

ROLE OF REMITTANCES IN THE INDIAN ECONOMY: PAPER III



Remittances have become a critical financial inflow for many developing countries, including India. The significant contribution of remittances to the economy not only supports millions of households but also bolsters national reserves, drives consumption, and stimulates investment. In this context, the recently released *World Migration Report 2024* by the International Organisation for Migration (IOM) highlights India's prominent position as the world's top recipient of remittances.

With the rise of digital platforms and the expanding influence of global migration, the role of remittances is undergoing transformation, demanding modernization to ensure cost-efficiency and security. Several key initiatives, such as Project Nexus and Central Bank Digital Currency (CBDC) pilots, reflect the proactive steps being taken to streamline cross-border payments. However, with these advancements come significant risks that need to be carefully managed.

Role of Remittances in the Indian Economy

India has long been a top destination for remittances from its global diaspora, which comprises millions of individuals working in various parts of the world, particularly in the Gulf, the United

States, and Europe. In 2023, according to the *World Migration Report 2024*, remittances to India surged to a record high of USD 111 billion, making it the largest recipient of remittances globally. This figure underscores the central role that remittances play in the Indian economy, contributing not only to household incomes but also to broader economic stability and growth.

The importance of remittances lies in their direct impact on improving the livelihoods of millions of Indian families. These financial inflows provide a safety net for households, helping to cover essential expenses such as education, healthcare, and housing. Moreover, remittances play a key role in boosting domestic consumption, which is a major driver of India's economic growth. The multiplier effect of remittances ensures that these funds not only support individual families but also stimulate economic activities in local economies.

Furthermore, remittances contribute to India's foreign exchange reserves, strengthening the country's external position. Since 2018, India's foreign exchange reserves have risen by over USD 311 billion, an impressive figure that reflects the critical role of remittances in stabilizing the country's financial system and supporting its balance of payments. The influx of remittances provides a buffer against external shocks, enhancing India's resilience in the face of global economic volatility.

World Migration Report 2024: A Global Perspective on Migration and Remittances

The *World Migration Report 2024* provides a comprehensive analysis of global migration patterns and the role of remittances in supporting development. It highlights that remittances have become a lifeline for many developing countries, including India, which leads the world in receiving remittance inflows. These remittances are vital for alleviating poverty, improving household consumption, and supporting education and healthcare in recipient countries.

The report also notes the increasing volume of global cross-border payments, which is projected to surpass USD 250 trillion by 2027, according to estimates by the Bank of England. This growth is driven by various factors, including the increasing mobility of people, the rise of cross-border e-commerce, and the expanding size of gross capital flows. The significant volume

of remittances and cross-border financial flows underscores the need for efficient, secure, and cost-effective payment systems to facilitate these transfers.

Project Nexus: A Multilateral Initiative for Cross-border Payments

In response to the growing demand for faster and cheaper cross-border payments, several countries, including India, have embarked on initiatives to modernize their payment systems. One such initiative is Project Nexus, a multilateral international project aimed at enabling instant cross-border retail payments by interlinking domestic instant payment systems (IPS) in participating countries.

Project Nexus currently involves four ASEAN countries—Malaysia, the Philippines, Singapore, and Thailand—along with India. The goal of this initiative is to create a seamless network that allows individuals and businesses in these countries to make cross-border payments in real-time. By interlinking their domestic payment systems, these countries can significantly reduce the time and cost of cross-border transactions, benefiting individuals and businesses alike.

For India, Project Nexus represents an important step in its efforts to enhance the efficiency of cross-border remittances. The initiative complements other bilateral and multilateral efforts to establish payment linkages with countries such as Singapore, the UAE, Mauritius, Sri Lanka, and Nepal. By creating a network of interconnected payment systems, India aims to reduce the barriers to cross-border payments, making it easier for individuals and businesses to send and receive money across borders.

Recent Measures to Facilitate Remittances

In addition to Project Nexus, the Reserve Bank of India (RBI) has taken several steps to facilitate cross-border remittances and payments. One such measure is the exploration of expanding Real-Time Gross Settlement (RTGS) systems to settle transactions in major trade currencies such as the US dollar, Euro, and British Pound. By allowing real-time settlements in these

currencies, India can reduce the time and cost associated with cross-border payments, enhancing the efficiency of its financial system.

Another key initiative is the introduction of Central Bank Digital Currency (CBDC), which has the potential to revolutionize cross-border payments. In November 2022, the RBI launched the wholesale pilot of CBDC for settling government bond transactions. This was followed by the launch of a retail CBDC pilot a month later. CBDC holds the promise of facilitating instant, secure, and cost-effective cross-border payments, reducing reliance on traditional banking intermediaries and minimizing transaction costs.

Moreover, the RBI has been working on harmonizing standards and ensuring the interoperability of payment systems to enable seamless cross-border transactions. These efforts aim to overcome the challenges posed by the fragmentation of global payment systems, which often leads to delays and higher costs for cross-border payments.

Risks Associated with Cross-border Payments and Digitization

While the modernization of payment systems offers significant benefits, it also comes with risks that need to be carefully managed. One of the primary risks associated with cross-border payments is the misuse of digital platforms and the potential for cyberattacks. As digital payment systems become more interconnected, they become more vulnerable to cyber threats, which can result in data breaches and financial losses.

In his recent address, RBI Governor Shaktikanta Das raised concerns about the over-reliance on artificial intelligence (AI) and digital platforms in the banking sector. While AI offers several advantages in terms of efficiency and cost reduction, it also poses risks related to cybersecurity and data privacy. Financial institutions must put in place robust risk mitigation measures to protect against these threats and ensure the safety of cross-border payments.

Another risk associated with cross-border payments is the potential for financial instability, particularly in a globally interconnected economy. The divergence in monetary policies across

countries—such as monetary easing in some economies and tightening in others—can lead to volatility in capital flows and exchange rates. This, in turn, can disrupt financial stability and pose risks to cross-border payment systems.

The Way Forward: Enhancing Efficiency and Managing Risks

Looking ahead, there is a clear need for continued efforts to modernize cross-border payment systems while mitigating the associated risks. For India, this means not only expanding its participation in multilateral initiatives such as Project Nexus but also exploring new technologies such as CBDC to enhance the efficiency of cross-border payments.

At the same time, financial institutions must remain vigilant in managing the risks associated with digitization. This includes strengthening cybersecurity measures, building robust liquidity buffers, and ensuring that payment systems are resilient in the face of global economic volatility.

In conclusion, remittances play a critical role in supporting the Indian economy and the livelihoods of millions of families. As cross-border payments continue to grow in importance, initiatives such as Project Nexus and CBDC pilots represent important steps toward reducing the cost and time of remittances. However, these advancements must be accompanied by robust risk management measures to ensure the security and stability of the global financial system. With the right policies in place, India can continue to lead the way in modernizing cross-border payments, creating a more efficient and resilient financial ecosystem for the future.

Main Practice Question

Discuss the significance of remittances in the Indian economy and the steps taken by the Reserve Bank of India (RBI) to enhance the efficiency of cross-border payments. In your answer, address how initiatives like Project Nexus and Central Bank Digital Currency (CBDC) pilots aim to reduce the cost and time of remittances, and explain the associated risks that come with the increasing digitization of payment systems.

Answer Guidelines:



1. Introduction:

- Define remittances and their role in the Indian economy.
- Mention the scale of remittances received by India (e.g., USD 111 billion in 2023) as highlighted in the *World Migration Report 2024*.

2. Significance of Remittances:

- Explain how remittances support household income, healthcare, education, and consumption.
- Discuss the role of remittances in bolstering India's foreign exchange reserves and its contribution to the balance of payments.

3. Steps by RBI to Enhance Cross-border Payments:

- Introduce the RBI's initiatives to reduce the cost and time of cross-border payments.
- Describe **Project Nexus**, its multilateral nature, and its focus on real-time payment systems.
- Discuss the **CBDC pilot projects** launched by the RBI, focusing on the potential for instant cross-border payments and reducing reliance on intermediaries.

4. Risks of Increasing Digitization:

- Mention the risks associated with AI and BigTech, including cybersecurity threats and data privacy concerns.
- Address potential challenges in regulating and securing cross-border payments in a rapidly digitizing world.

5. Conclusion:

- Summarize the importance of remittances and the need for balanced modernization to manage the risks associated with cross-border payments.