	

Note: a. data represents invoicing share in 2019; b. The above table does not represent the countries having USD as the maximum share in their invoicing. Among those countries, there are many which show a good percentage of share for the home currency invoicing. For example, Turkey (5%, 5%), Thailand (17%, 9%), Tanzania (10%, 1%), Taiwan(3%, 5%), South Korea (3%, 6%), Saudi Arabia (7%, 56%), Russia (15%, 31%), Norway (8%, 30%), New Zealand (19%, 20%), Malaysia (5%, 5%), Japan (37%, 24%), Chile (1%, 5%), Brazil (3%, 6%), Australia (15%, 33%); c. For India the data is available till 2014, however, inconsistent. In 1991, India's export and import share invoiced in the dollar was 57% and 59% respectively. It may be noted over time the share of export and import invoiced in the dollar increased substantially and is reported as 87% and 89% respectively in 2014.

Source: This dataset is jointly assembled by the IMF and the ECB. It contains invoicing data for the period from 1990 to 2019 for 102 countries. Available at www.imf.org/-/media/Files/ Publications/ WP/2020/Datasets/wp20126.ashx. Extracted on January 22, 2023.

to EUR. It may be interesting to note that EUR invoicing in global export and import transaction is recorded as having more demand than USD invoicing for more than 43 countries (Table 4.3).

It may be noted from Table 4.3, trade invoicing in home currencies or currencies other than the USD and EUR is nothing new. Many countries for which EUR is the dominant invoicing currency, experience a significant share in terms of invoicing for export-import business, for example, Fiji, Macao, Switzerland, Eswatini, Senegal, etc. the countries in which dollar hegemony is persistent, experience a significant share in invoicing their export-import in their respective home currencies. To name a few[2] Turkey, Thailand, Japan, Malaysia, Taiwan, Brazil, Tanzania, Botswana, Chile, Norway, New Zealand, Australia, Saudi Arabia, etc. It is interesting to note that Saudi Arabia, Russia, Norway, and Australia experience a substantial difference between the home currency invoicing between its export and import. For example, 56% of Saudi Arabia's imports in 2019 is invoiced in its home currency. While only 7% of export in the same year is invoiced in home currency. Naturally, encouraging more invoicing in the home currency saves forex reserves while encouraging more invoicing in foreign currency helps in the accumulation of forex reserves.

From the above discussion, it is clear that invoicing the export and import in respective countries' home currencies is nothing new. Rather it is a common practice in many countries. Surely, it has a high benefit if the coun-

2. The details of each of the country's export-import invoicing have been given in Note to Table 4.3.

tries' import share is paid more in home currency while the export share is received more in foreign currencies like EUR and USD. For India, we have observed that in 1991, India's share of export and import denominated in USD was only around 52% and 60%. Also, the international trade settlement in the local currency was much more, 28% and 8% respectively. Over time this share is reduced substantially. Although invoicing export more in home currency may not be beneficial for a country as it does not add to the accumulation of the foreign exchange reserves. In the recent phase, the target of internationalization of INR focuses more on the facilitation of trade without losing the advantage of the currency settlement process.

Though invoicing the export and import in INR is a long-permitted policy, this is not a one-step journey. Over time tangible progress with the expansion of international trade might help India to achieve such a goal. As per the recent circular of the Reserve Bank of India (RBI) on *International Trade Settlement in Indian Rupees (INR)*, dated July 11, 2022, a Special rupee VOSTRO account[3] is allowed to be opened by the authorized dealers. It was observed in the past that in case of a financial or economic crisis, the international trade channel may get blocked if the inflow or the outflow of the currency from a particular country is blocked. India's stance in resolving this problem is appreciable as it provides the opportunity for Indian importers to make payments in INR. As this payment gets credited into the special VOSTRO account of the correspondent bank of the partner country, the same INR liquidity can be used by the foreign counterparty to pay for all goods and services. Only the whole transaction requires the production of appropriate trade documents, for example, the invoices for the supply of goods or services from and to the overseas seller/supplier.

4.4. A Brief Journey of Rupee Settlement

India has come a long way from its initial Foreign Exchange Regulation Act (FERA) of 1947 to a more comprehensive framework of the FERA of 1973. Subsequently, following the financial liberalization, the Foreign Exchange Management Act (FEMA) replaced FERA in 1999. However, since 1993, following the recommendation of C Rangarajan, Chairman of the Balance of Payment Committee, INR has become a market-determined exchange rate. The recent emphasis of the Indian Government on Rupee settlement has come into place after the US sanction with the Russia-Ukraine war. Immediately after the covid crisis, the war between Russia and Ukraine had a major impact on the already disrupted supply chain. Moreover, an important disruption is seen in the currency settlement after the US sanction was imposed on Russia. It may be noted that sanctioning any country in terms of usage of the USD necessarily means the trade with the country would be disrupted. It may be noted that all cross-rate[4] settlement requires NOSTRO account clearance in the dollar. It has resulted in the share of USD having more than 88% of the total currency settlement (BIS, 2022). Also, any crisis makes the market one-sided. The demand for the USD increases, and so as the price of the USD. Recently, as an after-effect of the Covid crisis, we have observed a massive depreciation of most currencies against the USD.

Given the global political and economic instability, RBI's move to test the market sentiment is appreciable. Sanati (2022) argued that encouraging INR settlement has not only provided some stability to the disrupted supply chain with Russia, but it has also provided stability to INR in the exchange market at the time of continuous depreciation of the INR. Outwardly, this policy measure was announced to facilitate trade with Russia and Iran as the main supply source of fuel to India. On the contrary, India had to extend its support to Sri Lanka and this arrangement also required a smooth settlement system between India and Sri Lanka. However, there could be two discrete goals; 1) to prove support for INR against continuous appreciation of the Dollar while solving the problem of trade settlement triggered

3. If Citi Bank New York is keeping one account with State Bank of India (SBI), Mumbai in INR, it is a VOSTRO account for SBI, Mumbai (Sanati, 2018).

4. The currency pair in which USD is not seen explicitly. For example, GBP/INR, EUR/JPY, CHF/INR etc. are all cross-rates.

by the qualms due to the war between Russia and Ukraine; 2) to provide a message to the world that INR could be an alternative currency for international trade in future and test the market sentiment on the acceptance of INR as a currency of settlement by her trading partner, if not all, at least the BRICS countries and the South Asian countries. In this context, it has to be mentioned that many countries' currencies have depreciated in a big way in the post covid era[5] while the US was struggling to control its high inflation led by high liquidity injection during covid. The promotion of settlement meant is extremely timely, not only to improve the trade conditions with a few countries but it has helped India to combat the scuffle against the soaring fuel and commodity prices; appreciation of the Dollar against all the major currency pairs with an explicit move of EUR at Par with the Dollar; Recession in the US economy with high inflation and rising interest rate; Expected Recession in the Euro Zone, and the last but not the least Sanction on the Russian Central Bank (Sanati, 2022).

Also, emphasizing the INR settlement is apt as there is already an early warning signal when the sanction was imposed on the *Central Bank of Russia* (RCB) by the US, the European Commission, the UK, France, Germany, and Italy. It may be noted more than 11000 banks across the world are members of the Society for Worldwide Interbank Financial Telecom (SWIFT). SWIFT transaction allows a smooth record of documents to flow across countries which in a way helps the countries to settle the payment due for any import transaction. In the whole process, banks play a major role in the trade transaction. So, with the sanction imposed on Iran (previously) or Russia as seen recently, banks become annulled to conduct the trade transaction. In recent times, after being de-SWIFTed Russian Banks have no other way but to depend on telecom services or fax services for establishing trade transactions with their partners. The severity increases if a sanction is used on the country's central bank. Like in for Russia, the foreign exchange reserves of USD 600 million became illiquid overnight after the sanction imposed by the US. So, CBR could not sell the reserves in support to make the Rouble stable and the Rouble fell further. Moreover, the dollar NOSTRO fund became inaccessible to Russian banks. Simultaneously, all the trading partners might lose trust in dealing with the commercial banks as a letter of credit (LC) or bank guarantees (BG) could not be established by using the SWIFT platform for any of the export or import transactions.

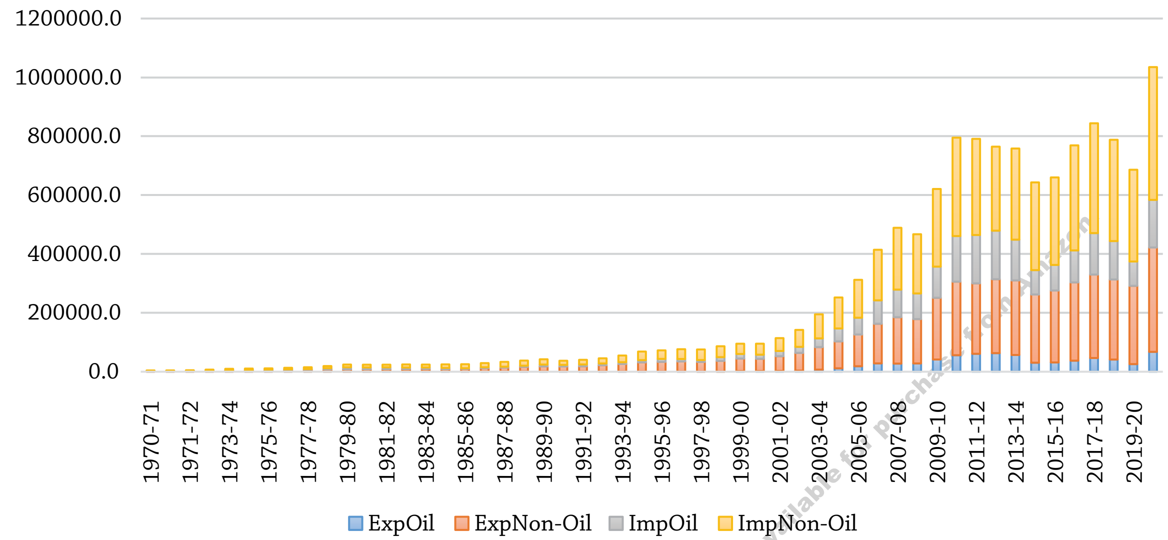
4.5. Operations through the NOSTRO Account

NOSTRO account is also called the settlement account. Any authorized dealer bank is allowed to keep multiple NOSTRO accounts. For example, SBI India may keep one USD NOSTRO account with Citi Bank New York and another NOSTRO account in JPY in Tokyo, Japan. The fund position or liquidity position in the NOSTRO account varies for a bank depending on the export receivable and import payables; moreover, it may vary due to proprietary trading positions. For example, if a country (say, Japan) has to make a payment in USD for any goods purchased from India and the invoice is USD 5 million for spot settlement then that bank (read Japanese bank) will debit its NOSTRO account kept with say, Citi bank New York to make the payment. If the exporter's bank is HDFC then HDFC's NOSTRO account gets credited by 5 million USD and against this receivable HDFC will convert the USD into INR using the market rate and will credit the customer account in India in INR. Naturally, with the imposed sanction on a country's payment mechanism, the entire chain gets broken. Also, usage of Forex reserve becomes ineffective. This is where the risk in foreign exchange settlement might trigger in the event of a political, economic, or financial crisis. Consequently, invoicing and using INR as a settlement currency will help the trade run between India and Russia. In such a case, the settlement has to work through the Rupee VOSTRO account. Since 2016, as per Regulation 7(1) of Foreign Exchange Management (Deposit) Regulations, Authorized

5. For example, JPY which was traded in the range of 105-115 YEN per unit of USD for a long, during the last financial year it was trading in the range of 142-147 YEN per USD before it stabilized at around 130 per dollar in the recent phase (Market Data, Reuters).

FIGURE 4.4

India's Share of Oil and Non-Oil Exports and Imports (USD Million)



Source: Author's representation from RBI database.

Dealers (AD) banks in India are allowed to open Rupee Vostro accounts of correspondent bank/s of the partner trading country. It may also be noted that India has a substantial share in importing oil and non-oil products compared to exporting (Figure 4.4). In addition to invoicing the oil import, India may use its negotiating power to enhance the INR invoicing for exporting a larger number of products.

However, we might note that RBI has not only emphasized INR settlement in its recent circular dated 11th July 2022 but also has emphasized trade settlement through a special VOSTRO account. Through this process, the amount parked in the special VOSTRO account on account of import payment by the Indian importers would be used by the counterparty to pay the Indian exporters in INR. This step reduces the volatility risk in the foreign exchange market and also mitigates the settlement risk for its international trade. Most importantly, if an overseas buyer has both receivables and payables then the 'set-off' of net import payables (net of export receivables and import payables) may be allowed through the rupee payment mechanism.

However, the whole process has to follow an approval route from RBI with the details of the arrangement. Also, all the documentary compliances under Uniform Customs & Practice for Documentary Credits (UCP 600) and International Standard Banking Practices (ISBP) for LC transactions, and Uniform Rules for Documentary Guarantees (URDG 758) for transactions with Bank Guarantees (BGs) to be retained. AD bank is not allowed to maintain the special Vostro Account if the correspondent bank is not from a country or jurisdiction in the updated Financial Action Task Force (FATF) Public Statement on High Risk & Non-Co-operative Jurisdictions on which FATF has called for countermeasures. It may be noted that two Indian banks were allowed to open similar VOSTRO accounts with a similar settlement mechanisms previously for trade with Iran and later, on those accounts dried up as India did not have sufficient INR funds following a reduction of import bill invoicing in INR. As per the regulatory rules of the US Office of Foreign Assets Control (OFAC) India had to reduce its import bill to INR. Most importantly, the 'set-off' of export receivables against import payables are allowed if an overseas buyer has both receivables and payables. Besides following all due diligence, releasing funds to the Indian exporter is subject to a) availability of funds post payment of all import bills; b) verification of the claim of the exporter by the Indian banks holding the special VOSTRO accounts. Also, paying advance payment is subject to receiving an advance from the correspondent overseas bank along with an instruction from the overseas importer. Interestingly, RBI allows the usage of the remaining funds in Special Vostro Accounts for: i) Payments for projects and investments, ii) Investment in Government Treasury Bills, Government securities, etc. in terms of extant guidelines and prescribed limits, subject to FEMA and similar statutory provisions. As India already has USD 6.6 billion with Russia (India's import from Russia is more than its export), Russia has two options; 1) hold the fund in an INR VOSTRO account which will not help them earn any return. Moreover, the yearly depreciation risk is 3-4%, and 2) invest in government securities (RBI, 2022).

4.6. Concluding Observations

RBI's move towards INR settlement is well timed and long-desired policy stance. In our discussion, we have seen that there are countries like Macao, Turkey, Japan, Thailand, Tanzania, Taiwan, South Korea, Saudi Arabia, Russia, Norway, New Zealand, Malaysia, and Fiji experience a substantial amount of their export and import invoiced in their respective home currency. Also, in many countries like Saudi Arabia, Russia, Norway and Australia invoicing in the home currency is much more for the import share. The settlement of home currency not only provides a country comfort in mitigating foreign exchange volatility but also helps in the continuation of the trade flow during the crisis in international borders which reduces country risk substantially. Consequently, encouraging the import payment invoiced in the home country will benefit India in a big way as India's oil import and non-oil import shares are substantially high in international trade. So, the goal of our central bank is much beyond overcoming the block of the US sanction on Russia. It is more so with the war and the pandemic-driven fragility in supply chains, the U.S. and its allies shift towards friend-shoring global trade, move toward INR settlement may have a manifold effect to determine the future settlement of trades among BRICS and other Asian countries. The China-plus-one model is already in place in global trade and India has a very important and effective role to play over time with its large market share and growing negotiating power in the international trade transaction. With the following three-fold criteria India might lead the world in the coming decades 1) invoicing more of its imports in INR which could be achieved through negotiation power and knowledge dissemination; in this banks may be able to take the major role to play in motivating the importer by choosing the appropriate payment method by invoicing in INR, 2) reducing reliance on the imports by establishing a comparative advantage in certain products to improve its export share in the international domain, 3) promotion of exports by providing incentives in the financing of the production cycle, especially to the small and medium industries. These goals may be achieved with proper encouragement, knowledge-based training, and with the availability of internal finance So, advocating the idea of emphasizing INR settlement in a macro framework under the China-plus-one model is expected to be advantageous and boon for many Asian countries, including India.

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