

FROM DOLLAR DEPENDENCE TO REGIONAL CURRENCIES: INDIA'S ROLE IN EMPOWERING REGIONAL ECONOMIC AUTONOMY

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Abstract

Geopolitical upheavals and structural economic changes are posing previously unheard-of challenges to the post-war global financial architecture, which was based on the dominance of the US dollar. In order to lessen their vulnerability to external shocks, unilateral sanctions, and the effects of U.S. monetary policy, an increasing number of countries—especially those in the Global South—are actively working to lessen their reliance on the dollar. With an emphasis on South Asia, this study analyses India's calculated and strategic approach to the internationalisation of the Indian Rupee (INR), which is a crucial facilitator of regional economic autonomy. It contends that rather than aiming for immediate reserve currency status, India's approach of developing workable, demand-driven mechanisms for trade settlement provides a feasible way for its neighbours to strengthen their financial sovereignty. The policy framework supporting this push, which includes bilateral currency swap agreements, the Special Rupee Vostro Account (SRVA) system, and the integration of digital payment infrastructure, is dissected in this analysis. The study assesses the practicality, advantages, and inherent drawbacks of this strategy using in-depth case studies of India's economic ties with Bangladesh, Nepal, Sri Lanka, Russia, and the Maldives. The main issue that has been identified is the structural imbalance in trade between India and its partners, which limits the extent of settlement based on the rupee.

Furthermore, India's cautious stance on capital account convertibility and competition from China's more assertive Yuan internationalization strategy present significant hurdles. The paper concludes that while the Rupee is unlikely to challenge the dollar's global hegemony, its growing role as a regional trade and settlement currency is a crucial component of India's "Neighborhood First" policy, contributing to a more resilient, multipolar, and economically integrated South Asian sphere.

Keywords: De-dollarization, Indian Rupee, Regional Economic Autonomy, Special Rupee Vostro Account (SRVA), South Asia, U.S. Dollar Dominance, Internationalization of Currency

1. Introduction

The international monetary system has been dominated by the U.S. dollar. This system began with the 1944 Bretton Woods Agreement, which linked global currencies to the dollar, itself backed by gold. Even after the gold standard ended in the early 1970s, the dollar remained dominant due to the strength and size of U.S. financial markets, its use in pricing global trade especially commodities like oil and the difficulty of replacing it. Today, the dollar is involved in almost 90% of global foreign exchange transactions and makes up

about 60% of global reserves, even though the U.S. accounts for only a quarter of the world's economy.

This dominance is now being challenged. A combination of political and economic factors is pushing more countries to seek ways to reduce their reliance on the dollar. One key reason is the growing use of dollar-based sanctions. For example, when Western countries froze nearly half of Russia's dollar assets after its invasion of Ukraine in 2022, it showed how vulnerable nations can be if they depend too much on the dollar. Many countries now see currency

diversification not just as a financial strategy but as a way to protect their independence. Additionally, long-term concerns like the U.S.'s large trade deficits and shrinking share of the global economy have raised doubts about the dollar's future stability. At the same time, new alliances like BRICS (Brazil, Russia, India, China, and South Africa, now expanded) are working together to encourage trade in local currencies and create alternative payment systems.

This study contends that India, motivated by two primary objectives—enhancing its financial autonomy and fostering regional stability—is adopting a prudent and incremental strategy to promote the international utilisation of the Indian Rupee (INR). India is assisting its South Asian neighbours in lessening their reliance on the US dollar by putting into practice carefully thought-out policies like the Special Rupee Vostro Account (SRVA) system and bilateral currency swaps.

The objective of this approach is to encourage increased economic independence in the area. India faces many obstacles in its endeavours. The nation's capacity to grow is constrained by structural problems such as restricted capital account convertibility and persistent trade deficits with important partners and the role of the Rupee worldwide. Furthermore, China's more assertive and state-led currency policies compete with India's strategy. In order to evaluate the Indian Rupee's potential to improve regional economic independence, this paper thoroughly examines these complexities.

2. The Architecture of Dollar Dominance: From Bretton Woods to a Floating Standard

The United Nations Monetary and Financial Conference in Bretton Woods, New Hampshire, in 1944 marked the beginning of the U.S. dollar's dominance on a global scale. After World War II, representatives from 44 Allied nations convened to establish a stable economic framework. They decided that all currencies would be tied to the US dollar, which the US would exchange for gold at a set rate of \$35 per ounce, rather than directly to gold. The dollar became the primary medium of exchange in the global financial system as a result. Because it had maintained its

industrial capacity during the war and held the majority of the world's gold reserves, the United States was in a unique position to lead this system at the time.

For more than twenty years, this arrangement helped facilitate global trade and post-war recovery. But by the 1960s, the system began to face serious challenges. The U.S. ran large deficits to fund the Vietnam War and domestic programs, increasing the amount of dollars circulating globally. As more dollars flowed out of the country, doubts arose about whether the U.S. could continue converting them into gold. Foreign central banks began redeeming their dollar reserves for gold, draining U.S. gold supplies. This led President Richard Nixon in 1971 to suspend the dollar's convertibility to gold, effectively ending the Bretton Woods system. A later attempt to stabilize the system through the Smithsonian Agreement, which devalued the dollar and allowed for wider exchange rate fluctuations, ultimately failed to sustain the arrangement.

Even after the formal gold peg ended, the U.S. dollar's dominance not only continued but, in some ways, became even stronger. The world shifted to floating exchange rates, yet the financial systems and institutions that had been built around the dollar stayed in place. Because there was no practical alternative and also the U.S. financial markets were large and highly liquid, the dollar remained the primary currency used for global trade, finance, and central bank reserves.

3. Mechanisms of Hegemony: Network Effects, Reserve Currency Status, and the SWIFT System

The continued strength of the U.S. dollar is explained by what economists call “network effects” where a currency becomes more useful as more people use it. The more the dollar is accepted for global trade, the more others are encouraged to use it as well, since it reduces conversion costs and simplifies transactions. This creates a self-reinforcing cycle that strengthens the dollar's role and makes it very difficult for any country or institution to operate outside of it. This influence is clear in global finance: the dollar is involved in nearly 90% of all foreign exchange transactions and makes up about 60% of global foreign exchange reserves. Even though the U.S. now accounts for a smaller share of the

world's economy than it did two decades ago, the dollar's dominance has declined only slightly. The dollar has an impact on global finance's infrastructure in addition to market forces. One important example is the Society for Worldwide Interbank Financial Telecommunication (SWIFT), a system based in Belgium that handles the majority of international money transfers. The U.S. Treasury has considerable control over the system, despite its formal neutrality, which enables it to monitor transactions and impose sanctions by barring foreign organisations when required. Because of this, the United States has unparalleled control over international financial flows, making the dollar-based system an effective instrument for achieving its foreign policy goals.

4. Strategic Justification: Strengthening Monetary Sovereignty and Mitigating External Vulnerabilities

India's intentional push to make the Rupee global in response to the dangers posed by the dollar-dominated global financial system, India has initiated a purposeful and multi-layered plan to promote the use of the Indian Rupee (INR) in international markets. Instead of replacing the dollar, the goal is to establish a more parallel and stable framework for regional finance and

trade. This plan aims to strengthen India's financial independence while bolstering its resilience to external economic shocks. There are several benefits to this approach. Trading in Indian rupees (INR) reduces exchange rate risks, transaction costs, and the need for expensive hedging for Indian businesses by avoiding multiple currency conversions. Promoting the Rupee in international trade relieves the Reserve Bank of India (RBI) of the need to maintain substantial foreign exchange reserves, freeing up funds for domestic development. Additionally, it strengthens India's economic independence and strengthens its standing in the global financial system, which could eventually enable the country to raise money by issuing rupee-denominated bonds on foreign exchange markets.

5. The Policy Toolkit

The Indian government with its agency, the Reserve Bank of India (RBI) has implemented a well-thought-out set of policy tools to promote and facilitate use of the Rupee in cross-border transactions in order to accomplish these strategic objectives. The Official Roadmap: Analysis of the RBI Inter-Departmental Group's (IDG) Recommendation

Table 1: Key Mechanisms for INR Internationalisation

Mechanism	Purpose	Key Features	Status / Key Participating Countries
Special Rupee Vostro Account (SRVA)	To facilitate bilateral trade invoicing, payment, and settlement directly in Indian Rupees (INR).	Foreign banks open INR-denominated accounts with authorized Indian banks. Surplus balances can be invested in Indian government securities.	Operational. Banks from 22+ countries have opened accounts, including Russia, UAE, Sri Lanka, Malaysia, Bangladesh, and Mauritius.
Currency Swap Agreements	To provide short-term foreign exchange liquidity and support trade settlement in local currencies, bypassing the need for a third currency.	Bilateral agreements between central banks to exchange pre-determined amounts of their respective currencies.	Active. Major agreements with Japan (\$75 billion). Regional framework for SAARC members with a dedicated ₹25,000 crore INR window. MoUs with UAE, Indonesia, Maldives.
Digital Payment Integration	To create alternative, low-cost, real-time payment rails for retail and small-value cross-border transactions.	Linking India's Unified Payments Interface (UPI) and RuPay card network with international payment systems.	Operational and expanding. Linkages established with UAE, Singapore, France, Bhutan, and Nepal.

6. Managing Asymmetries: Benefits and Challenges for Bangladesh, Nepal and Bhutan

The use of Rupee-based trade mechanisms with India's other neighboring countries shows a mixed outcome while offering clear benefits, it is also constrained by underlying economic imbalances.

6.1 Bangladesh: Facing dwindling dollar reserves, Bangladesh began partial trade settlements in Rupees in July 2023. However, the system is limited by a large trade imbalance. Bangladesh imports about \$14 billion worth of goods from India annually, while its exports to India are only around \$2 billion. As a result, Rupee-based trade is effectively limited to the \$2 billion earned from exports, with the remaining \$12 billion still requiring dollar payments. Despite this constraint, the arrangement provides clear benefits, including lower transaction costs estimated at up to 6% savings for some businesses and protection from the volatility of the Bangladeshi Taka against the dollar, which has been more severe than its movement against the Rupee.

6.2 Nepal and Bhutan: These Himalayan nations have the closest financial ties with India. Their currencies the Nepalese Rupee (NPR) and Bhutanese Ngultrum (BTN) are pegged to the INR, and most bilateral trade is conducted in Rupees. This peg ensures exchange rate stability, supporting smooth trade and investment. However, it limits their monetary policy independence, as their central banks must align with RBI policies, and it exposes them to “imported inflation” from India. Both countries, particularly Bhutan, have also faced periods

of Rupee shortages due to persistent trade deficits, requiring interventions from their monetary authorities and, at times, the sale of foreign currency reserves to obtain Rupees.

6.3 Emerging Corridors:

India is also promoting the use of the rupee beyond South Asia, including in the UAE and Maldives, extending its local currency settlement framework to important strategic and economic partners.

6.3.1 United Arab Emirates (UAE): The UAE, as a key trading partner and major source of remittances and energy for India, was a natural choice for a local currency arrangement. In July 2023, India and the UAE signed a Memorandum of Understanding to set up a Local Currency Settlement System (LCSS). This was soon followed by a landmark transaction in which India purchased crude oil from the UAE and paid in Rupees, marking an important step toward reducing reliance on the U.S. dollar for energy imports.

As a result, India's strategy goes beyond commercial objectives it serves as a tool of its “Neighborhood First” foreign policy. The Rupee framework is used not only to facilitate trade but also to provide crisis support and extend regional influence. For example, India's rapid financial assistance to Sri Lanka, using currency swaps and credit lines when dollar markets froze, helped stabilize the country and counter China's influence. The formal adoption of the INR in Sri Lanka's financial system demonstrates how the Rupee is being actively leveraged as an instrument of statecraft to support neighboring economies and strengthen India's strategic

Table 2: Bilateral Trade between India and Key Partners (FY 2023-25)

Country/Bloc	Exports from India (USD billion)	Imports to India (USD billion)	Total Trade (USD billion)	Trade Balance for India (USD billion)
Russia	4.88	63.84	68.72	-58.96
Sri Lanka	4.1	1.4	5.5	+2.7
Bangladesh	11.06	1.84	12.91	+9.22
Nepal	8.0 (approx.)	1.5 (approx.)	9.5 (approx.)	+6.5 (approx.)
Bhutan	1.0 (approx.)	0.5 (approx.)	1.5 (approx.)	+0.5 (approx.)
UAE	35.63	48.02	83.65	-12.39
Maldives	0.59	0.07	0.66	+0.52

Source: Data is compiled from various sources for FY2023-25 and may include estimates for some partners.

position in the region.

6.4 Hurdles on the Path to a Multipolar Currency System

Although India has made strategic progress in promoting Rupee-based trade in the region, its journey toward wider currency internationalization faces substantial internal and external challenges. These obstacles not only slow the Rupee's growth but also shape its long-term potential in the changing global financial system.

6.4.1 Internal Constraints: The Critical Challenge of Capital Account Convertibility and Deepening Financial Markets

One of the biggest domestic challenges to the Rupee's global ambitions is India's partial capital account convertibility. While the Rupee can be freely converted for trade-related transactions (the current account), there are still strict restrictions on the capital account, which governs cross-border investments. This means that foreign investors cannot freely convert Rupees to other currencies to invest in Indian financial assets or repatriate funds without following regulatory limits and approvals.

This limited convertibility reduces the Rupee's appeal

as a reserve currency, which requires the ability to invest freely in deep, liquid, and open markets. India's cautious approach protects the economy from sudden capital flight but makes holding large Rupee balances less attractive to foreign central banks and corporations. The S.S. Tarapore Committees (1997 and 2006) recommended full capital account convertibility, but several macroeconomic conditions such as fiscal consolidation, controlled inflation, and a robust banking system with low non-performing assets have not been consistently met, supporting the government's gradual approach.

This situation reflects the “policy trilemma” of international macroeconomics, which states that a country cannot simultaneously have an open capital account, a fixed or managed exchange rate, and an independent monetary policy. India has prioritized maintaining monetary policy independence to control inflation and managing the exchange rate to protect export competitiveness, which has required keeping the capital account partially closed. While this approach supports domestic stability, it also places a structural limit on the Rupee's internationalization by restricting its free use as a global asset.

Table 3: Comparative Analysis of Rupee vs. Yuan Internationalization Strategies

Dimension	India (INR)	China (CNY)
Primary Driver	Economic resilience; enhancing monetary sovereignty; regional stability.	Geopolitical ambition; challenging U.S. hegemony; de-dollarization.
Key Mechanism	Special Rupee Vostro Account (SRVA) for trade settlement; UPI for retail payments.	Cross-Border Interbank Payment System (CIPS); financing for BRI projects.
Geopolitical Linkage	"Neighborhood First" policy; crisis support for regional partners.	Belt and Road Initiative (BRI); Shanghai Cooperation Organisation (SCO).
Capital Account Policy	Partial convertibility with a cautious, gradualist approach to liberalization.	Strict capital controls with managed, state-directed liberalization.

Pace & Style	Cautious, market-driven, bottom-up, and consensus-oriented.	Assertive, state-driven, top-down, and strategically directed.
Key Challenge	Structural trade deficits with partners limit the scope of INR settlement.	Lack of trust in governance; opacity of capital controls and financial system.

6.4.2 External Competition: A Comparative Analysis of India's Gradualist Strategy versus China's Assertive Yuan Internationalisation

7. Policy Recommendations for a Phased and Resilient Internationalization

Based on these findings, a set of policy recommendations can be formulated to build on the current momentum while managing the associated risks:

- **Address the Trade Imbalance:** To increase the international use of the Rupee, partner countries need more opportunities to earn Rupees. India can achieve this by boosting imports from regional partners, especially in South Asia, reducing non-tariff barriers, streamlining customs procedures, and encouraging Indian investment in neighbouring countries' productive sectors. Balanced trade flows would create a natural demand for Rupee-based settlements.

- **Deepen and Liberalize Financial Markets:** Making the Rupee more attractive as a store of value requires deeper and more accessible domestic financial markets. This includes improving liquidity in government and corporate bond markets for foreign investors holding SRVA balances and expanding the availability of hedging instruments.

- **Accelerate Digital Integration:** India should expand the international reach of its digital payment systems, such as UPI and RuPay. Integration with more countries, particularly in Asia and Africa, can embed the Rupee in everyday retail transactions, creating strong network effects and a broader ecosystem for its use.

- **Maintain a Calibrated Approach to Capital Account Convertibility:** Full convertibility of the

Rupee remains a long-term goal, but India should continue a gradual approach, liberalizing specific capital flows as macroeconomic fundamentals strengthen. A sudden opening could trigger destabilizing capital flight, so careful sequencing is essential, in line with the RBI's Inter-Departmental Group recommendations.

The Indian Rupee is unlikely to challenge the U.S. dollar's global dominance in the near future, due to structural limitations and the strong network effects supporting the dollar. However, measuring the success of India's strategy by this standard misses its true purpose.

The key achievement of Rupee internationalization is its regional impact. By providing a credible, efficient, and accessible alternative for trade settlement, India can help smaller neighbours reduce exposure to global financial volatility. The Rupee lowers transaction costs, supplies critical liquidity during crises, and gives these countries a degree of monetary autonomy they would not otherwise enjoy.

In this light, the Rupee's internationalization should be seen not as a pursuit of global status, but as a strategic tool to strengthen South Asia. It contributes to building a more stable, integrated, and economically sovereign region, with India at its centre. In an era of increasing geopolitical fragmentation, the Rupee is emerging as a currency of regional resilience.

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