M.A. Economics, Semester-II, Paper-II, International Economics Topic: Convertibility

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- **Currency Convertibility**
- Currency convertibility refers to the freedom to convert the domestic currency into other internationally accepted currencies and vice versa at the market determined exchange rate. Current account convertibility means freedom to convert domestic currency into foreign currency and vice versa to execute trade in goods and invisibles. On the other hand, capital account convertibility implies freedom of currency conversion related to capital inflows and outflows.

- **Current account convertibility-**
- Current account convertibility means freedom to convert domestic currency into foreign currency and vice versa for trade in goods and invisibles (services, transfers or income from investment). Individuals and entities can convert currencies in the foreign exchange market.

- Current account convertibility is one part of currency convertibility. The other part is capital account convertibility. Current account and capital account convertibility indicate the purpose for which currency is converted

- Currency convertibility refers to the freedom to convert domestic currency into other internationally accepted currencies and vice versa. Exporters, importers, foreign investors, domestic investors investing abroad, residents and corporate etc., would like to convert domestic currency into foreign currency and vice versa to meet their international engagements.

- **Example:-** When there is current account convertibility for rupee, an exporter can sell the US Dollars (or other foreign currency) he obtained from exporting a commodity at the market determined exchange rate in India. This means that there is no exchange controls (foreign exchange controls). Similarly, when an importer buys foreign currency from India’s foreign exchange market by exchanging rupee, it is current account convertibility.

- **Introduction of full current account convertibility in India**
- In India, there is full current account convertibility since August 20, 1993. A series of measures were launched then to liberalise exchange controls and the exchange rate system was shifted to market- determined exchange rates since March 1993. After that, on August 20, 1993, the RBI announced that that the rupee became fully convertible on current account. This was after India accepted the status and obligations of Article VIII with the IMF.

- **Capital account convertibility**
- Compared to current account convertibility, capital account convertibility is a complex issue because of the peculiar feature of capital account transactions. An important one is the high frequency and volume of international capital movements across borders which may produce many macroeconomic effects in host countries like India.

- Capital Account Convertibility is not just the currency convertibility freedom, but more than that, it involves the freedom to invest in financial assets of other countries. The Committee on Capital Account Convertibility (1997, Chairman Dr S S Tarapore) in its report has given a working definition for the CAC which is as following. "CAC refers to 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 and liabilities and embodies the creation and liquidation of claims on, or by, the rest of the world."

- Capital account convertibility is thus the freedom of foreign investors to purchase Indian financial assets (shares, bonds etc.) and that of the domestic citizens to purchase foreign financial assets. It provides rights for firms and residents to freely buy into overseas assets such as equity, bonds, property and acquire ownership of overseas firms besides free repatriation of proceeds by foreign investors.

- Countries prefer capital account convertibility to promote the inflow of foreign capital. Despite the various risk associated with capital flows like fluctuations in various segments of the financial market, countries like India goes for it to get the advantage of having additional foreign capital.

- Status of capital account convertibility in India
- There is partial capital account convertibility in India. Though tremendous capital account liberalisation measures were taken place since the launch of economic reforms, introduction of full capital account convertibility is yet to be implemented. In the case of current account there is full convertibility. Altogether, there is the rupee is partially convertible.

THANK YOU