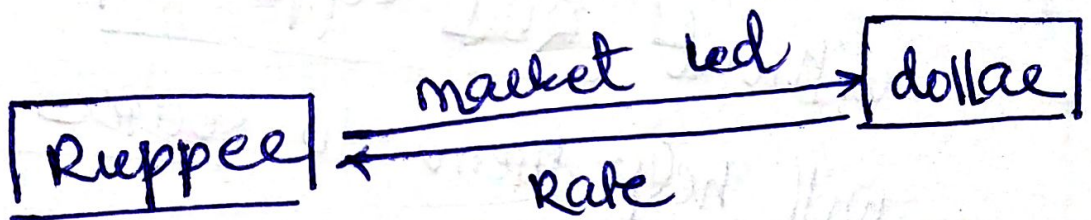


Capital Account convertibility (CAC)

remain a highly debated issue since
LPG reforms, yet India does not have
full CAC.

Capital Account convertibility means
freedom to convert local financial asset
like Rupee into foreign financial asset
like dollar or Euro and the vice versa
at a market determined rate.



And many eminent economists
like Raghuram Rajan, G. Padmanabhan
etc voted for full CAC, because

(i) Investment - It will reduce the transaction cost and boost investor confidence to meet India's dire need of fund.

(ii) Freedom - Indian resident will then be capable to acquire foreign asset above current limit of - \$ 2,500.

(iii) External commercial borrowing (ECB)

CAC will allow corporates to ECB without RBI approval and this will help them to source cheap fund against high domestic capital cost.

(iv) Financial institutions like NBFC will benefit via excess of global market.

However, there are reasons, why India's still follow 60:40 ratio in CAC

(i) Inflation - market led exchange rate are higher than fixed exchange rate, which can push import price [oil].

(ii) Destability - Global crisis like 2008 crisis can destabilise economy.

(iii) speculation - being ~~ex~~ speculative CAC is risky. for example in south-east Asian crisis (1997), investors pulled out large money.

(iv) Irreversible - once made, its equal to impossible to go back.

However, India is going forward to achieve CAC by following TARAPUR COMMITTEE recommendations

like (i) fiscal consolidation [FPM 2003].

(ii) Low Inflation through monitory
committee.

(iii) low NPA via several initiatives
and banking reforms.

(iv) Strengthening financial market,
sound policies, efficient and
robust regulatory mechanisms.