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Explained | Why are India-Russia trade payments in crisis?

PREMIUM

What is the current size of India's imports from Russia? Why is there an issue of what currency to use for payments? Why did the rupee-rouble mechanism not work? What other currencies is India exploring for payments?

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Oil pumpjacks outside Almeteyevsk in the Republic of Tatarstan, Russia on June 4, 2023. | Photo Credit: Reuters

The story so far: As India continues to import oil from Russia, it is getting tougher for the country to pay for it. On the one hand, it faces repercussions of breaching the oil price cap of



India has already started doing, has its own geopolitical ramifications and strained ties with Beijing.

Where do oil imports from Russia stand?

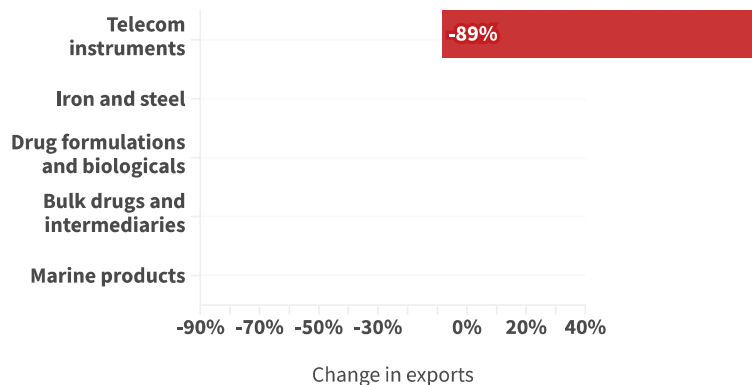
Until a year ago, most of India's oil imports came from West Asia, the U.S., and West Africa but today, a bulk of crude unloading at India's ports is likely to be coming from Russia.

In February 2023, Russia surpassed Saudi Arabia to become the second biggest exporter of crude oil to India in FY23. Since the start of Russian President Vladimir Putin's "special military operation" in Ukraine on February 24, 2022, Moscow has been hit by Western banking and economic sanctions. Against this backdrop, it found a ready market for its goods, especially crude oil, in India and offered steep discounts. India, meanwhile, unlike the West, chose to not join the list of countries formally imposing sanctions on Moscow.

India's exports to Russia (principal commodities)

Indian exports are grappling with payment-settlement uncertainty, leading to declining exports.

Change in trade from Feb 24, 2022 to April 5, 2023 compared to same period in the previous year.



Source: [Reuters](#) • The Hindu Graphics

A Flourish chart

As a result, India's imports of crude oil from Russia increased nearly 13 times in 2022-23 to over \$31 billion from less than \$2.5 billion in 2021-22. Russia is now the largest supplier of oil to India, displacing traditional players such as Iraq, Saudi Arabia, and UAE. In the four-month period between November 2022 and February 2023, Russia took over the top spot



Which currency is being used for payments?

For starters, as part of war-induced sanctions on Moscow, the U.S., the EU, and the U.K. have blocked multiple Russian banks from accessing the Society for Worldwide Interbank Financial Telecommunication (SWIFT), a global secure interbank system. An estimated \$500 million is pending for goods already shipped by Indian exporters to Russia and it is now not possible to get the payments through the SWIFT channel.

Thus, in an effort to economically strain Russia, the West targeted one of its biggest traded goods — energy — for which transactions have traditionally been dollar-dependent. Besides an oil ban jointly agreed between multiple countries last year, it was also decided to cap the price to a maximum of \$60 per barrel of Russian oil transported through waterways. While India is not a formal signatory, it has tacitly agreed to maintain the price cap as much as possible. Besides, banks and traders may not want to get involved in transactions that breach the oil cap over fears of repercussions for their funds. Until recently, the blends of oil India was importing from Russia were largely below the price cap fixed by G-7 countries and India was able to pay for the oil using dollars. However, Russia has lowered its discounts due to high demand from China and lower grade oil is now in short supply.

What about the rupee-rouble mechanism?

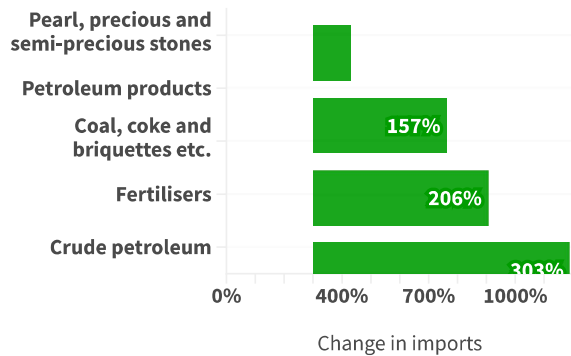
Notably, India was in negotiations with Russia to reactivate the rupee-rouble trade arrangement, which is an alternative payment mechanism to settle dues in rupees instead of dollars or euros.

However, media reports showed in May that the rupee-rouble payment mechanism could not take off. There are a couple of reasons for this — analysts point out there is scepticism on the rupee-rouble convertibility as the rouble's value is kept up by capital controls and not determined by the market, as in the case of reserved currencies. On the flip side, Russia has also pointed out that it finds the rupee to be “volatile”.



India on key commodities.

Change in trade from Feb 24, 2022 to April 5, 2023 compared to same period in the previous year.



Source: [Reuters](#) • The Hindu Graphics

A Flourish chart

Lastly, and more significantly, the unforeseen surge in oil trade between India and Russia in one year alone has led to a massively ballooning trade deficit. India's trade deficit with Russia touched \$43 billion in 2022-23 as it imported goods worth \$49.35 billion while its exports were at \$3.14 billion. This has led to staggering amounts of Indian rupees in Russian banks that cannot be used by Russia in its war efforts.

Is de-dollarisation being attempted?

Since the dollar is largely considered the global reserve currency, many countries have seen the U.S. sanctions as a way for America to weaponise the dollar. This has given rise to countries looking at de-dollarisation, which means the replacement of the U.S. dollar with other currencies as the global reserve currency.



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Is India's growing reliance on Russian supplies a long-term risk?

India too, has recently released a roadmap for the internationalisation of the Indian rupee to create broader acceptance. It is important to note, however, that the value and the acceptability of any currency depend mainly on its purchasing power, that is, the number of goods and services that can be bought using it and right now, the daily average share for the rupee in the global foreign exchange market is ~1.6%, while India's share of global goods trade is ~2%.

Meanwhile, Indian refiners have also settled some non-dollar payments for Russian oil in the Chinese yuan and the UAE dirham.

What next?

Experts have pointed out that while India could use the yuan for payments, there are concerns about how that would appear geopolitically as it continues to have strained ties with Beijing since the border standoff. Besides, another solution could be to counter the deficit with Russia by getting it to make investments in energy projects in India or to invest in government bonds.