

Rupee Invoicing Mechanism in India¹

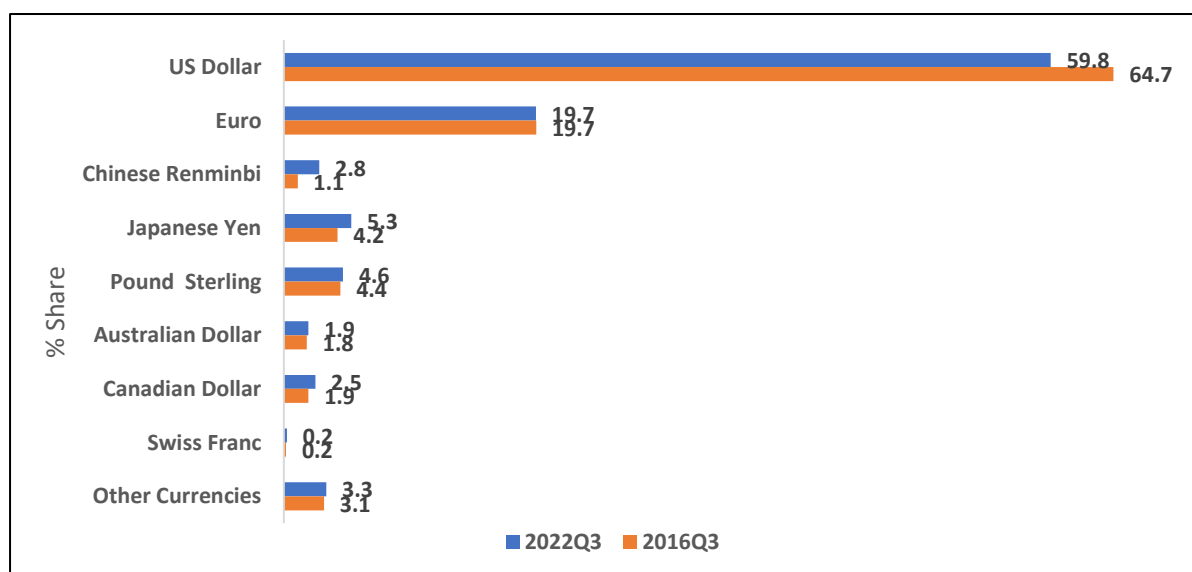
Introduction

The Indian Rupee (INR) invoicing or settlement mechanism is a form of payment arrangement designed for the settlement of bilateral trade transactions between India and its trade partner countries, whereby both countries raise their invoices and settle payments for their trade transactions on bilateral basis in INR. The mechanism is expected to bridgehead internationalization of Indian rupee.

The process of increasing the use of a currency in cross-border transactions is known as internationalisation. An international currency is one that non-residents can freely use to settle cross-border transactions. It reflects external credibility in both the currency and the economy. One of the prerequisites for an international currency is its increasing use in trade invoicing. In terms of foreign exchange market turnover (daily averages), as per the BIS Triennial Central Bank Survey 2022, the US dollar is the most dominant currency accounting for 88% of the global forex turnover, followed by Euro (31%), Japanese Yen (17%), and Pound Sterling (13%) in 2022. The Indian Rupee accounts for only 2% of global currency market turnover².

Similarly, as per the IMF COFER data of 149 reporters, USD's share of global foreign exchange reserves during 2022Q3 stood at 59.8%, followed by Euro (19.7%), Japanese Yen (5.3%), Pound Sterling (4.6%), Chinese Renminbi (2.8%), Canadian dollar (2.5%), Australian dollars (1.9%), and Swiss Franc (0.2%).

Chart: World Currency Composition of Official Foreign Exchange Reserves



Note: IMF started publishing Value of Chinese Renminbi since 2016Q4. Hence for Chinese Renminbi data is for 2016Q4

Source: IMF

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² As two currencies are involved in each transaction, the sum of the shares in Individual countries will total 200%.

RUPEE INVOICING – RECENT EVENTS

Reserve Bank of India Circular on International Trade Settlement in Indian Rupees

In July 2022, the RBI issued a circular permitting an additional arrangement for invoicing, payment, and settlement of exports/imports in INR to promote the growth of global trade with emphasis on exports from India and to support the increasing interest in the global trading community in INR as an international currency. The framework involves invoicing of exports and imports in INR, market-determined exchange rates between the currencies of the trading partner countries, and settlement through Special Rupee Vostro Account (SRVA)³ accounts. The approval process is that for opening of SRVA, banks of partner countries may approach Authorised Dealer (AD) banks in India which may seek approval from RBI with details of the arrangement. The AD bank maintaining the SRVA is required to ensure that the correspondent bank is not from a country or jurisdiction in the updated FATF Public Statement on High Risk & Non-Co-operative Jurisdictions on which FATF has called for counter measures.

Under this arrangement for settlement, (a) Indian importers undertaking imports through this mechanism shall make payment in INR which shall be credited into the SRVA of the correspondent bank of the partner country, against the invoices for the supply of goods or services from the overseas seller /supplier, while (b) Indian exporters, undertaking exports of goods and services through this mechanism, shall be paid the export proceeds in INR from the balances in the designated SRVA of the correspondent bank of the partner country. The framework put in place by RBI is applicable for any partner country seeking to undertake trade with India in INR.

The balance in SRVA can be used for: a) Payments for projects and investments, b) Export/Import advance flow management and c) Investment in Government Treasury Bills, Government securities, etc. in terms of extant guidelines and prescribed limits, subject to Foreign Exchange Management Act of India and similar statutory provisions. An additional benefit is that the balance in SRVA can be repatriated in freely convertible currency and/or currency of the beneficiary trading partner country depending on underlying transaction, i.e., for which the account was credited. For example, for import payments through SRVA like any Rupee Vostro account the fund can be remitted to overseas exporter either in freely convertible currency or in domestic currency of the overseas exporter.

This framework for international settlement in INR acquires significance against the backdrop of the US Fed aggressively hiking the policy rates and its hawkish stand, the consequent rallying of the US dollar to multi-decade high levels, and concomitant weakening of currencies of various EMEs including the INR. The exchange rate of the Indian Rupee is market-determined as the RBI's intervention in the foreign exchange market is mainly to contain instances of excessive volatility. During 2022, INR has depreciated by over 11%, while the US dollar has appreciated by over 6% in terms of the US dollar index. Before the RBI Circular, settlement in INR was possible for trade with only select countries like Bhutan and Nepal.

The framework could largely reduce the net demand for foreign exchange, the US dollar in particular, for the settlement of current account related trade flows. Further, the use of INR in cross-border trade

³ A Vostro account is an account that a domestic bank holds for a foreign bank in the domestic bank's currency, i.e., Rupee. Such accounts enable domestic banks to provide international banking services to their clients who have global banking needs.

is expected to mitigate currency risk for Indian businesses. Protection from currency volatility not only reduces the cost of doing business but also enables better business growth, improving the chances for Indian businesses to grow globally. It also reduces the need for holding foreign exchange reserves and dependence on foreign currency, making Indian economy less vulnerable to external shocks. Reduced exposure to currency risk would also substantially mitigate the pain of reversal of capital flows. The 'Taper Tantrum' episode in 2013 and recent currency volatility in most emerging market economies (EMEs) are examples of such risks. It will protect India from Balance of Payments (BoP) crises as it can pay for external deficits with its own currency. Further, it could assist Indian exporters in getting advance payments in INR from overseas clients and in the longer term promote INR as an international currency once the rupee settlement mechanism gains traction.

Amendments in Foreign Trade Policy

The Directorate General of Foreign Trade (DGFT) of India had amended the Indian Foreign Trade Policy in August 2022, to allow for International Trade Settlement in INR, i.e., invoicing, payment, and settlement of exports / imports in Indian Rupees in sync with RBI's July 2022 Circular. Further changes have been introduced in the Foreign Trade Policy vide DGFT in November 2022 for grant of exports benefits and fulfilment of Export Obligation for export realisations in Indian Rupees as per the RBI guidelines. Given the rise in interest in internationalisation of Indian Rupee, the given Policy amendments have been undertaken to facilitate and to bring ease in international trade transactions in Indian Rupees.

Rupee Invoicing and Indian Exports

Rupee invoicing mechanism is expected to enhance India's international trade by bringing down transactions cost involved as the process will derisk a lot of transactions. The mechanism would promote global trade growth with an emphasis on exports from India and will support the increasing interest of the global trading community in India's domestic currency. The new facility gives both importers and exporters a greater degree of price transparency and potential cost savings. Since there would be no requirement for currency exchange process exporters may be paid sooner when they submit invoices in INR, saving cost and speeding up the payment process.

For importers of Indian products, buying goods in INR can potentially reduce the cost of the goods, where the production and administrative costs of the Indian companies are denominated in INR. For Indian exporters, invoicing their goods and receiving payments in INR is now possible. This supports the company's international growth, whilst allowing more flexibility in managing its foreign exchange exposures related to the currency exchange costs incurred in the sales process. On the import front, since India imports more than it exports India will save dollars by paying in rupees for its imports, enhance forex inflows and would be a step towards stabilizing the rupee.

The framework is especially beneficial for trade with those partner countries which face a dollar crunch/ forex shortage due to various reasons. The new mechanism will help India promote its exports in these countries. Under rupee invoicing system, Indian importers pay rupees and exporters receive rupees into SRVA.

Trading in India rupee would be more favourable with trade partners such as Russia, Saudi Arabia, Nigeria and UAE, where India is a large importer on one hand and there exists potential demand for

Indian exports. Although, list of countries with Vostro accounts have not been officially released, as per various reports the RBI has allowed opening of 12 vostro accounts so far, with Sri Lanka, Mauritius and Russia on the approved list. The Middle East countries such as UAE and Saudi Arabia are reported to have expressed interest to participate, and Central Banks of countries are working out the details. According to the Federation of Indian Export Organisations (FIEO), rupee trade mechanism could generate an additional export US\$ 5 billion to Russia.

Table: Potential Countries for INR Settlement

Countries	India's Exports in 2021 (US\$ mn)	India's Imports in 2021 (US\$ mn)	India's Trade Balance in 2021 (US\$ mn)
Iraq	2032.4	26566.1	-24533.7
Saudi Arabia	8245.4	27689.3	-19443.9
UAE	25446.6	43070.3	-17623.7
Russia	3334.3	8695.0	-5360.8
Nigeria	4523.1	9157.9	-4634.8
Guinea	596.0	3446.7	-2850.7
Ghana	1099.2	1588.9	-489.8
Papua New Guinea	66.7	325.6	-258.9
Libya	207.9	368.5	-160.6
Cameroon	390.8	481.3	-90.5
Myanmar	839.0	798.8	40.3
Zimbabwe	188.9	5.7	183.1
Zambia	334.8	130.9	203.9
Bhutan	867.7	343.9	523.9
Maldives	591.8	50.7	541.1
Mauritius	745.5	66.7	678.8
Sudan	1006.1	258.8	747.3
Iran	1284.0	408.7	875.3
Sri Lanka	4799.8	979.8	3819.9
Nepal	9189.9	1317.7	7872.1
Bangladesh	14092.7	1764.1	12328.6

Source: ITC Trade Map

Conclusion

The recent initiatives of the RBI in enhancing trade settlement in INR are indeed significant in paving way for increased internationalization of INR, enhancing India's position in global trade ecosystem and maintain a stable domestic currency. However, the effectiveness of the rupee trade will ultimately depend on whether India is running a net trade deficit or surplus with the participating trading partners, as well as the extent of trading in rupee in comparison to the total bilateral trade. There is also a need to bringing some of the major trading partners in the INR settlement framework to make the initiative a success.