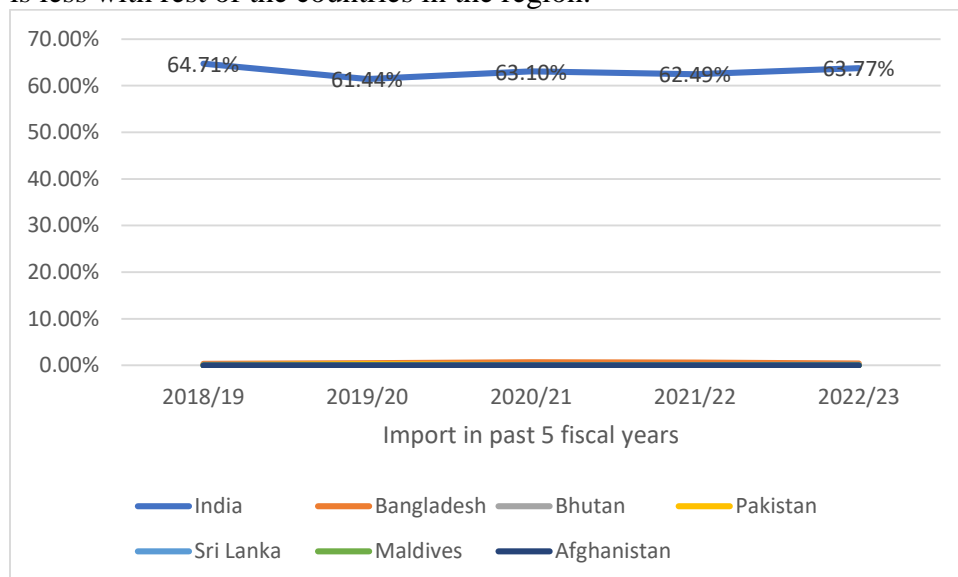


Trading in Local Currencies for SAARC Countries: Nepalese context

The Context:

1. Nepal is a land-locked country located in South Asian region. It shares northern border with the Tibetan region of the People's Republic of China, and its eastern, southern and western borders with India.
2. The relation between the two nations is not only geographical but also socio-cultural and close economic relation. Before 1951 AD, Nepalese trade concentration was only with India and Tibet but after the period it has expanded to other countries in the world.
3. Historically trade was concentrated with India due to large open border along with socio cultural and economic relation. It resulted in existence of use of Nepalese currency along with Indian Currency around the border areas.
4. Prior to establishment of Nepal Rastra Bank (NRB) as central bank of Nepal in 1956, there was exchange rate volatility in the NC-IC exchange rate threatening confidence of public in both the currencies. In 1956, NRB was established with one of the objectives being stabilization of exchange rates of Nepalese currency in order to ensure the convenience and economic interests of the general public. Consequently with effect from 13 April 1960, the exchange rate of Indian currency was fixed with Nepalese Rupees (NC 160/IC100).
5. Currently, Nepal has an open, liberal and transparent trade regime. The trade-related rules and regulations are governed by the Ministry of Industry, Commerce, and Supplies and its various entities, along with the Department of Customs under the Ministry of Finance. Further the regulation on currency exchange required in international trade is done by Nepal Rastra Bank, Central bank of Nepal.
6. The trade concentration of Nepal accounts more than 60% with India only while the share is less with rest of the countries in the region.





7. Since most of the trade concentration of Nepal is with India, trade settlement in INR with other convertible currencies is justifiable.
8. Asian Clearing Union has been established for transaction settlement on netting basis. Currently there are 10 member countries in ACU including, Bangladesh Bank, National bank of the republic of Belarus, Royal Monetary Authority of Bhutan, Reserve bank of India, Central bank of the Islamic Republic of Iran, Maldives Monetary Authority, Central Bank of Myanmar, Nepal Rastra Bank, State Bank of Pakistan, Central Bank of Sri Lanka. Moreover, currency used in transaction settlement is ACU Dollar, ACU Euro and ACU Yen. Moreover, Nepal's Trade transaction with Bhutan can be settled with INR in addition to ACU mechanism as per the provision of NRB.
9. Presently Nepal has fixed exchange rate system with India and convertible exchange rate with other 20 currencies across globe. In SAARC region, Nepal has direct exchange rate convertibility with Indian Currency Only. Other convertible currencies are: USD, EUR, GBP, CHF, AUD, CAD, SGD, JPY, CNY, SAR, QAR, THB, AED, MYR, KRW, SEK, DKK, HKD, KWD and BHD.
10. Import of goods and services from India can be done through Letter of credit, draft or TT but for import above INR 3 crore must be done through Letter of credit. Imports from India are normally paid in Indian Rupees. However, the Nepal government allows imports of some products from India with payment in hard foreign currency.
11. Direct currency convertibility plays crucial role in trade promotion as it helps in facilitation of trade by direct settlement of transaction in local currencies. In SAARC region as countries rely on internationally convertible currency rather than local currencies due to different reasons.
12. The South Asian Association for Regional Cooperation (SAARC) holds immense potential for economic cooperation. With a large combined population and diverse resources, intra-regional trade could be a major driver of growth. However, a significant hurdle is the

current reliance on external currencies for transactions. This section delves deeper into the problems and prospects of trading in local SAARC currencies.

13. There has been agreement on South Asian Free Trade Area (SAFTA) and SAARC Agreement in Trade in Services (SATIS), but its effective implementation also depends on currency convertibility among the countries in the region.
14. There are certain problems associated with implementation of trading in local currencies in SAARC region.

Problems:

1. **Currency Convertibility:** Nepal has pegged exchange rate system with India. The provision for currency exchange is not formulated for rest of the countries in the SAARC region. For transaction settlement, businesses go through either INR or other convertible currencies.
2. **Low transaction:** Except India, the volume of trade and other transactions is less with other countries in the region. In the fiscal year 2022/23, combined import portion with other SAARC countries except India is around 0.52% of total import, while combined export portion with other SAARC countries except India is around 0.82% of total export.
3. **Legal Framework and Institutional setup:** Trading in local currencies require legal framework for currency convertibility which is yet to be developed. Moreover, robust financial system within the country is required to handle large scale local currency trade.
4. **Limited Financial Infrastructure:** The financial systems within SAARC countries might not be robust enough to handle large-scale local currency trade. Deficiencies include:
 - **Payment Mechanisms:** Lack of efficient systems to transfer funds between SAARC countries in local currencies.
 - **Settlement Systems:** Difficulty in finalizing transactions and ensuring timely receipt of payments.
5. **Money Laundering and Terrorism Financing:** Local currency convertibility might attract money laundering and terrorism financing across region. Moreover, trade based money laundering and terrorism financing might increase due to direct currency convertibility.
6. **Confidence in local currencies:** India demonetized banknotes in November 2016, but the exchange of demonetized currency held in Nepalese banking system is not done. Such incidence lowers the confidence in use of local currencies.

Possible Solutions:

1. **Gradual Currency Convertibility:** SAARC countries can progressively loosen restrictions on currency convertibility. This would allow for increased circulation and easier trade settlements in local currencies.
2. **Currency Swap Arrangements:** Central banks within SAARC could establish agreements to exchange currencies at predetermined rates. This would mitigate exchange rate volatility and provide businesses with more predictability.
3. **Developing Regional Payment Systems:** Creating a dedicated regional payment system for SAARC trade would streamline transactions. This could involve:

- Establishing a regional clearinghouse for settling payments in local currencies.
- Integrating existing payment systems of member countries.
- 4. **Promoting Regional Political Cooperation:** Improved political relations between SAARC members would foster trust and create a more favorable environment for economic integration. This can be achieved through:
 - Regular dialogue and confidence-building measures between governments.
 - Addressing political disputes and fostering regional stability.

The Road Ahead:

Trading in local currencies presents a significant opportunity for economic growth within SAARC. Overcoming the challenges requires a collaborative effort from:

- **Governments:** Implementing policies to promote currency convertibility and regional financial integration.
- **Central Banks:** Establishing currency swap arrangements and collaborating on regional payment systems.
- **Private Sector:** Businesses taking advantage of local currency trade and advocating for regional economic cooperation.

By working together, SAARC countries can unlock the potential of local currency trade and create a more prosperous and integrated south Asia.

Recommendations:

1. **Harmonization of Regulations:** SAARC countries could work towards standardizing regulations and streamlining administrative procedures to facilitate local currency trade.
2. **Infrastructure Development:** Investing in robust financial infrastructure, including payment systems and clearing mechanisms, is essential for supporting local currency transactions.
3. **Capacity Building:** Initiatives to enhance financial literacy and awareness among businesses and consumers can promote the adoption of local currency trade.
4. **Policy Coordination:** Coordination among SAARC member states on monetary policies and exchange rate management can promote stability and confidence in local currencies.
5. **Public-Private Partnerships:** Collaboration between governments, central banks, and the private sector is crucial for driving the adoption of local currency trade through targeted initiatives and incentives.

By addressing these challenges and capitalizing on the prospects, SAARC countries can potentially unlock the benefits of trading in local currencies, contributing to regional economic growth and integration.