Source : www.thehindu.com Date : 2018-10-06

AVOIDING THE CURRENCY BASKET CASE

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Foreign capital, Foreign Trade & BoP

Illustration of a vector green leaf icon with a rupee sign

The Indian rupee was once a multilateral currency, its usage prevalent across the Indian Ocean in places as varied as Java, Borneo, Macau, Muscat, Basra and Zanzibar. The historic dhow trade ensured that the Gulf had a familiarity with the rupee for over five centuries, with Oman utilising the ‘Gulf rupee’ till 1970.

The accession of George V to the throne in 1911, enshrining his rule of the British Raj, led to the issuance of a new rupee coin. The colonial rupee leveraged the Mughal rupee’s popularity, facilitated by trading communities, migration and the Raj’s hegemony. The annexation of Sindh, Ceylon and Burma further encouraged the primacy of the rupee in these areas. Meanwhile, a number of Indian merchant communities had established themselves in such regions, aiding in its convertibility.

Even after Independence, Dubai and other Gulf states were using RBI-minted Gulf rupees until 1966. Between the 1950s and 1970s, gold smuggling was rampant on the Konkan coast, with a number of Gulf businesses buying gold cheaper in the Gulf in rupees and smuggling it to India. Only the devaluation of the Indian rupee in 1966, after the 1965 war, led to such nations switching to their own currencies. Now, only Nepal and Bhutan regularly conduct bilateral trade with India in rupees.

The rupee’s valuation is often of concern. The value of the rupee itself has varied over the years too – contrary to WhatsApp rumours, the rupee was never equal to the U.S. dollar. In 1947, the rupee-dollar rate was at 3.30. The aforementioned devaluation in 1966 raised it to 7.50, reaching 32.4 by 1995. This decline was precipitated by a variety of factors – wars with Pakistan and China, the adoption of Five Year Plans requiring foreign loans, political instability and the Oil Price Shock of 1973. Of late, the rupee has been declining given higher oil prices and FII outflows from stocks and bonds. The ongoing U.S.-China trade war, Iran sanctions and further upward movement in oil prices will continue to test the rupee’s valuation.

While such see-saws do happen, the Reserve Bank of India and the Ministry of Finance do have a number of options for stabilisation, including overtly intervening in the forex market, selling non-resident Indian bonds (as last done in 2013) and conducting a sovereign bond issuance. In addition, the rupee’s dependency on the U.S. dollar must be reduced – India should consider formalising the rupee payment mechanism with friendly countries such as Russia, with a focus on reducing its overall current account deficit. We must continue to guard against fiscal profligacy, with any slippage viewed negatively by the currency markets, further encouraging investors to flee Indian markets. Industrial growth should be a priority; without having goods to sell, rupee swaps (say with Iran) will be difficult to institutionalise. A lower rupee is a recipe for a higher import burden, spiralling eventually into a currency crisis.

The formalisation of the Indian economy, by deterring black money transactions in the rupee, is also much needed. Somehow, the rupee always ends up falling just prior to an election – looking at the data in 2013, Malini Bhupta and Vishal Chhabria found that rupee had depreciated just prior to the election date six times in the past seven elections. India’s black money strategy should consider four pillars — it should encourage tax rate rationalisation, reform vulnerable sectors, support a cashless economy and create effective and credible deterrence. Tax rate

rationalisation, with lower tax rates as an end goal, would increase the tax base and increase compliance with tax returns. Administrative agreements with countries like the U.K. and Switzerland which can offer mutual tax sharing should be encouraged. It is important to create a remittance database detailing company transfers out and NGO transfers into India, all reporting to the Financial Intelligence Unit (FIU). The Direct Tax Administration's Directorate of Criminal Investigation should be provided the right IT training, infrastructure and funding to become an effective deterrent, while the audit cycles for income tax, service tax and excise tax departments should be aligned, helping the Large Taxpayer Unit (LTU) become more effective, increasing the scope of simultaneous scrutiny and examination.

Finally, looking ahead, the internationalisation of the rupee is a worthwhile goal to aim for. While the Chinese yuan is increasingly being positioned for an alternative reserve currency through a variety of multilateral trades, institutions (the Belt and Road Initiative, the Asian Infrastructure Investment Bank) and swaps, the Indian rupee remains woefully behind in internalisation. China campaigned hard for the inclusion of its currency in IMF's benchmark currency basket in 2015, introducing a range of reforms to ensure that the yuan was considered as "freely usable". The RBI, meanwhile, has adopted a gradualist approach – allowing companies to raise rupee debt offshore, enabling the creation of "masala bonds" and allowing foreigners to invest in rupee debt onshore; the rupee has transformed from a largely non-convertible pegged currency before 1991 to a managed float. The rupee is currently not even in the top 10 traded currencies.

There is no magic wand to making the rupee appreciate. But institutional resistance against rupee convertibility should be overturned. To restore the rupee's multilateral nature, we must unshackle its usage.

Feroze Varun Gandhi is a Member of Parliament, representing the Sultanpur constituency for the BJP.

END