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Impact of De-Dollarisation Move on the Indian Rupee

Manjinder Kaur[1]

Abstract

Since the Russia-Ukraine war, it seems to be an era of economic uncertainties and tense geopolitical relations. Could India reap some benefits from these tense geopolitical scenarios and uncertain geo-economic conditions? Post the invasion of Ukraine by Russia, Russia and China entered into a strategic relationship which provided a window for a more multi-aligned India. India could reap the benefits of this strategic relationship of Russia and China if it can utilise this as an opportunity and emphasise its economic growth and market-oriented reforms. It could be possible for India to strive to drive service-based exports besides extending the manufacturing sector and gaining a pivotal role on the economic front through major global trade. India can utilise this strategic alliance of Russia and China as an opportunity, especially by strengthening its economic power by focusing on service-based exports and expansionary moves in the manufacturing sector. India could gain from these opportunities since many events are occurring globally aiding India. Recent complex notifications from the Ministry of Commerce and Industry emphasised that a few exporters and importers should execute trade transactions in the Indian rupee. It is a turning point amidst the latest phenomenon of global trade, promoting globalisation in almost every sphere of trade with a great hue and cry. These bilateral trade orders made the citizens nostalgic about the EXIM policy in the past before the globalisation move. But how did these notifications deviate from when India used to have a closed economic system? At that time, the dollar was king, tariffs strictly regulated imports, foreign exchange reserves were limited, and above all, these recent measures of foreign trade in India in the Indian Rupee pose an essential question: whether this is a move towards de-dollarisation and if it provides a window for Indian Rupee to rise.

Introduction

Since the invasion of Ukraine by Russian troops, international trade and financial decisions are constantly restructured in favour of bilateral trade agreements and, thereby, gradually replacing the multilateral system of international trade. All that is happening due to the weaponisation of the US dollar, as following the Russian war, the US has delinked the Russian banking system from SWIFT. Even many US and European companies have abandoned their operations in Russia. US resorted to these sanctions against Russia, expecting that Russia will bow to US demands and withdraw troops from Ukraine. However, these sanctions represent a violation of multilateralism,

[1] Dr. Manjinder Kaur, Assistant Professor, Post Graduate Department of Commerce, Guru Nanak Dev University College, Chungh, Tarn Taran, Punjab-143304, India. E-mail: manjindergndu@gmail.com

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forcing even developing nations to explore options other than the US dollar. Due to these geopolitical tensions, developing countries have resorted for bilateral trade arrangements so that these countries need not run after US dollar reserves and could settle mutual trade obligations through local currency instead. This could be viewed as a drastic step and shift towards de-dollarisation from the earlier regime of dollarisation.

History of US Dollar Hegemony and Need for De-Dollarisation.

One hundred years ago, sterling (British Pound) was the most weighted currency in terms of value. It was only post-World War I that the US dollar started replacing pounds. The reason was that the US stayed safe and unharmed as US land remained free from invasions of World War I. Consequently, the US could receive the lion's share of gold reserves and the USD, being backed by the largest gold reserves in the world and holding a prime creditor position, it became quite easy for the US dollar to replace the British Pound as a global trade currency. Subsequently, at the Bretton Woods conference in 1944, USD was declared officially as international reserve currency. All this carried the connotations that the US could settle its trade obligations and invest abroad in its local currency, i.e., USD; however, other countries would need US dollars to settle international trade transactions and even to seek external debts. Every nation that resorts to external debt (foreign currency) must only discharge this debt obligation in USD. Presently, the US dollar is the pre-eminent currency all around the globe.

Further, in 1971, President Nixon delinked USD from gold; thus, US FED got ultimate freedom. This drastic shift made the US dollar king, and the US needed not sell its US dollars in the forex market to purchase any other currency like pound sterling, euro, rouble, etc. The process led to all-time gains for the US, which currently has zero foreign currency debt. Instead, all debts of the US are in US dollars only, which the US could always print. While the US enjoys dollar hegemony, simultaneously, other nations which have piled up US dollar debt have to bear the inflationary waves transmitted by the US through the printing of US dollars and subsequent interest rate hikes by the US to manage the US inflation will jeopardise the financial system of emerging economies. This is basically because emerging economies carry huge US dollar debt and have capital inflows from the US Following the interest rate hikes in the US, US investors withdraw their investments from other economies. In order to keep foreign investors invested in emerging economies, these economies have to raise their domestic interest rates. In nutshell, it can be said that dollarisation since 1944, made US dollar king at the cost of other economies.Hence, USD hegemony is only at the mercy of other nations. It will not be an exaggeration to compareUSD with a master keywith which one can enter anybody's house and use its amenities. However, nobody expects such an entry into their respective house. Unfortunately, as far as international trade and external debts are concerned, it is one master currency i.e., USD that dictates the international policies. With the unprecedented authorisation to print as many US dollars as the US wants, the US can easily pass the financial losses to the whole world. For instance, during the

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ISSN (On-Line Version) 2278-1277

recent covid pandemic, the US government and FED reserve offered a financial stimulus to its US citizens. Under this financial stimulus, the government of US provided its adult citizens with 1200 and child dollars 500 as one-time payment.

Consequently, the US resorted to all all-time highest volume of printing USDs, which turned out to be 40 percent of the money the US has ever printed. Following this act of US authorities, economies all around the globe predicted inflation and as expected, inflation rate began rising from 2021 onwards and during May 2022, it was highest ever i.e., 9.1%. Hikes further followed this hike in US inflation in interest rates. Due to the constant hikes in interest rates by US authorities, supply of USDs tends to decline and consequently value of USD gets elevated. One need not be astonished if the USD appreciates vis-a-vis other currencies as it always expected due to the undue liberty being availed by US This in turn keeps other countries busy in managing their forex reserves to finance their mounting current account deficit. Now, it is the high time that economies like India instead of emphasising to ramp up USD reserves, should come forward for bilateral trade arrangements. Undoubtedly, this is a break away from earlier system of dollarisation but it is like killing two birds with one stone as this on the one hand assist in combating the rising current account trade deficit and it will relieve the authorities from the fear of declining USD reserves.

Review of Literature

An effort is being made to present in chronological order a brief review of the trajectory from dollarisation to recent move towards de-dollarisation:

Chen (2022) examined how Russia's de-dollarisation influences the international position of the US Dollar using year-wise data from 2012 to 2021 and employing OLS regression analysis. The author employed asset substitution to measure the degree of Russia's dollarisation and global proportion of US dollar reserves to estimate the US dollar's international status. The regression results demonstrate that when Russia increases its gold reserves and decreases its degree of dollarisation, the global proportion of dollar reserves exhibits a downward trend, implying that Russia's de-dollarisation policies have adversely affected the US dollar's international position in terms of foreign exchange reserves.

Chortane and Pandey (2022) used market model estimates along with the event study approach to investigate the influence of the Russia-Ukraine invasion on the value of some international currencies vis-a-vis USD. The findings show that the turmoil between Russia and Ukraine had a detrimental effect on the value of globally traded currencies. Meanwhile, a closer examination at individual regions reveals that the currencies of the Pacific region were significantly appreciated whereas European currencies specifically the Polish zloty, Czech koruna and Russian rouble were depreciated in relation to the USD. On the contrary, insignificant impact has been found

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ISSN (On-Line Version) 2278-1277

on the Middle East and African currencies. Furthermore, the country-wise analysis reveal that due to Poland and Czech Republic's close proximity to the conflict zonein addition tofinancial and economic restrictions imposedby these nations on Russia, their currencies were depreciated sharply against USD.

Li et al. (2022) investigated the effects of current Russia-Ukraine war on the volatility spillover and dynamics across international financial markets consisting of the global stock market, major cryptocurrency markets, commodity markets (crude oil and gold) using data from January 2017 to March 2022. The results of pairwise spillover indicate a strong correlation between different markets and during the war, there was a substantial rise in the total spillover among international financial markets. Likewise, as per directional spillover, the French and German equity markets were the biggest transmitters of net volatility both before and during the crisis while Japanese equity market was the biggest receiver of net volatility. Conversely, prior to the conflict, the US equity market was a transmitter of volatility but during the conflict, it changed into a receiver of volatility.

Nerlinger and Utz (2022) analysed whether crisis between Russia and Ukraine has had an impact on the stock prices of energy firms byusing an event study methodology revolving Russia- Ukraineconflict on February 24, 2022 which is based on an international sample of 1630 energy companies. The findings indicate a positive cumulative average abnormal return in considered firms as on the event date, meaning thereby,these energy companies excellently performedin stock market specifically North American firms beaten European and Asian firms.

Tiwari et al. (2022) examined how the war between Russia and Ukraine has affected the value of the Indian Rupee against the US dollar by using paired t-test. For this, the daily changes in exchange rate of 120 days before and after the beginning of war have been considered.The study discovered that the war had an adverse impact on the value of the Indian Rupee. India's heavy reliance on imported crude oil, gold, defence equipment, fertilisers etc. has increased the rupee's sensitivity to geopolitical shocks.The authors suggest that India should break its tie with US dollar and should start trade transactions in Indian Rupee or other mutual currencies of its trading partner nations in order to distant itself from the US dollar.

Appiah-Otoo (2023) empirically examined how the war between Russia and Ukraine has affected the cryptocurrency market especially trading volume of Bitcoin and its returns using panel regression model on 20 countries covering a period from January 23 2022 to April 16 2022.The results exhibit that the volume of Bitcoin trade is hindered by the Russia-Ukraine conflict both in short and long-run. In fact, this effect is more evident in the aftermath of the war, particularlyafter one week of its occurrence.

ISSN (Print Version) 0975-3931
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Hossain et al. (2023) by using the crisis between Russia and Ukraine made an effort to scrutinise the association between geopolitical risks and foreign exchange rates against US dollar of 39 countries considered.The time period for the analysis is from February 17, 2022 to March 3, 2022,that is, one week before and immediately after the start of the Russia-Ukraine invasion i.e., on February 24, 2022. The study's key findings reveal that the war had a detrimental effect on foreign exchange rates due to elevated geopolitical risks.The negative impact of geopolitical risks is more evident in nations that depend heavily on Russian energy, have a high degree of policy uncertainty in their economies and are geographically located near Russia and Ukraine. The paper also disclosed that Russia–Ukraine conflict adversely affects global stock market returns and its volatility.

Xu et al. (2023) delve into the impact of the Ukraine invasion by Russia on the Russian rouble exchange rate by using daily exchange rate from January 1 2022 to May 31 2022. The findings of the difference-in-difference regression model discovered that the war in Ukraine adversely affected the Russian rouble and thus exhibited signs of a sharp and constant depreciation in its value.The results reveal an unexpected deviation in the value of rouble from counterfactual forecasts. The actual exchange rate is constantly lower than anticipated exchange rate in the absence of any kind of conflict.

Above mentioned review of the studies clearly shows that in the coming time, the dollar might lose its shine in favour of some other currencies or some other technological system of international payments.

From the foregoing discussion, the following are the disadvantages of the dollarised world:

- The major disadvantage of a dollarised economy is that it loses control over its domestic interest rate and domestic money supply.

- Since the economy is dependent upon USDs instead of the local currency for international trade, this dollarisation also causes loss of revenue to the dollarised economy which the economy could have earned if it were to issue local currency instead of USDs.

- Also, the exports and imports of a dollarised economy become more vulnerable to changes in the US monetary policy. Thus, it can be said that a dollarised economy has to sacrifice its financial freedom and international trade decisions in favour of USD's gains.

De- Dollarisation Move

De-dollarisation roots can be traced back to the late twentieth century when Sino-Russian dream of post western order sounded in various parts of the world including

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ISSN (On-Line Version) 2278-1277

India. But that dream shattered due to the conflicting compromises made by Russia and China respectively with the US.

- Due to escalated geopolitical tensions across the globe, many countries especially BRICS nations have started exploring other means of international reserve currency which could replace USD and even have started indulging in bilateral trade deals for exports and imports from allied nations.

- Recently in 2013, share of USD as global forex reserve has witnessed a sharp decline from 88% to 58% in 2023, as a consequence of harsh action of US sanctioning Russia's use of forex reserves and subsequent retaliation by Russia along with other allied economies.

- De-dollarisation, which has been observed in ASEAN zone, varies from abandoning the USD as in case of bilateral trade deals to other modes of reducing the share of USD in forex reserves.

- For instance, Thailand, Indonesia and Malaysia struck bilateral trade deal in 2016 in which the three nations decided to trade in their national currencies.

- Even recently, QR codes have also appeared, which could be used as a mode of international payment settlement system. Singapore and Malaysia have launched one such system i.e., NETS-DuitNow QR in March 2023. It is a system developed jointly by Singapore and Malaysia as a cross-border payment settlement system.

- Further, recently five nations, China, Malaysia, Thailand, Japan and South Korea, has set up a local currency transaction cooperation.Thus, it can be said that even e-commerce or technology has a more significant role to play in international trade, which could also reduce the dominance of USD.

- To reduce the dominance of USD and as a move towards de-dollarisation, Russia has signed currency swap agreements with other nations.

- In fact, SWIFT has been used as a weapon of sanctioning Russia and other economies like Iran, North Korea by the US and European Union. For example, in 2014, the US imposed sanctions on Russia by sanctioning the bank cards of the seven Russian banks which caused a great inconvenience to the Russian people.

- Further in March 2022, European Union excluded seven Russian banks from SWIFT. Recently even Iran, North Korea and a few other countries have also been denied the access of SWIFT system.

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ISSN (On-Line Version) 2278-1277

- In order to overcome the impact of sanctions imposed by US and EU, Russia developed a new SPFS system in 2012. The SPFS is a financial message transmission system of Russia which provided access to 440 bank customers all around the globe by September 2022.

- Malaysia and India also entered into a memorandum of understanding (MoU) in April 2023 and this MoU is basically meant for mutual trade transactions between Malaysia and India in Indian rupee (INR).

- The recent phase of bilateral trade agreement is basically aimed at de-dollarisation following the freezing of Russian forex reserves by US. The bilateral trade between India and Russia has attained a massive hike as it reached $ 50 billion during the last financial year of 2022-23. However, an asymmetrical bilateral trade agreement of oil purchases between India and Russia using Indian rupee as payment mode during the past year following Russia-Ukraine war led to piling up of $ 1 billion worth rupees each month in Vostro account of Russia in Indian bank. Due to stagnant exports to Russia from India, Russia stayed helpless in overcoming the surplus in the Vostro account i.e., the rupees of Russia lying in India.

- However, India being second largest market and most favoured destination for the foreign companies to set up their centres there in India, Russia can work out a strategy to establish Russian companies in India and use surplus rupees of Russia lying in Indian banks and even Central Bank of India has suggested putting surplus from Russian exports to India in local securities of India such as investing in the government bonds of India.

- Recently, during the prime minister Modi's visit to UAE in July 2023, a local currency payment MoU has been signed between India and UAE. This MoU set up a Local Currency Settlement System (LCSS) between two nations for promoting the use of INR and AED (UAE dirham) for cross-border trade settlements for both current and capital account transactions. Following which Indian Oil Corporations Limited (IOCL), one of the India's top refineries imported million barrels of oil from Abu Dhabi National Oil Company (ADNOC) using INR. This is another example of deviation from earlier system of purchasing oil through USDs and thus, signifying the declining dominance of USD in the international trade.

- In the backdrop of providing INR the status of international currency, India is expecting its trading partners in local currencies from Latin America and Africa for the future bilateral agreements. Moreover, in March 2023, RBI have authorised banks from 18 countries to open Special Vostro Rupee Accounts (SVRAs) for trade settlements in INR. Following this, RBI approved domestic and foreign Authorised Dealers (ADs) banks in 60 cases for opening SVRAs of banks from 18 countries, namely, Botswana, Fiji, Germany, Guyana, Israel, Kenya, Malaysia, Mauritius, Myanmar, New Zealand, Oman, Russia, Seychelles, Singapore, Sri Lanka, Tanzania, Uganda and the United Kingdom.

- All these above-enumerated cases of bilateral deals, currency swaps, cross-border QR code system etc. make a gesture towards the de-dollarisation.

The above discussion clearly shows that Asian economies are particularly striving for de-dollarisation. It is clear from the journey of USD dominance that India has entered into bilateral trade deals with countries, especially in the Asian region and Russia which is the outcome of the de-dollarisation move.

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