



Trading in Local Currencies: Problems and Prospects to the SAARC Countries

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1. Introduction

Trading in local currencies involves making payments in domestic currencies instead of an internationally convertible currency such as the US dollar. For example, for a transaction between two residents in Sri Lanka and India, the local currencies would be the Sri Lanka rupee and the Indian rupee. Trading in local currency is gaining traction globally, where some countries are reevaluating their heavy reliance on the US dollar in their international transactions and reserve holdings (Gopinath, 2024). With the increasing popularity of bilateral arrangements and regional initiatives aimed at reducing reliance on major international currencies, this trend is expected to further grow.

2. Key aspects of trading in local currency

Some key elements of trading in local currency are discussed below.

- **Bilateral Agreements:** Countries enter into bilateral agreements to trade goods and services where payments are made using their respective local currencies.
- **Currency Swaps:** Central banks may establish currency swap lines, allowing them to exchange a specific amount of their currencies. This facilitates trade and investment between the countries by providing liquidity in local currencies.
- **Payment Systems:** Efficient payment systems are essential for facilitating local currency trade. Countries may develop or integrate payment platforms that support transactions in local currencies.
- **Central Bank Digital Currency (CBDC) and Blockchain Technology:** The rise of CBDC could facilitate the use of local currencies in international trade. CBDCs are being explored currently by various countries for this purpose.
- **Trade Invoicing:** Businesses may invoice their international transactions in local currencies instead of a third-party currency like the US dollar. This reduces the need for currency conversion and minimizes exposure to exchange rate fluctuations.

3. Benefits and risks of trading in local currency

Trading in local currencies can have significant implications for global trade and finance and provide a range of benefits as follows.

- **Reduced Dependency on Major Currencies:** This can help mitigate risks associated with exchange rate volatility and political influences from major economies.
- **Strengthening Regional Trade Blocs:** Trading in local currencies can strengthen regional trade agreements and economic blocs.
- **Promoting Economic Sovereignty:** Countries can enhance their economic sovereignty by promoting the use of their own currencies in trade. This can lead to more stable economic policies and reduced vulnerability to external economic shocks.
- **Facilitating Trade Among Developing Economies:** Developing economies may benefit from trading in local currencies by reducing the costs associated with currency conversion and foreign exchange risks. This can promote trade and economic cooperation among developing nations.

Despite the above benefits, trading in local currency can give rise to several challenges and risks. These include issues related to liquidity where some local currencies may not be widely traded or easily convertible, leading to difficulties in completing transactions. Also, the local currency stability which is influenced by the country's political or economic instability may cause challenges for local currency trading. Additionally, inadequate financial systems and payment mechanisms can complicate transactions and increase the risk of delays or failures of settlement while complexities in managing multi-currency accounts, billing, and financial reporting can increase administrative burdens when conducting transactions in local currency. Furthermore, having limited options for financial instruments and markets to hedge against currency risks can leave traders exposed to exchange rate fluctuations. Countries will need to address these challenges to ensure the success of local currency trading.

4. Local currency trading in the SAARC Countries

Several considerations can be identified if local currency trading is to be adopted in the SAARC region, as discussed below.

- **Bilateral and Multilateral Agreements:** SAARC countries might need to establish new or extend existing bilateral and multilateral agreements to facilitate local currency trading.
- **Development of Payment Systems:** Efficient and reliable regional payment systems are essential for the successful implementation of local currency trading.

- **Capacity Building:** Building capacity among businesses and financial institutions to handle local currency transactions is crucial for the success of this initiative.
- **Policy Coordination:** Coordinated policies and regulatory frameworks among South Asian countries are necessary to promote and sustain local currency trading.

By addressing these considerations and leveraging on the long-established trade links among the countries in the region, South Asia can significantly benefit from local currency trading, leading to enhanced economic stability, reduced transaction costs, and greater regional integration.

5. Sri Lanka's Trade performance in the SAARC Countries

Trade among SAARC countries predominantly involve transactions in foreign currencies such as the US dollar. This reliance on foreign currencies is rooted in historical practices as these currencies are more stable and liquid than local currencies. As a result, many intra-SAARC trade transactions, including exports and imports, are mainly settled in US dollars instead of using local currencies.

5.1 Overall Export Performance

Table 01: Export Performance of Sri Lanka (country wise)

		USD mn						
Export		2017	2018	2019	2020	2021	2022	2023
Afghanistan	USD mn	0.7	0.5	0.6	0.2	0.9	0.8	1.0
Bangladesh	USD mn	122.4	135.8	162.0	152.8	222.1	211.0	174.5
Bhutan	USD mn	0.3	0.01	0.0	0.4	0.03	0.9	0.002
India	USD mn	691.3	776.9	768.0	606.1	829.0	860.0	852.9
Maldives	USD mn	108.0	110.0	114.1	77.6	103.2	106.1	112.9
Nepal	USD mn	1.7	8.2	6.9	5.4	11.4	2.1	1.0
Pakistan	USD mn	74.0	76.0	81.6	74.3	91.9	78.0	74.3
SAARC Region	USD mn	998.4	1,107.2	1,133.3	916.8	1,258.6	1,258.9	1,216.5
Total Exports	USD mn	11,360.4	11,889.6	11,940.0	10,047.4	12,498.6	13,106.4	11,910.7
As a % of total for SAARC	%	8.8%	9.3%	9.5%	9.1%	10.1%	9.6%	10.2%

From 2017 to 2023, Sri Lanka's exports to the SAARC region have been stagnant. The highest export value was recorded in 2022 at US dollars 1,258.9 million and followed by a slight decrease to US dollars 1,216.5 million in 2023.

Afghanistan:

Exports to Afghanistan remained relatively low. However, it fluctuated between US dollars 0.2 million and US dollars 1.0 million during the considered time period. The highest export value was at US dollars 1.0 million in 2023, while showing modest growth compared to other SAARC countries, and showing an increasing trend from 2020 onwards. The primary agricultural exports to Afghanistan were coconut kernel and non-kernel products, while industrial exports included animal fodder and base metals.

Bangladesh:

Bangladesh is a significant export destination in the SAARC region, with exports growing from US dollars 122.4 million in 2017 to a peak of US dollars 222.1 million in 2021. However, there was a slight decline in 2022 to US dollars 211.0 million and a further decrease to US dollars 174.5 million in 2023. Sri Lanka's exports to Bangladesh were diverse, including agricultural products such as spices, tea, natural rubber, and coconut kernel products. Industrial exports included textiles, machinery and mechanical appliances, petroleum products, base metals, wood and paper products, chemical products, and plastics. The broad range of exports underpins the robust trade relationship between Sri Lanka and Bangladesh.

Bhutan:

Exports to Bhutan are minimal compared to the other SAARC export destinations. The highest recorded export value was at US dollars 0.9 million in 2022, but it dropped sharply to US dollars 0.002 million in 2023. The primary export to Bhutan was transport equipment.

India:

India is the largest export destination within the SAARC region, with exports peaking at US dollars 860.0 million in 2022. Although there was a slight decrease in 2023 to US dollars 852.9 million, India remains the most important market for Sri Lankan exports in the SAARC region. The export portfolio included a wide array of products from the agricultural and industrial sectors. Key agricultural exports were spices, tea, natural rubber, and coconut products. Industrial exports included animal fodder, textiles, food and beverages, garments, machinery and mechanical appliances, petroleum products, base metals, wood and paper products, and high-value items such as gems, diamonds and jewelry. This extensive list reflects the strong and diverse economic ties between Sri Lanka and India. However, Sri Lanka has a persistent and considerable trade deficit with India.

Maldives:

Exports to the Maldives have been relatively notable, ranging from US dollars 77.6 million to US dollars 114.1 million in the recent years. The highest export value was at US dollars 114.1 million in 2019, with a gradual increase recorded in 2023 to US dollars 112.9 million. Key agricultural exports included vegetables, seafood, tea, spices, and coconut kernel products. Industrial exports comprised food and beverages, machinery, chemical products, base metals, wood and paper products, plastics, and garments.

Nepal:

Exports to Nepal show significant volatility, peaking at US dollars 11.4 million in 2021, then sharply declining to US dollars 2.1 million in 2022 and further to US dollars 1.0 million in 2023. Sri Lanka's exports to Nepal included key agricultural items such as tea, coconut kernel products, and natural rubber, along with various industrial products. Industrial exports consisted of food and beverages, animal fodder, machinery, and chemical products.

Pakistan:

Exports to Pakistan have remained relatively notable compared to other countries, ranging from US dollars 74.0 million to US dollars 91.9 million. The highest export value was at US dollars 91.9 million in 2021 and followed by a decrease to US dollars 74.3 million in 2023. Key agricultural exports included minor agricultural products, coconut kernel and non-kernel products, natural rubber, spices, and tea. Industrial exports included textiles, machinery and mechanical appliances, petroleum products, chemical products, rubber products, base metals, wood and paper products, and plastics.

Regional Export Contribution

The SAARC region as a whole accounted between 8.8 per cent and 10.2 per cent of Sri Lanka's total exports. The contribution peaked at 10.2 per cent in 2023, indicating a growing significance of the SAARC region in Sri Lanka's export strategy. Sri Lanka's exports to the SAARC region have generally increased over the years, with notable contributions from exports to India, Bangladesh, and the Maldives. Bilateral Trade Agreements between India (ISFTA), Pakistan (PSFTA) with Sri Lanka and Regional Trade Agreements such as South Asian Free Trade Area (SAFTA) significantly contributed to increase trade between Sri Lanka and SARRC region. Despite fluctuations and occasional declines due to policy decisions, the overall trend indicates a strengthening of trade ties within the region. The data highlights the importance of maintaining and enhancing trade relationships while exploring potential growth opportunities between SAARC countries. The variety of exported goods enhances Sri Lanka's diverse economic capabilities and strategic trade practices within the SAARC region.

5.2 Overall Import Performance

Table 02:Import Performance of Sri Lanka (country wise)

		USD mn						
Import		2017	2018	2019	2020	2021	2022	2023
Afghanistan	USDmn	0.1	0.1	0.1	0.03	0.1	0.1	0.1
Bangladesh	USDmn	43.6	34.7	40.9	47.9	83.3	81.7	66.8
Bhutan	USDmn	0.00001	0.0	0.0001	0.00002	0.001	0.0005	0.0
India	USDmn	4,527.4	4,231.2	3,898.8	3,079.1	4,625.1	4,738.1	3,136.4
Maldives	USDmn	163.5	192.7	33.4	35.1	220.3	156.7	133.8
Nepal	USDmn	0.1	0.1	0.1	0.1	0.1	0.2	0.1
Pakistan	USDmn	349.1	428.4	369.8	324.3	394.4	342.3	323.0
SAARC Region	USD mn	5,083.8	4,887.2	4,343.0	3,486.5	5,323.2	5,319.1	3,660.2

Sri Lanka's import landscape within the SAARC region over the period from 2017 to 2023 was notable, consistently accounting for more than 20 per cent of total imports. The SAARC countries, mainly India, Pakistan, Maldives, and Bangladesh have contributed significantly to Sri Lanka's import portfolio, reflecting the interconnected economic dynamics of the SAARC region.

Afghanistan:

Imports from Afghanistan have remained minimal, drifting around US dollars 0.1 million annually. The primary imports included fruits, spices, mineral products, and rubber articles. Despite the small volume, these imports contributed to the diversity of Sri Lanka's consumer and intermediate goods.

Bangladesh:

Bangladesh is a notable trading partner for Sri Lanka, with imports peaking at US dollars 83.3 million in 2021 and before declining to US dollars 66.8 million in 2023. Major imports from Bangladesh included a broad spectrum of consumer goods such as medical and pharmaceutical products, clothing, cosmetics, household items, and vegetables. Additionally, intermediate goods such as textile articles, chemical products, and food preparations play a crucial role in Sri Lanka's industrial inputs.

Bhutan:

Bhutan's contribution to Sri Lanka's imports is minimal, often recorded as zero or very low values. This showed the limited trade activity and minimal economic interdependence in terms of imports between the two countries.

India:

India stands out as Sri Lanka's largest import source within the SAARC region, with imports reaching a peak level of US dollars 4,738.1 million in 2022 before dropping to US dollars 3,136.4 million in 2023. The variety of imported goods is extensive, including consumer goods (sugar, medical and pharmaceutical products, spices, vegetables, clothing, and household items), intermediate goods (textile articles, chemical products, petroleum products), and investment goods (machinery, building materials, and transport equipment). This indicates the deep economic integration of Sri Lankan economy with Indian products.

Maldives:

Imports from the Maldives have been relatively notable, while peaking at US dollars 220.3 million in 2021 and declining to US dollars 133.8 million in 2023. Key imports included seafood and beverages for consumer use, agricultural inputs, and investment in building materials and machinery. These imports reflect bilateral trade focused on specific sectors such as food and construction.

Nepal:

Similar to Afghanistan, imports from Nepal have remained minimal. Consistently, it was at around US dollars 0.1 million. The primary imports from Nepal are medical and pharmaceutical products and chemical products.

Pakistan:

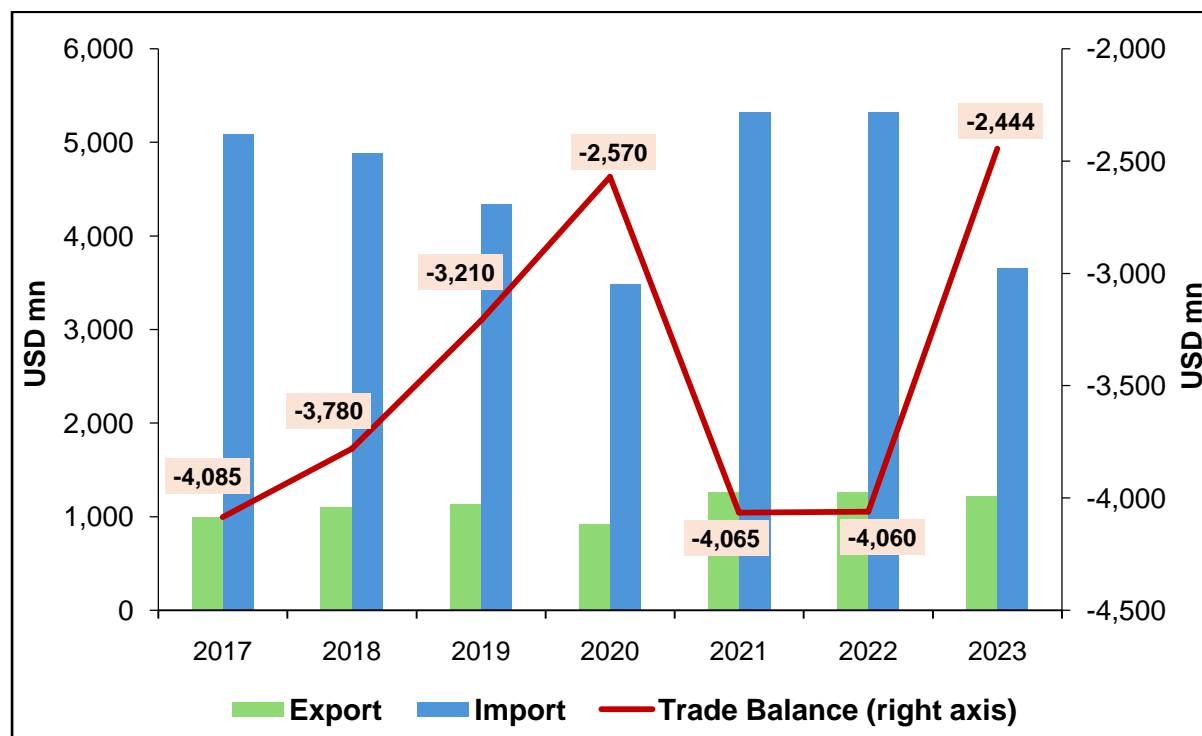
Pakistan is a notable import partner for Sri Lanka, with import values peaking at US dollars 428.4 million in 2018 and slightly decreasing to US dollars 323.0 million in 2023. Imports from Pakistan included a diverse range of consumer goods (vegetables, medical and pharmaceutical products, clothing, spices, cereals, sugar, fruits, household items, seafood), intermediate goods (textile articles, wheat, maize, mineral products, chemical products, plastics), and investment goods (building materials, machinery). This diversity showcases the strong trade relations and the variety of imports from Pakistan.

Regional Import Contribution

From 2017 to 2023, Sri Lanka's total imports from SAARC countries ranged from US dollars 3,486.5 million to US dollars 5,323.2 million. The percentage of total imports from SAARC was above 20 per cent even Sri Lanka's overall imports values were declined and recorded a notable peak at 29.1 per cent in 2022 before declining to 21.8 per cent in 2023. This indicates a dependency of Sri Lanka on SAARC countries for imports over the years. Sri Lanka's imports from SAARC member countries are crucial and significant. The trends over the years demonstrate the complex and evolving nature of trade relations, marked by a combination of volatility and strategic diversification. Both bilateral and regional trade agreements have helped imports from the region although imports under these agreements were not significant. As Sri Lanka continues to navigate its economic path, strengthening these trade ties will be essential for sustainable development and regional cooperation.

5.3 Sri Lanka's Trade Performance in the SAARC Region

Figure 1: Sri Lanka's Trade Performance in the SAARC Region



Based on the trade data for Sri Lanka within the SAARC region from 2017 to 2023, there is a noticeable trend of increasing imports compared to exports, resulting in a persistent trade deficit with some fluctuations over the years. In 2017, Sri Lanka's exports were recorded at USD 998.4 million, which increased gradually to US dollars 1,258.9 million by 2022. However, imports grew significantly from US dollars 5,083.8 million in 2017 to US dollars 5,319.1 million in 2022, highlighting a substantial imbalance. The trade deficit reached US dollars 4,060.2 million in 2022. The trade deficit showed a decreasing trend until 2020 and recorded US dollars 2,569.6 million, reflecting some improvement in the trade balance during this period. The trend of trade balance indicates that Sri Lanka is consistently spending more on imports than earning from exports within the SAARC region.

6. Further studies on the key related areas for trading in local currencies

In the context of trading in local currencies under the Balance of Payments (BOP) framework, trade account discussions are primarily focused here. Also, the Services Account, Secondary Account, Financial Account, and Capital Account should be focused. For shaping an external economic engagement of the country, each account in the BOP plays a vital role. Hence, it's important to follow a further analysis of this. The proposed collaborative research on this topic will be able to cover the main areas with a comprehensive analysis.

- *Services Account*: transactions related to tourism, computer services, transportation, and professional services
- *Secondary Account*: mainly workers' remittances.

- *Financial Account and Capital Account*: inflows and outflows of financial assets and liabilities, including direct investments, portfolio investments, and loans.

The proposed collaborative research will be anticipated to yield significant benefits and advance the knowledge as well. This study will support enhancing more robust policy frameworks within the SAARC region. Based on the study, member countries will be able to understand the global economic challenges as well as identify and improve the advantages of local currency trading across various sectors of the economy.

Having more comprehensive data available in the SAARCFINANCE database is important to enhance the assessment of intra-regional economic cooperation. As an example, the Association of Southeast Asian Nations (ASEAN) exemplifies this by utilizing extensive data collection to facilitate economic integration among member countries. The enhanced data availability may support informed decision-making and effective policy formulations.¹

7. References

Gopinath, G. (2024). *Geopolitics and its Impact on Global Trade and the Dollar*. Retrieved from [imf.org: https://www.imf.org/en/News/Articles/2024/05/07/sp-geopolitics-impact-global-trade-and-dollar-gita-gopinath](https://www.imf.org/en/News/Articles/2024/05/07/sp-geopolitics-impact-global-trade-and-dollar-gita-gopinath)

¹ Link for publications: <https://asean.org/category/library/books/>
Link for Statistics: <https://www.aseanstats.org/>