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**TRADING IN LOCAL CURRENCIES:  
PROBLEMS AND PROSPECTS FOR THE SAARC COUNTRIES**

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# Trading in Local Currencies: Problems and Prospects for the SAARC Countries

## 1. Introduction

### 1.1. Background

US dollar (USD) plays the dominant role as an invoicing currency in global trade. Roughly 40 percent of international trade transactions in goods are invoiced in dollars, while the US share of global trade is only 10 percent (Gopinath et al., 2020). However, recent global geopolitical tension, accompanied by frequent use of economic and financial sanctions, mainly by the United States and its allies led countries like Russia, Iran, and Venezuela to look for alternatives to reduce their vulnerability to sanctions.

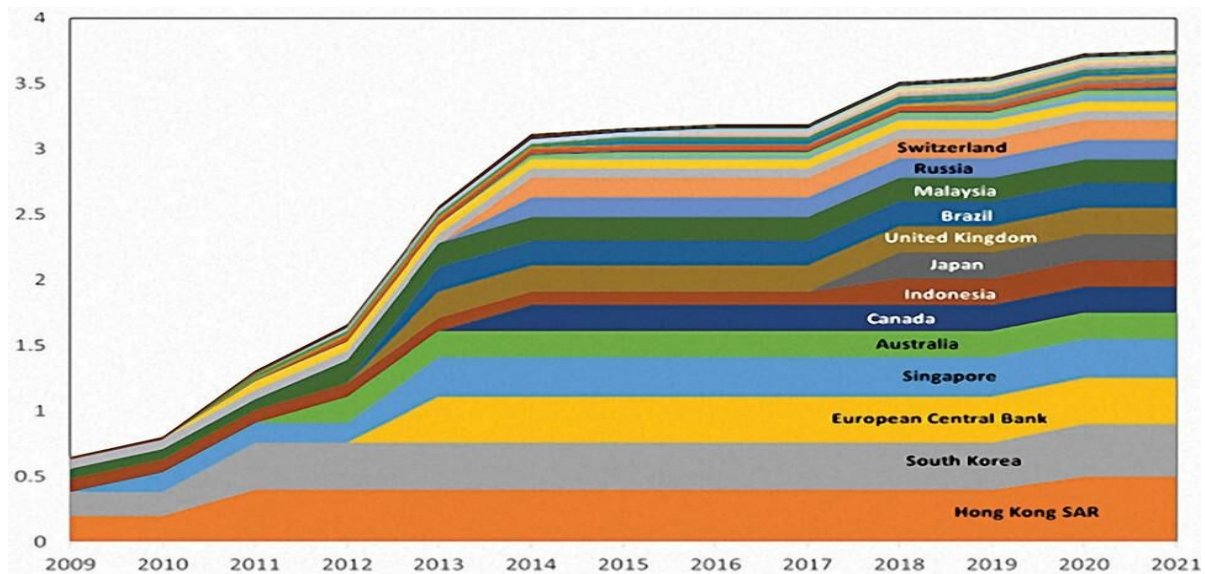
Moreover, the Fed's conduct of monetary policy is believed to cause wild swings in capital flows and exchange rates, especially in emerging market countries. Consequently, more and more countries have tried to develop alternative cross-border payment mechanisms to reduce their reliance on the USD. Basically, pairs of countries have agreed to settle cross-border trade and investment transactions between themselves in their local currencies, facilitated by bilateral currency swap lines<sup>1</sup> arranged by their central banks (Canuto, 2023). For example, China's RMB<sup>2</sup> has emerged as the most advanced currency used for bilateral cross-border payments, facilitated by an extensive network of bilateral currency swap agreements the People's Bank of China (PBOC) has signed with the central banks of 41 countries, amounting to 3.5 trillion yuan (\$480 billion at current exchange rates) as depicted in Figure 1.1. Recently, RMB has been used for third party payments, for example, by Argentina to pay off some of its debt from the IMF. Going forward, this could herald a possible multilateralization of the international use of the RMB – a development with important implications for SAARC countries as well.

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<sup>1</sup> Currency swap agreements, which entail the exchange of one currency for another between central banks, have long been instrumental in bolstering liquidity and stabilizing foreign exchange markets. Before the COVID-19 outbreak, these arrangements primarily served to address short-term liquidity needs and reinforce foreign currency reserves. Central banks strategically engaged in currency swaps to ensure adequate reserves to support trade and investment activities. However, the onset of the pandemic brought about unprecedented challenges, leading to a surge in demand for liquidity and a heightened reliance on currency swap agreements.

<sup>2</sup> RMB stands for Renminbi, the official name of China's currency.

**Figure 1.1: Evolution of PoBC Swap Lines in RMB trillions (Perez-Saiz et al., 2023)**



## 1.2. Local currency always preferred. But not possible, Why?

While trading in local currencies is often preferred for its simplicity and cost-effectiveness, several barriers may hinder its widespread adoption. These barriers include currency convertibility issues, regulatory constraints, and market acceptance concerns, which may limit the feasibility of settling trade transactions in local currencies.

Not all currencies are freely convertible on the international market. Some countries impose restrictions on currency exchange, making it difficult for businesses to convert their local currency into foreign currencies needed for international trade settlements. Using local currency in trade transactions exposes parties to exchange rate risks. Fluctuations in exchange rates can impact the value of trade transactions and create uncertainty for businesses. Regulatory barriers related to foreign exchange controls, trade finance regulations, and taxation can hinder the seamless exchange of local currencies in international trade. Local currencies may have limited acceptance beyond their borders, particularly in regions where they are not widely traded or recognized.

International trade partners may prefer more widely accepted currencies for transactions, leading to challenges in using local currencies for cross-border trade. Moreover, if a country has a systematic surplus, it tends to accumulate foreign reserves in the currency of the country on the deficit side, instead of doing so in a currency that is fully convertible and generally accepted.

### **1.3. Factors important for successful local currency trade**

- **Strength of currencies:** Ensuring the convertibility of local currencies is vital for promoting their use in international trade. Countries need to liberalize their exchange rate regimes and reduce restrictions on currency conversion to facilitate the seamless exchange of local currencies in trade transactions.
- **Reciprocity and compatibility of the financial infrastructure:** Developing robust financial infrastructure, including payment systems, clearing mechanisms, and settlement platforms, is critical for facilitating local currency trade. Investments in modernizing financial infrastructure are necessary to support the efficient settlement of international trade deals in local currencies.
- **Market access and confidence:** Building trust and confidence among traders, businesses, and investors in the stability and reliability of local currencies is essential for promoting their use in trade transactions. Central banks and governments need to implement sound monetary and fiscal policies to maintain currency stability and minimize exchange rate risks.
- **Regulatory Framework:** Establishing clear and supportive regulatory frameworks is essential for promoting local currency trade. Governments need to implement policies that facilitate currency convertibility, remove barriers to trade settlement in local currencies, and provide legal certainty for businesses engaging in such transactions.

### **1.4. Treatment of currency swap transactions in central bank balance sheets**

Currency swap transactions are typically reflected in the central bank balance sheets as either assets or liabilities. The classification depends on whether a country is providing or receiving foreign currency. For instance, if a central bank extends US dollars to another central bank through a swap agreement, it is recorded as an increase in foreign currency assets. Conversely, if a central bank receives US dollars through a swap, it registers as a liability, representing the obligation to repay the foreign currency in the future. These transactions also hold significance for a country's balance of payments (BOP) and

external balances. A currency swap agreement that bolsters foreign currency reserves contributes to a surplus in the capital and financial account of the BOP, reflecting inflows of foreign currency. Conversely, if a central bank provides foreign currency through a swap, it impacts the BOP by recording an outflow in the capital and financial account, potentially leading to a deficit.

## **1.5. Literature review**

In international trade, the U.S. dollar, Euro, and Yen have long held outstanding dominance as vehicle currency. However, there is a growing acknowledgment of the advantages tied to trading in local currencies. By sidestepping the constant need for conversion into foreign currencies, local currency trade offers several benefits including bolstering economic stability, diminishing reliance on foreign exchange, mitigating exchange rate volatility, reducing the severity of uncertainty, and increasing policy independence and autonomy for participating nations. Promoting trade in local currencies can foster regional cooperation and economic integration, which can lead to increased intra-regional trade, benefit local industries and promote economic diversification, enhance financial connectivity.

In this regard, many studies like by Marshall and O'Neill (2018), Kichiji and Nishibe (2008), Williams et al. (2001), and Ruddick et al. (2015) shed light on the challenges faced by local currencies in gaining acceptance and achieving impact.

Marshall and O'Neill's research on the Bristol pound revealed that despite its availability, local businesses predominantly sourced products from external suppliers who did not accept the currency. This limitation hindered the Bristol pound's ability to stimulate local production and consumption. The barriers identified included political influence, capital mobility, free trade dynamics, corporate power, banking system constraints, and cultural resistance rooted in trust issues within the community.

Similarly, Kichiji and Nishibe (2008) highlighted challenges such as the lack of trading partners and resistance from vendors to accept the local currency, Illiams et al. (2001) identified barriers related to the lack of promotion and publicity of Local Exchange Trading Systems (LETS), limited awareness among participants, coordination issues, and insufficient government support.

Canuto (2023) highlights the experiences of the emerging trend among various countries, particularly those in the BRICS group, to increase the utilization of their national currencies in cross-border transactions, reducing dependence on dominant international currencies like the US dollar. This shift is driven by geopolitical factors, especially the threat of sanctions from dominant currency-issuing nations, as evidenced by Russia, Iran, and Venezuela. However, even countries like China are seeking to minimize their exposure and increase the internationalization of their currency. Some researchers emphasize the growing use of the RMB in cross-border transactions, facilitated by bilateral agreements and currency swaps with numerous countries. China's Belt and Road Initiative brought along a rise in the use of the Yuan in international trade, at the same time, countries like Russia and India are also looking for alternatives to the US dollar. (Tran H. 2023)

The increasing trend among countries to utilize their national currencies in cross-border transactions is mainly driven by both geopolitical considerations and potential economic benefits. The growing prominence of currencies like the Chinese renminbi reflects this shift, with bilateral agreements and currency swaps facilitating its international use.

Local currency trading also poses various challenges and risks for its stakeholders. Studies such as those by Clark, Tamirisa, and Wei (2004) highlight that exchange rate volatility can adversely affect trade flows, particularly when firms are unable to effectively hedge against currency risks. Another study by Melvin and Taylor (2009), found that local currency markets often lack the depth and liquidity of major currencies, making it difficult to execute large trades without significant price impact. Goldberg and Tille (2008) examined how an underdeveloped payment system and widespread preference for major currencies like the USD or EURO, create a barrier to the acceptance of local currencies in international trade. The economic and political instability, regulatory barriers, and inadequate banking and financial infrastructure hinder local currency trade in many ways. A study by Krugman (1991) explores how persistent trade imbalances can affect a country's ability to sustain local currency transactions in international trade. Ruddick et al. (2015) emphasized the importance of awareness and knowledge in driving the circulation of local currencies.

To mitigate the above-mentioned challenges, studies by Eichengreen (2011), Borensztein,

Eichengreen, and Panizza (2006), Acemoglu, Johnson, and Robinson (2001), and Allayannis, Brown, and Klapper (2003) suggest bilateral and multilateral agreements, development of local currency financial instruments, strong institutions in building confidence in local currencies and advanced risk management techniques respectively. It also provides insights into potential strategies to mitigate these challenges, emphasizing the importance of robust financial systems and supportive international agreements.

These studies collectively illustrate that the success of local currencies hinges on overcoming various barriers related to credibility, awareness, and acceptance. To be effective, emerging currencies must gain acceptance as a legitimate means of payment by major suppliers, including banks and local authorities.

It is well versed that in addition to geopolitical considerations, there are potential economic benefits associated with using local currencies for cross-border payments. By reducing reliance on convertible currencies like the dollar and Euro, countries can potentially lower their reserves held in these currencies, thereby enhancing financial stability. However, there may be costs associated with bilateral cross-payment agreements, particularly for countries with systematic trade surpluses.

Facing the challenge of acceptability of local currencies in international trade is crucial.

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The increasing use of local currencies for bilateral trade and investment is facilitated by technological advancements and regional economic integration. This trend helps reduce dependency on the USD and shields countries from external economic policies and sanctions. However, it fragments the global payment landscape, introducing complexities and inefficiencies that can reduce global economic output. The benefits of this shift, such as greater economic sovereignty, must be weighed against its costs. If benefits prevail, local currency use may expand.

Trading in local currencies holds significant potential in reshaping global economic dynamics. As countries increasingly recognize the benefits of conducting trade in their local currencies, we may witness a shift towards a more multi-polar and inclusive international monetary system.



## **2. Objectives**

The objective of this paper is to look into ways to promote foreign trade settlements denominated in local currencies among SAARC countries. Exploring the potentials of local currency trade across SAARC countries unveils promising avenues for enhancing economic collaboration and integration within the region.

By embracing local currencies for trade settlements, SAARC nations can mitigate reliance on external currencies, thereby reducing susceptibility to exchange rate fluctuations and external economic shocks. This shift towards local currency trade holds the potential to streamline cross-border transactions, fostering greater efficiency and cost-effectiveness for businesses operating within the region. Moreover, promoting local currency trade can bolster financial inclusion, particularly among underserved populations, by facilitating access to financial services and promoting economic participation. The exploration of local currency trade within the SAARC framework not only strengthens regional economic ties but also lays the foundation for sustainable development and shared prosperity across member countries.

## **3. Current practices in local currency trade**

The US Dollar has long dominated global trade and financial transactions, comprising nearly 90% of OTC foreign exchange turnover and about 80% of export invoicing. Although its usage dipped from 89.9% in 2001 to 84.9% in 2010, it rebounded to 87.6% in 2016. Conversely, major currencies like the Euro, Yen, and Australian Dollar have experienced declines in market share. Meanwhile, emerging market currencies, notably the Chinese Renminbi (RMB), have made gains. The RMB's share doubled from 2.2% in 2013 to 4% in 2016, advancing from the 9th to the 8th position globally, largely due to increased trading against the USD. Similarly, the Indian Rupee expanded its market share from 0.2% in 2001 to 1.1% in 2016, despite a slight decrease in its global ranking from 15th in 2010 to 18th in 2016. Here this study sheds light on the issue of trade in local currency in regional, bilateral, and SAARC regions especially (Priyadarshi D.2019).

### **3.1. Regional Arrangements:**

#### **3.1.1. Intra-regional Trade in South Asia**

The most prominent forum in South Asian countries, the SAARC forum was established with the primary objective of accelerating economic and social development among member states, later focusing on trade promotion. Despite efforts to expand intra-SAARC trade using macroeconomic and regional trade link models, the current level of trade within the region remains low compared to other regional forums like the EU and ASEAN.

South Asia made a remarkable economic transformation from being the slowest-growing region in the 1960s and 1970s to becoming one of the fastest-growing regions globally since the 1980s. This shift underscores the region's resilience and potential for development. Even with such growth momentum, intra-regional trade within South Asia lags behind other regions such as ASEAN, and South Asian countries predominantly trading with nations outside the region. Despite a slow start, SAARC gained momentum with the introduction of the SAARC Preferential Trading Agreement (SAPTA) in the mid-1990s, followed by the implementation of the South Asian Free Trade Area (SAFTA) in the early 2000s, leading to increased trade activity. However, in 2008, intra-regional trade accounted for only 4.8% of South Asia's total foreign trade, compared to 25.8% for ASEAN. While India's trade with SAARC countries has notably expanded, overall intra-regional trade remains relatively low. Nevertheless, there have been significant increases in both exports from India to other SAARC nations and imports from SAARC countries to India, particularly from Pakistan and Sri Lanka. (Rajeev J. and J. B. Singh J. B. 2009).

This disparity is attributed to differences in the market sizes of SAARC economies, limiting the potential for substantial intra-regional trade flows. Larger SAARC countries like India and Pakistan cannot view smaller economies such as Bhutan or Nepal as major export destinations, resulting in modest expectations for intra-SAARC trade. However, smaller SAARC nations maintain strong trade links with India, though these constitute a small portion of India's total exports. Efforts to promote intra-regional trade within SAARC may require addressing economic disparities and fostering closer economic integration among member states.

### **3.1.2. An ASEAN Highlights:**

Research by ASEAN Secretariat combined with Research Study Group Mae Fah Luang University, Singapore Institute of International Affairs, and Charles A. Barrett Consulting Services Inc. shows that using a single currency for pricing, invoicing, and payment settlement in international trade, particularly focusing on Thailand's currency dynamics. It notes an increase in the use of the Thai baht in exports, especially in intra-ASEAN trade, aligning with the objectives of regional economic integration.

The U.S. dollar dominates Thailand's international trade, constituting 95% of trade with the U.S. and 4% with the Euro area, driven by industry convergence and hedging purposes. Euro invoicing currency usage is tied to Thailand's trade with the Euro area but remains small at 5%. According to this research, Thai Baht represents less than 7% of export invoices, declining from 2001-2008 in both exports and imports. The Euro's increased usage is due to expanded EU trade and its role as a vehicle currency.

### **3.1.3. Experience of Singapore**

The case study of Singapore in the above research reveals that USD is commonly used for trade settlements with Singapore-based firms. The trading country's currency is more prevalent in imports than exports. Besides the U.S. dollar, the yen and Singapore dollar are accepted to a small but significant extent. Reasons for currency selection include customer needs, transaction costs, accounting ease, parent company influence, and supplier preferences. Despite some enthusiasm, attitudes towards greater use of local currencies in trade settlement are mixed, with concerns about liquidity and implementation challenges.

### **3.1.4. The experiences of NAFTA and EU**

The experiences of the North American Free Trade Agreement (NAFTA) and EU countries in currency invoicing practices offer valuable insights into the challenges and opportunities for East and Southeast Asia's regional trade and monetary integration. In North America, market forces have largely driven economic integration, with the US dollar serving as the dominant currency for trade transactions. Conversely, European economic integration has been a staged process, guided by a political vision of creating a single market and enhancing Europe's global monetary role. The creation of the Euro

was a significant milestone in strengthening Europe's position within the global monetary system.

### **3.1.5. ASEAN local currency cross-border payments in a multilateral setting**

The ASEAN Summit in May 2023 in Indonesia emphasized regional connectivity and local currency transactions (LCT), intending to bolster economic ties within the region. A Local Currency Transactions Framework will be devised to actualize this plan.

Previously, Thailand and Malaysia launched the Local Currency Settlement Framework (LCSF) in March 2016, enabling businesses to use baht or ringgit sourced from domestic banks for bilateral trade. Indonesia joined in 2018, extending LCSF to investment transactions.

Recently, the central banks of Indonesia, Malaysia, Singapore, and Thailand introduced a contactless QR-code-based local currency payment system, facilitating direct currency exchanges without USD or RMB intermediation. This system, soon to include the Philippines, aims to enhance financial inclusion, particularly benefiting unbanked individuals in the region.

### **3.1.6. The BRICS local currency payment project**

The BRICS Summit in Johannesburg in August 2023 emphasized the increased use of local currencies in cross-border transactions among member countries, with plans to include six new members. This initiative builds on existing frameworks like the BRICS Interbank Cooperation Mechanism and BRICS Pay, aiming to facilitate cross-border payments in local currencies. Bilateral agreements among member nations already support this effort, marking a shift away from traditional international currencies like the USD. This move reflects a collective endeavor to promote financial autonomy within the BRICS bloc and extend its influence beyond its current membership.

This project aims to facilitate cross-border payments using digital RMB and other member countries' digital currencies, marking a significant advancement in international monetary infrastructure.

## **3.2. Bilateral Movement with Local Currency Trade**

### **3.2.1. The RMB in bilateral cross-border payments**

China's RMB has become a prominent currency for bilateral cross-border payments due to extensive currency swap agreements with 41 countries, totaling 3.5 trillion yuan (\$480 billion). With record balances activated from these swaps, China settles nearly half of its cross-border transactions in RMB, surpassing the USD. IMF data shows significant growth in RMB usage in cross-border payments, with median usage increasing from 0% in 2014 to 20% in 2021, and even reaching 70% for a quarter of sampled economies. Two key developments to notice are the potential for RMB to be used multilaterally in transactions involving third parties, indicating a shift beyond bilateral usage, and collaborative efforts among central banks, like mBridge, to develop a Multi-Central Bank Digital Currency platform. This project aims to facilitate cross-border payments using digital RMB and other member countries' digital currencies, marking a significant advancement in international monetary infrastructure (Hung T. 2023).

IMF data shows significant growth in RMB usage in cross-border payments, with median usage increasing from 0% in 2014 to 20% in 2021, and even reaching 70% for a quarter of sampled economies. Two key developments to watch are the potential for RMB to be used multilaterally in transactions involving third parties, indicating a shift beyond bilateral usage, and collaborative efforts among central banks, like mBridge, to develop a multi-central Bank Digital Currency platform. This project aims to facilitate cross-border payments using digital RMB and other member countries' digital currencies, marking a significant advancement in international monetary infrastructure.

### **3.2.2. India promotes the rupee (INR) in cross-border payments**

India has also stepped up efforts to increase the usage of its currency, the INR, in cross-border payments, as seen by its agreement with the UAE to settle trade in INR. This follows many years of precedent in the use of the INR to settle trade with SAARC countries through the SAARC Currency Swap Facility. India is now expanding further with the imminent announcement of an Asian Clearing Union, including Iran and Myanmar, to facilitate INR settlements. In addition, India has allowed banks from 22 countries to open Special Vostro Rupee Accounts (SVRCs) to conduct transactions with

Indian entities. It should be noted that while India accounts for a relatively small share of global trade (1.8% compared to China's 15%), the usage of the INR in cross-border payments may be more limited compared to the RMB. Bangladesh has made bilateral arrangement with India for cross-border trade settlement. (Hung T., 2023).

### **3.2.3. Russia forced by sanctions to use the RMB**

Following sanctions imposed after the Russia-Ukraine war, Russia faced challenges settling international transactions in major currencies like USD, Euro, Pound sterling, or Yen due to frozen reserves and SWIFT exclusions. Russia observes Russia's increased reliance on RMB and Rubles for up to two-thirds of trade with China. However, Russia and India suspended efforts to settle trade in rupees and rubles, opting for RMB and UAE dirham for oil payments. In March 2022, Russia decreed that "unfriendly" countries must pay for Russian gas in Rubles, leading foreign companies to open special accounts with Gazprombank to convert payments. While promoting Ruble demand, this measure does not bypass USD in cross-border payments.

### **3.2.4. China-Nigeria Alliance**

China has taken extensive action to extend the usage of RMB in cross-border payment and use. In alliance with it, Nigeria's Central Bank, in August 2016, shifted the exchange of the Naira from the US dollar to the Chinese renminbi, signaling the RMB's impact on the economy of Africa. This followed the currency swap deal between China and Nigeria, where the Central Bank of Nigeria deposited 65 billion yuan. The reason is also to save Africa from the dominance of the US dollar. Particularly, the trade instigated by the Belt and Road initiative increased. The Nigeria-China settlements in US dollars previously carried a lot of risks and costs. With huge revenues from crude oil, the Naira, on its devaluation, was decoupled from the US dollar to find stability on the RMB platform.

Differences in Sino-Nigerian Trade before and after the docking of RMB and Naira Trade analysis with US dollar settlement show that from 2014 to 2016, China-Nigeria bilateral trade saw a significant decline marked by a 41.3% overall decrease. Throughout this period, trade transactions between China and Nigeria were conducted in US dollars, contributing to the gradual decline in trade volume by approximately 40%.

The impact on other African currencies under the docking of the RMB and Naira is very

noteworthy. Nigeria maintains its position as China's third-largest trading partner in Africa, fostering strong cooperation. With the adoption of local currency swap agreements, more African nations have embraced the RMB, solidifying its status as Africa's international currency. Nigeria's central bank has deposited a substantial amount of RMB, which has been reciprocated by China's Industrial and Commercial Bank with Naira deposits. This arrangement allows China-Nigeria trade to bypass the US dollar, strengthening direct trade relations. As Africa's most populous and largest GDP country, Nigeria's direct trade with China challenges the dollar's dominance in Africa, prompting other African nations to consider aligning with the RMB (Hanbo.W, 2019)

### **3.2.5. The status and influence of the RMB in Africa**

In recent years, Chinese-funded commercial banks have established new institutions such as the Sino-Congolese Bank for Africa and branches of major Chinese banks in countries like Angola and South Africa. The Bank of China alone has set up seven institutions in Africa, with other Chinese banks also making significant investments. African countries have also incorporated the RMB into their foreign exchange reserves, while others have entered China's interbank bond market. African enterprises increasingly favor the RMB for its cost-saving benefits and risk reduction. The internationalization of the RMB is a market-driven process, poised for success as conditions mature.

## **4. Trade in Local Currency in SAARC**

SAARC nations, faced with economic uncertainties and financial strains, feel the need to intensify their utilization of currency swaps to fortify foreign exchange reserves, stimulate economic recovery, and mitigate the pandemic's adverse impacts on financial stability. However, intraregional trade within SAARC remains remarkably low, accounting for about 5% of the region's total trade. This is in stark contrast to regions like ASEAN, where intraregional trade constitutes around 25% of the total (World Bank).

Payments in local currencies offer mutual benefits by reducing the adverse effects of exchange rate fluctuations and promoting the broader use of these currencies in global foreign exchange markets. This presents an opportunity for countries in the Global South to collaborate within the framework of South-South cooperation. By working together, they can mitigate these impacts and contribute to the broader development process.

#### **4.1. Experience of the Rupee trade scheme by India**

India has trialed local currency trade arrangements, like the rupee trade scheme, with Nepal, Russia, Iran, and recently Bangladesh. Under this scheme, imports from India to these countries are often settled in Indian rupees (INR), facilitating bilateral trade. For example, in Nepal, INR is convertible for most products, maintaining a fixed exchange rate with the Nepal Rashtra Bank, and boosting Indian exports by leveraging export promotion schemes. Extending this to Iran since 2014, India has paid a portion of its oil bill in INR, benefiting both nations. Similar attempts were made with Russia. These experiences suggest exploring local currency trade among SAARC countries to enhance regional cooperation and mutual benefits.

The Indian rupee is accepted as a means of payment in countries like Malaysia, Singapore, Hong Kong, Indonesia, the UK, and Sri Lanka can vary depending on factors such as bilateral agreements, economic ties, and local regulations. Besides this, India is the largest trade partner in SAARC. Moreover, India is taking noteworthy steps toward cross-border trade in Indian rupees with its neighboring countries like Pakistan, Myanmar, Sri Lanka, Bangladesh, and Nepal. For example, in Singapore and Malaysia, there is a significant Indian diaspora, and Indian rupees might be accepted in specific areas or by certain businesses catering to Indian tourists or residents. In the case of Sri Lanka, there have been historical and cultural ties between India and Sri Lanka, which may facilitate the acceptance of the Indian rupee in certain contexts.

It's essential to note that while there may be instances of the Indian Rupee being accepted or used in transactions in these countries, its acceptance as a widely recognized and official means of payment would typically require formal arrangements between the respective countries. In addition, this thought applies to other countries in SAARC.

India has undertaken significant efforts to promote trade in its local currency, the Indian rupee, with both developed and developing countries. These efforts include Rupee trade with Australia, Japan, Korea, China, and Canada, and expressing interest in extending it to oil-producing countries. Additionally, there are plans to initiate Yuan-Rupee trade with China, indicating growing economic ties. India has also extended currency swap arrangements with countries like Japan, Sri Lanka, Bhutan, and SAARC nations, and is



considering a similar agreement with the United Arab Emirates. These initiatives aim to reduce dependency on traditional reserve currencies, foster stronger economic relationships, and facilitate smoother trade and investment flows.

## **4.2. Bangladesh India Trade**

Bangladesh and India, on July 11, 2023, rolled out the cross-border trade settlement in the rupee to cut the dependence on the US dollar. The trade is being done through the lenders' nostro accounts, which are essentially bank accounts held in another country by domestic banks and denominated in the currency of the overseas country. Bangladeshi exporters are receiving their proceeds in rupees in those accounts, and that balance is being used to pay for imports from India. In short, import bills equivalent to export proceeds can be settled under the mechanism. The exchange rate used is market-determined. Between July 11 and December 26, two banks – Eastern Bank and Standard Chartered Bank – settled export and import trades worth 3.51 million rupees.

Trade between India and Bangladesh has seen substantial growth in recent years. The bilateral trade volume reached approximately USD16 billion in the fiscal year 2022-23, significantly increasing from \$5.3 billion a decade earlier. In 2022, India's exports to Bangladesh totaled USD 13.8 billion, with key exports including refined petroleum, non-retail pure cotton yarn, and raw cotton. Conversely, Bangladesh's exports to India amounted to \$2 billion, with the major exports being non-knit men's suits, other pure vegetable oils, and textile scraps. This disparity highlights a substantial trade deficit for Bangladesh.

However, the lack of interest in using the Indian currency in bilateral trade was due to a high demand for US dollars, a dearth of rupee earnings and a lack of competitiveness. The challenge to trade in the rupee because exporters demand US dollars due to its competitive edge. Importers want to buy products using the rupee. But they have no earnings in the currency.

## **4.3. Trade opportunity in local currency in SAARC**

Trade in local currency in SAARC has huge potential as well as vast challenges and risks because of the disparity in economy size and trade among the member countries. In Asia, regional trade and investment have experienced rapid growth over the past two

decades, accompanied by a strong desire to deepen regional integration through institutional arrangements. The emergence of an effective regional trade community and intra-regional trade enhancement crucially depends on its attractiveness as a medium of exchange, store of value, and unit of account. This would require the establishment of liquid markets with low transaction costs and full convertibility on both current and capital accounts. Against this backdrop, local currency trade is a highly valued concept because of the benefits.

#### **4.4. Lesson Learned**

While reducing reliance on the US dollar holds promise, practical considerations demand careful evaluation. Factors such as trade volumes and currency acceptability necessitate thorough examination before adopting local currency settlements. Rushing into such decisions will not be acceptable. Instead, advocating for comprehensive analyses of export potential, market expansion strategies, and banking/payment infrastructure improvements is prudent. SAARC countries must assess their economic readiness and strategic positioning for local currency trade. Through a cautious and informed approach, Bangladesh can navigate geopolitical and economic shifts while safeguarding its economic interests.

Intra-SAARC trade has historically lagged behind other regional blocs due to factors like political tensions, trade barriers, infrastructure deficiencies, and logistical challenges. Despite the potential benefits such as economic growth, job creation, and poverty reduction, progress has been sluggish.

However, efforts are underway to tackle these challenges through regional cooperation, infrastructure development, and policy reforms. Despite the persisting obstacles, there's a concerted push to enhance intra-regional trade in South Asia. Continued emphasis on these initiatives is crucial for unlocking the full potential of intraregional trade and fostering economic prosperity in the region.

### **5. Potential scopes of local currency trade in Bangladesh**

#### **5.1 Current trade of Bangladesh by currency**

The level of diversification among several currencies in international trade is essential for a country's participation in multi-currency trade. Countries with extensive experience in participating in currency trades other than the US dollar have a wider opportunity to transition to multicurrency trades. Bangladesh heavily relies on the US dollar for its trade in exports and imports. Table 1 shows that Bangladesh has engaged in several currency trades, including the US dollar, ACU-dollar, ACU-euro, Japanese yen, and pound sterling, over the years. Nevertheless, the US dollar continued to be the primary driver of exports. The aggregate value of exports reached USD 28.2 billion in FY15, increased to USD 34.2 billion in FY19, and further rose to USD 42.3 billion in FY23, accounting for about 97 percent of total exports throughout the years.

**Table 1: Currency wise Export**

(In million USD)

Name of Currency	FY15		FY19		FY23		Growth between FY14 and FY19	Growth between FY19 and FY23
	Amount	Share	Amount	Share	Amount	Share		
ACU currency - dollar	379.8	1.30	654.4	1.85	978.6	2.25	14.6%	10.6%
US dollar	28181.2	96.65	34152.3	96.64	42286.6	97.05	4.9%	5.5%
ACU currency - euro	6.3	0.02	0.5	0.00	0.2	0.00	-46.7%	-20.9%
EURO	401.1	1.38	322.3	0.91	246.0	0.56	-5.3%	-6.5%
Japanese yen	1.2	0.00	3.9	0.01	2.0	0.00	34.9%	-15.6%
Pound starling	35.7	0.12	25.8	0.07	39.0	0.09	-7.8%	10.9%
Othes currencies	152.0	0.52	181.8	0.51	19.7	0.05	4.6%	-42.6%

In a similar vein, the US dollar accounted for the majority of Bangladesh's import payments, with its percentage rising from 80.0 percent in FY15 to 84.4 percent in FY23. A portion of import payments are made using the ACU-dollar, which initially uses the US dollar but settles at the ACU payment settlement period. This ACU-dollar payment gives the country the chance to hold onto some dollars in its reserves for a particular period of time. In FY23, ACU-dollar payments totaled USD 7589.4, or 11.1 percent of the total import payments (Table 2).

**Table 2: Currency wise Import**

(In million USD)

Name of	FY15	FY19	FY23	Growth	Growth
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Currency	Amount	Share	Amount	Share	Amount	Share	between FY14 and FY19	between FY19 and FY23
ACU currency - dollar	6048.0	14.90	7195.2	12.83	7589.4	11.06	4.44%	1.34%
US dollar	32466.2	80.01	45559.1	81.27	57865.3	84.35	8.84%	6.16%
ACU currency - euro	13.5	0.03	11.9	0.02	8.1	0.01	-3.13%	-9.35%
EURO	1358.1	3.35	2456.3	4.38	2298.8	3.35	15.97%	-1.64%
Pound starling	97.8	0.24	94.8	0.17	85.3	0.12	-0.80%	-2.61%
Other currency	595.6	1.47	743.5	1.33	753.9	1.10	5.70%	0.35%

If the currency wise trade is being considered with India, Table 3 shows that more than 50 percent export earnings were settled by ACU-dollar in recent years, while the share of export earning in US dollar was 46.4 percent in FY23.

**Table 3: Currency wise Export to India**

(In million USD)

Name of Currency	FY15		FY19		FY23		Growth between FY14 and FY19	Growth between FY19 and FY23
	Amount	Share	Amount	Share	Amount	Share		
ACU - dollar	224.9	48.60	484.2	52.03	914.8	53.48	21.13%	17.24%
US dollar	225	48.62	445.8	47.90	793.6	46.40	18.64%	15.51%
ACU - euro	5.5	1.19	0.5	0.05	0.2	0.01	-45.09%	-20.47%
Euro	7.4	1.60	0.1	0.01	1.9	0.11	-65.90%	108.78%

If currency-wise trade with India is taken into account, Table 3 demonstrates that in recent years, more than 50% of export earnings were settled in ACU-dollar, whereas 46.4 percent of export earnings were settled in US dollars in FY23.

**Table 4: Currency wise import from India**

(In million USD)

Name of Currency	FY15		FY19		FY23		Growth between FY14 and FY19	Growth between FY19 and FY23
	Amount	Share	Amount	Share	Amount	Share		
ACU - dollar	4967.3	85.24	5882	76.91	6854	72.21	4.32%	3.90%
US dollar	823.7	14.14	1620.9	21.19	2541	26.77	18.44%	11.89%
ACU - euro	8.5	0.15	9.1	0.12	3.2	0.03	1.72%	-22.99%
Euro	25.8	0.44	130.4	1.71	56	0.59	49.94%	-19.05%
Other currencies	2	0.03	5.5	0.07	37.6	0.40	28.78%	61.70%

**Table 4: Currency wise remittances**

(In million USD)

Name of Currency	FY15		FY19		FY23		Growth between FY14 and FY19	Growth between FY19 and FY23
	Amount	Share	Amount	Share	Amount	Share		
United States dollar	14588.0	93.8	15868.0	96.6	21128.0	97.8	0.0	0.1
Euro	230.0	1.5	345.0	2.1	165.0	0.8	0.1	-0.2
United Arab Emirates dirham	77.0	0.5	1.0	0.0	231.0	1.1	-0.7	2.9
Pound sterling	430.0	2.8	202.0	1.2	85.0	0.4	-0.2	-0.2
Other currency	228.0	1.5	4.0	0.0	2.0	0.0	-0.6	-0.2

Consequently, the tables above show that US dollars are used in the majority of Bangladesh's international trade. To facilitate Bangladesh's import-export trade with other nations, a trade settlement system between the Bangladeshi taka and the local currency of the exporting nation can be implemented in order to lessen the ongoing pressure on the US dollar. Under Memorandums of Understanding (MoU) with trade-related countries, Bangladesh's import trade in local currency can be conducted in a variety of ways involving both central banks and commercial banks.

## 5.2 Possible options of currency trade

### 5.2.1. Roles of central banks and commercial banks

The People's Republic of Bangladesh's government has the authority to start Memorandums of Understanding (MoU) with the governments of countries with which Bangladesh has substantial import trade, allowing for the payment of import prices in the

local currency of each country. The aforementioned Memorandum of Understanding permits the execution of currency swap arrangements central banks or between designated commercial banks.

#### **5.2.1.1. Currency swap agreement between central banks**

Under a MoU, Bangladesh Bank as the central bank of the country can enter into currency swap agreement with the central bank of the country where Bangladesh has significant import trade. Under the agreement for a specified period, a fixed amount of money in local currency will be deposited in the central bank of the respective country as Nostro account in the name of the central bank of the opposite country.

In this case, the central bank of the other country will pay the export bill in local currency to the exporters through the exporters' bank of the other country according to the loan demand of the importer's bank of Bangladesh and the approval of Bangladesh Bank from the funds of Bangladesh Bank's Nostro account.

The importer in Bangladesh will repay the loan on the due date. In this case, the importing bank will inform the Bangladesh Bank about the repayment of the loan and through the exporting bank of the other country, the amount payable in foreign currency will be deposited as Nostro account of Bangladesh Bank preserved in the central bank of the other country.

#### **5.2.1.2. Currency swap agreement between designated commercial banks**

Under the bilateral currency swap agreement, the local bank operating in Bangladesh designated by the Government of the People's Republic of Bangladesh will open a Nostro account in the bank designated by the government of the contracted country with the local currency of that country. The funds received in the local currency of the other country will be deposited in the Nostro account.

Similarly, the bank designated by the government of the other contracting country shall open a nostro account in Bangladeshi currency in the bank designated by the government of Bangladesh. The Bangladeshi currency received through currency swap shall be deposited as the Nostro account.

Bilateral currency swap line will be effective in this process. The price of the imported goods will be paid by the importer's bank from the Nostro account of the designated bank of the government of the respective country. According to this process, the importers will pay the import price in the local currency of the country from which they are importing and the exporters will receive their export money in their own country's currency.

### **5.2.2 Trade deficit settlement**

If during the term of any of the above agreements, the trade deficit of either country is greater, after adjusting the import liabilities with the export earnings, the amount equal to the remaining import deficit can be settled in any other foreign currency acceptable to the two countries.

### **5.2.3 Import payments by means other than opening LC**

The Import Policy Order, 2021-24 has provided several facilities for payment of imported goods other than LC which would lessen the pressure on dollar to some extent. Currently, the importers can avail the following facilities:

- Import of daily essential food items through all customs stations of Bangladesh can be done through purchase or sale agreement without any letter of credit without any price limit. In addition, in the case of perishable food products, only 50 thousand US dollars per consignment can be imported through Teknaf Customs Station and 10 thousand US dollars per shipment through other land routes.
- Industrial sector importers can import raw materials, capital equipment and fire doors used in their factories irrespective of the price limit and commercial importers can import any importable product worth more than 500 thousand US dollars annually by paying the price from Bangladesh.
- In order to expand exports, the government can grant permission to import goods regardless of the price limit through TT (Telegraphic Transfer) without opening letter of credit on a case-to-case basis.

- Under the latest banking arrangements signed under the Border Trade Agreement executed in 1994 between the Government of the People's Republic of Bangladesh and the Union of Myanmar, from Myanmar –
  - Import of rice, dal, maize, beans, ginger, garlic, soybean oil, palm oil, onion and fish in a single consignment exceeding 50 thousand US dollars and in case of other products 30 thousand US dollars in a single consignment;
  - In case of import of rice under government management, up to USD 2 million in a single shipment can be imported without credit and in this case the maximum limit of USD 5 lakh per year is not applicable.
- As per various instructions of Bangladesh Bank, in case of import of machinery, raw materials for use in own industry, coastal vessels/seagoing ships, agricultural machinery/chemical fertilizers, life-saving medicines, active pharmaceutical ingredients and laboratory reagents, unprocessed yarn, hot rolled coil, scrap, pig iron and sponge for steel industries etc., payment of price may be delayed at various times or goods may be imported against supplier's credit.
- Any importable goods can be sent to the name of a Bangladeshi resident in Bangladesh irrespective of the price limit by direct payment abroad only by expatriate Bangladeshis and the name and address of the consignee must be mentioned in the import document.

The above methods without opening LCs will provide several benefits to Bangladesh's foreign trade sector. It will reduce the pressure on foreign exchange reserves to carry out trade, which will reduce the exchange costs of traders.

## **6. Recommendations and conclusions**

Moreover, Bangladesh needs to focus on expanding its export market before embracing local currency settlements. India's rupee trade scheme with Nepal, Russia, and Iran has provided important lessons for designing such payment arrangements for smooth trade between countries in the South. The merits of trade in the local currency and currency swap arrangements are recognized widely now. In that sense, trade in local currency can be an effective instrument for promoting cooperation in SAARC.



To establish local currency trade with neighboring SAARC countries, the policy makers can focus on the following issues:

- To change exporter/importer attitudes through educational initiatives and capacity building to encourage local currency usage necessitates.
- To gradually relax the capital flows to establish a secure trade settlement system.
- To initiate arrangements or agreements to reduce tariff and non-tariff barriers among member countries.
- To encourage bilateral and regional trade and investment agreements and closer economic relationships to foster economic integration.
- To adopt foreign exchange regulation policies so that the regulations can promote the use of local and regional currencies in trade and investment.
- To introduce new trade settlement/payment systems to facilitate increased use of local currencies.
- To promote cooperation with trading partners, strategic intra-regional production, and trade networks in major export industries to bolster regional economic cooperation.

Overall, these policy recommendations aim to enhance regional economic integration, reduce costs, and promote stability in trade and investment activities within the region. Concisely, to enhance the aim of trade in local currency, three main actions that are indispensable for Bangladesh and other members of SAARC are regional initiatives, bilateral agreements, and private sector engagement.

The above-discussed recommendations will help traders increase their trading efficiency and profitability. By reducing the need for multiple currency conversions, trading in local currency will increase trade competitiveness for businesses in SAARC countries, thereby increasing trade volumes overall. In many cases, there will be no need to deal with the complexity of opening an LC in foreign currency. Moreover, these measures will help reduce transaction costs for commercial partner banks.

As Bangladesh prepares to be promoted to a developing country in 2026, trading in local currency will strengthen economic ties and build stronger trade ties between trading

partners of SAARC countries and Bangladesh. However, if imbalanced terms of trade exist, a third currency (such as the US dollar) may have to be used to settle the final deficit. In this case, bilateral long-term credit facilities on easy terms can play an effective role. Apart from the agreement between governments or the agreement between private institutions, the matter of executing currency swap agreement between government and private institutions can also be considered.

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