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.

$$\boxed{\text{Ruppee}} \underset{\text{Rate}}{\overset{\text{market led}}{\rightleftarrows}} \boxed{\text{dollar}}$$

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 investors 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 - $2,5000.

(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 still follow 60:40 ratio in CAC

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

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

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

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

However, India is going froward to achieve CAC by following TARAPUR COMMITTEE recommendations like (i) Fiscal consolidation [FRBM act 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.