International Journal of Research
Available at https://edupediapublications.org/journals
e-ISSN: 2348-6848
p-ISSN: 2348-795X
Volume 05 Issue 7
March 2018

Capital Account Convertibility and India

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ABSTRACT:

Capital account convertibility facilitates conversion of domestic financial assets into foreign financial assets or vice versa at market exchange rates. In other words, it refers to restriction free inflow and outflow on capital account of a county. It can be totally unrestricted (full capital account convertibility) or partially restrained (partial capital account convertibility). This study aims to strengthen the knowledge about CAC and current status of India in this regard.

The study argues that adoption of full CAC is a good decision or not .However this is in vague but later or soon every economy has to adopt it. India is in way to adopt full CAC and had allowed current account convertibility in past in 1994. There are many reasons like incapability of financial market, instability etc which hinders the adoption of full capital account convertibility. Therefore, this study made an attempt to study the current scenario in Indian Economy.

Key Words: Capital account convertibility, current account, India.

INTRODUCTION

Capital account convertibility is an important as well as inevitable part of a country while globalization. Convertibility of currency means that a currency can be converted into other with no restriction or control. In other words, Indian Rupees can be converted into US Dollars or to any other currency or vice versa without any restriction, is convertibility of currency. There are two types of convertibility- Current Account Convertibility and Capital Account Convertibility. Current account convertibility refers to that which allows exchanging goods and services, money transfers or other items which are categorized in current account of a country. Except capital

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purpose it allows to transact for all the purposes. Capital account convertibility refers to free international flow on a country's capital account. It allows exchange of items which are categorized in capital account of a country.

In 1997 this theory, to enable third world economies to grow as globalised economies, was proposed by the Tarapore Committee setup by the RBI. In India it was introduced when most of the economists agreed the concurrence of Article VIII of the IMF's Articles.

OBJECTIVES OF THE STUDY

1. To study the concept of Capital Account Convertibility.

2. To know the current status of India with respect to CAC.

3. To analyze the benefits and losses of full CAC.

RESEARCH METHODOLOGY

Research Design:

This study is Descriptive in nature. It is because through this study researcher made an attempt to describe the present scenario of CAC in India.

Sources of Data:

The present study is totally based on secondary data, which is collected through various research articles, newspapers, RBI reports, Magazines etc.

CAPITAL ACCOUNT CONVERTIBILITY

Capital account convertibility means that there is no limitation on conversion of the local currency into a foreign currency at market determined rate to facilitate a resident to get hold of any distant asset and vice versa. It is also recognized as capital asset liberation. In an article of Benu Schneider 2000, it is quoted that capital account convertibility (CAC) is "the freedom to convert local financial assets into foreign financial assets and vice versa at market determined rates of exchange. It is associated with changes of ownership in foreign/domestic financial assets

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and liabilities and embodies the creation and liquidation of claims on, or by the rest of the world. CAC can be, and is, coexistent with restrictions other than on external payments. It also does not preclude the imposition of monetary/fiscal measures relating to foreign exchange transactions which are of a prudential nature."

CURRENT STATUS OF INDIA

The Committee highlighted in its report that that in August 1994, India had adopted current account convertibility officially accommodating the obligations under Article VIII of the Articles of Agreement of the International Monetary Fund (IMF). It means that the full amount of the foreign exchange required by someone for current purposes will be made available to him at the official exchange rate and there could be an unprohibited outflow of foreign exchange (earlier it was partially convertible).Till date there is partial capital account convertibility of 40:60 in India. Furthermore, after the recommendations of the Tarapore Committee (1997) on Capital Account Convertibility, India is moving towards allowance of full convertibility with some obligatory safety measures. However, still it is a debatable issue that India should adopt full CAC or not.

IS IT BENEFICIAL TO ADOPT FULL CAC?

Capital Account Convertibility (CAC) is the feature of a country's financial system which allows the translation of domestic financial assets into foreign financial assets and vice versa at market determined rates. This convertibility may be wholly abandoned or partially proscribed. It is a debatable topic

The main advantage of full capital account convertibility for India are:-

1. It will assist India to intensify its market and in attaining the leading status in worldwide economy.
2. It will support Indian company to use peripheral commercial borrowing route without the approval of RBI or Government.
3. It will enhance the open competition among financial markets of India with global countries which leads to economic development.

4. It will lead to better access of international financial markets and drop the cost of capital.

5. It will maximize the efficiency of use of capital which is a scarce resource. It is because capital can be migrated to that place where returns are high even in outside a nation.

Losses of adopting full capital account convertibility to India are:

1. Full CAC can lead to unpredictable or unstable flow of foreign capital, which brings excess financial volatility in domestic market.

2. Once full CAC has allowed it would be difficult for RBI to control it in this globalised world.

3. It may cause high inflation in domestic economy. It is because CAC will allow free flow of capital whenever needed.

Considering the above points it can be concluded that it is still in vague either India should adopt full capital account convertibility or not. Shri G Padmanabhan, in his report (May 18, 2015) stated that "it is generally accepted that sooner or later all countries have to be there but the thing is that when, how and at what pace it should be adopted so that the benefits of CAC outweigh its costs, as Tarapore Committee advocated."

IS INDIA READY FOR FULL CAC?

At present Indian financial market is not much deep and developed. Financial need of Indian corporations cannot be fulfilled from local investors; they have to raise funds from foreign investors. Before the implementation of full CAC India needs to make its macroeconomic parameters more stable. Thus, it can be said that India is not ready for full capital account convertibility.

Raghuram Rajan, the previous Reserve Bank of India governor, had said that the central bank was looking at bringing in capital account convertibility in a few years.

CONCLUSION

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Capital account convertibility facilitates conversion of domestic financial assets into foreign financial assets or vice versa. India had adopted current account convertibility but not full capital account convertibility yet. Adopting full CAC is a challenging task for any developing country like India.

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