

Table of Contents

New Exchange Rate regime	2
Partial and full convertibility	10
Capital Account Convertibility	10
Recommendations of Tarapore Committee 1, 1997	11
Second Tarapore Committee on Capital Account Convertibility, 2006	11
Should India go for fuller convertibility of rupee?.....	12

4. BOP speech (done)

New Exchange Rate regime

Objectives of exchange rate policy in India are: (i) to ensure that economic fundamentals are reflected in the external value of the rupee, (ii) to reduce excess volatility in exchange rates, and ensure that the market correction of overvalued or undervalued exchange rate is orderly and calibrated, (iii) to help maintain an adequate level of foreign exchange reserves and; (iv) to help eliminate market constraints in the way of development of a healthy FEM.

In this context, a new instrument, named as the Market Stabilisation Scheme (MSS) has evolved as a useful instrument of monetary policy to sustain open market operations. The MSS was made operational from April 2004. Under this scheme, which is meant exclusively for liquidity management, the Reserve Bank has been empowered to issue Government Treasury Bills and medium duration dated securities for the purpose of liquidity absorption.

India's exchange rate policy has evolved over time in line with the gradual opening up of the economy as part of the broader strategy of macroeconomic reforms and liberalization since the early 1990s. This change was also warranted by the consensus response of all major countries to excessive exchange rate fluctuations that accompanied the abolishment of fixed exchange rate system. The major changes in the exchange rate policy started with the implementation of the recommendations of the High Level Committee on Balance of Payments (Chairman: Dr. C. Rangarajan, 1993) to make the exchange rate market determined. The Expert Group on Foreign Exchange Markets in India (popularly known as Sodhani Committee, 1995) made several recommendations with respect to participants, trading, risk management as well as selective market intervention by the Reserve Bank to promote greater market development in an orderly fashion. Consequently, the period starting from January 1996 saw wide-ranging reforms in the Indian foreign exchange market. In essence, the exchange rate developments changed in side-by-side with the reform in the external sector of India.

With the external sector reform, India stands considerably integrated with the rest of the world today in terms of increasing openness of the economy. As a result of calibrated and gradual capital account openness, the financial markets, particularly forex market, in India have also become increasingly integrated with the global network since 2003-04. This is reflected in the extent and magnitude of capital that has flown to India in recent years. Exchange rates exhibited considerable volatility and increased capital mobility has posed several challenges before the monetary authorities in managing exchange rates.

Against this backdrop, the following section analyses in retrospect India's exchange rate story, with particular focus on the policy responses during difficult times and the reforms undertaken to develop the rupee exchange market during relatively stable times.

1. Chronology of Reform Measures

In the post independence period, India's exchange rate policy has seen a shift from a par value system to a basket-peg and further to a managed float exchange rate system. During the period 1947 till 1971, India followed the par value system of the exchange rate whereby the rupee's external par value was fixed at 4.15 grains of fine gold. The RBI maintained the par value of the rupee within the permitted margin of $\pm 1\%$ using pound sterling as the intervention currency. The devaluation of the rupee in September 1949 and June 1966 in terms of gold resulted in the reduction of the par value of rupee in terms of gold to 2.88 and 1.83 grains of fine gold, respectively. Since 1966, the exchange rate of the rupee remained constant till 1971 ([Chart 2.1](#)).

Chart 2.1: History of rupee dollar exchange rate



With the breakdown of the Bretton Woods System, in December 1971, the rupee was linked with pound sterling. Sterling being fixed in terms of US dollar under the Smithsonian Agreement of 1971, the rupee also remained stable against dollar. In order to overcome the weaknesses associated with a single currency peg and to ensure stability of the exchange rate, the rupee, with effect from September 1975, was pegged to a basket of currencies (Table 2.1). The currencies included in the basket as well as their relative weights were kept confidential by the Reserve Bank to discourage speculation.

By the late 'eighties and the early 'nineties, it was recognised that both macroeconomic policy and structural factors had contributed to balance of payment difficulties. The current account deficit widened to 3.0 per cent of GDP in 1990-91 and the foreign currency assets depleted to less than a billion dollar by July 1991. It was against this backdrop that India embarked on stabilisation and structural reforms to generate impulses for growth.

Table 2.1 : Chronology of the Indian Exchange Rate

Year	The Foreign Exchange Market and Exchange Rate
1947-1971	Par Value system of exchange rate. Rupee's external par value was fixed in terms of gold with the pound sterling as the intervention currency.
1971	Breakdown of the Bretton-Woods system and floatation of major currencies. Rupee was linked to the pound sterling in December 1971.
1975	To ensure stability of the Rupee, and avoid the weaknesses associated with a single currency peg, the Rupee was pegged to a basket of currencies. Currency selection and weight assignment was left to the discretion of the RBI and not publicly announced.
1978	RBI allowed the domestic banks to undertake intra-day trading in foreign exchange.

1978-1992	Banks began to start quoting two-way prices against the Rupee as well as in other currencies. As trading volumes increased, the 'Guidelines for Internal Control over Foreign Exchange Business' were framed in 1981. The foreign exchange market was still highly regulated with several restrictions on external transactions, entry barriers and transactions costs. Foreign exchange transactions were controlled through the Foreign Exchange Regulations Act (FERA). These restrictions resulted in an extremely efficient unofficial parallel (hawala) market for foreign exchange.
1990-1991	Balance of Payments crisis
July 1991	To stabilize the foreign exchange market, a two step downward exchange rate adjustment was done (9% and 11%). This was a decisive end to the pegged exchange rate regime.
March 1992	To ease the transition to a market determined exchange rate system, the Liberalized Exchange Rate Management System (LERMS) was put in place, which used a dual exchange rate system. ¹ This was mostly a transitional system.
March 1993	The dual rates converged, and the market determined exchange rate regime was introduced. All foreign exchange receipts could now be converted at market determined exchange rates.

Source : Reserve Bank of India

The Report of the High Level Committee on Balance of Payments (Chairman Dr. C. Rangarajan) laid the framework for a credible macroeconomic, structural and stabilisation programme encompassing trade, industry, foreign investment, exchange rate and the foreign exchange reserves. With regard to the exchange rate policy, the committee recommended that consideration be given to (i) a realistic exchange rate, (ii) avoiding use of exchange mechanisms for subsidization, (iii) maintaining adequate level reserves to take care of short-term fluctuations, (iv) continuing the process of liberalization on current account, and (v) reinforcing effective control over capital transactions. The key to the maintenance of a realistic and a stable exchange rate is containing inflation through macro-economic policies and ensuring net capital receipts of the scale not beyond the expectation. The Committee further recommended that a decision be taken to unify the exchange rate, as an important step towards full convertibility.

The initiation of economic reforms saw, among other measures, a two step downward exchange rate adjustment by 9 per cent and 11 per cent between July 1 and 3, 1991 to counter the massive draw down in the foreign exchange reserves, to install confidence in the investors and to improve domestic competitiveness. The two-step adjustment of July 1991 effectively brought to a close the period of pegged exchange rate. Following the recommendations of Rangarajan Committee to move towards the market determined exchange rate, the Liberalised Exchange Rate Management System (LERMS) was put in place in March 1992 involving dual exchange rate system in the interim period. The dual exchange rate system was replaced by unified exchange rate system in March 1993.

¹ A 60:40 conversion formula was put in place whereby all Indian exporters were allowed to sell 60% of their dollar earning at the market-determined exchange rate and the rest at the officially pegged rate to authorized dealers. This was change to 100:0 next year

2. Foreign Exchange Intervention

In the post-Asian crisis period, particularly after 2002-03, capital flows into India surged creating space for speculation on Indian rupee. The Reserve Bank intervened actively in the forex market to reduce the volatility in the market. During this period, the Reserve Bank made direct interventions in the market through purchases and sales of the US Dollars in the forex market and sterilised its impact on monetary base. The Reserve Bank has been intervening to curb volatility arising due to demand-supply mismatch in the domestic foreign exchange market ([Table 2.2](#)).

Table 2.2: Reserve Bank's Intervention in the Foreign Exchange Market

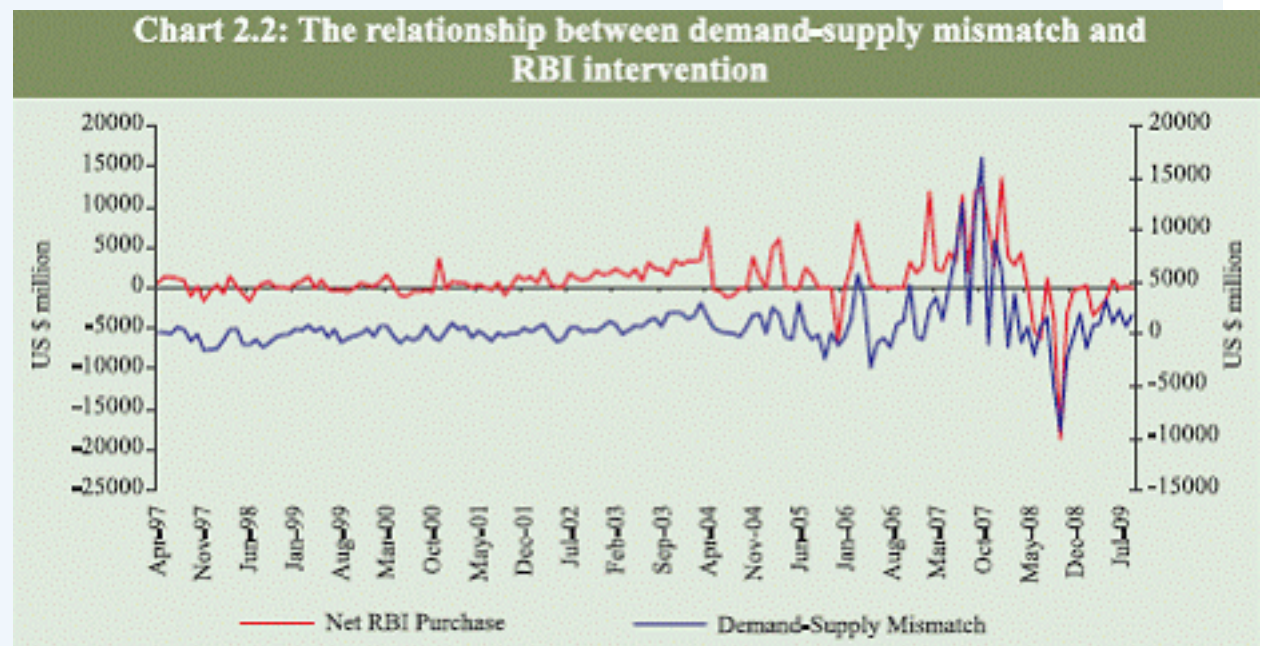
(US\$)

	Purchase	Sale	Net	Outstanding Net Forward Purchase (end-March)
1995-96	3.6	3.9	-0.3	
1996-97	11.2	3.4	7.8	
1997-98	15.1	11.2	3.8	
1998-99	28.7	26.9	1.8	
1999-00	24.1	20.8	3.2	
2000-01	28.2	25.8	2.4	
2001-02	22.8	15.8	7.1	
2002-03	30.6	14.9	15.7	
2003-04	55.4	24.9	30.5	
2004-05	31.4	10.6	20.8	
2005-06	15.2	7.1	8.1	
2006-07	26.8	0.0	26.8	
2007-08	79.7	1.5	78.2	
2008-09	26.6	61.5	-34.9	

Source : Reserve Bank of India.

Sales in the foreign exchange market are generally guided by excess demand conditions that may arise due to several factors. Similarly, the Reserve Bank purchases dollars from the market when there is an excess supply pressure in market due to capital inflows. Demand-supply mismatch proxied by the difference between the purchase and sale transactions in the merchant segment of the spot market reveals a strong co-movement between demand-supply gap and intervention by the Reserve Bank ([Chart 2.2](#)) 3. Thus, the Reserve Bank has been prepared to make sales and purchases of foreign currency in order to even out lumpy demand and supply in the relatively thin foreign exchange market and to smoothen jerky movements. However, such intervention is generally not governed by any

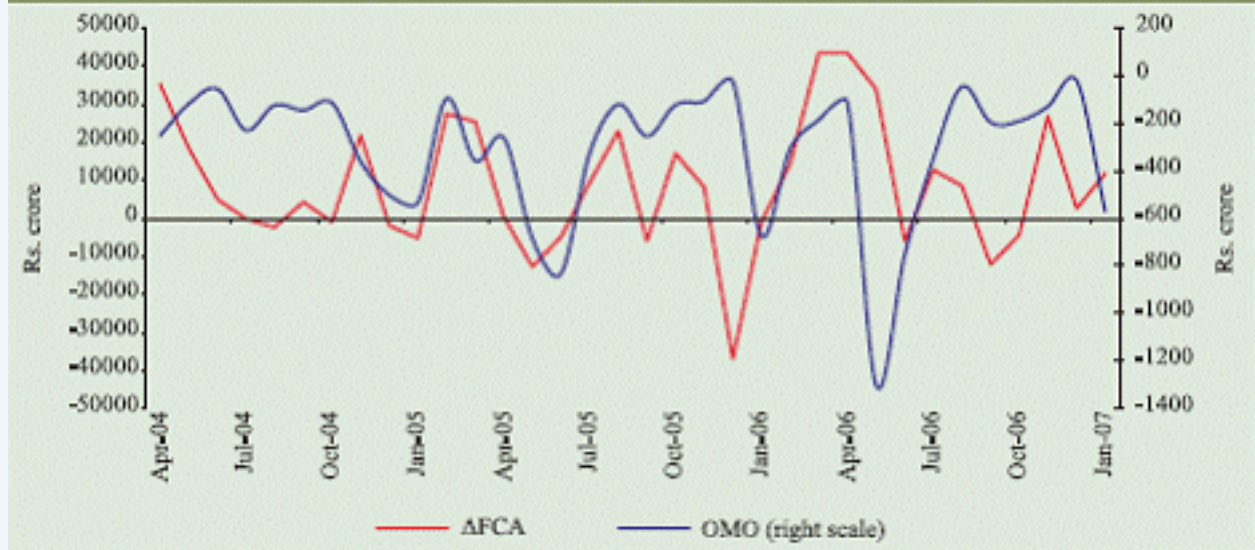
predetermined target or band around the exchange rate (Jalan, 1999).



The volatility of Indian rupee remained low against the US dollar than against other major currencies as the Reserve Bank intervened mostly through purchases/sales of the US dollar. Empirical evidence in the Indian case has generally suggested that in the present day managed float regime of India, intervention has served as a potent instrument in containing the magnitude of exchange rate volatility of the rupee and the intervention operations do not influence as much the level of rupee (Pattanaik and Sahoo, 2001; Kohli, 2000; RBI, RCF 2002-03, 2005-06).

The intervention of the Reserve Bank in order to neutralise the impact of excess foreign exchange inflows enhanced the RBI's Foreign Currency Assets (FCA) continuously. In order to offset the effect of increase in FCA on monetary base, the Reserve Bank had mopped up the excess liquidity from the system through open market operation (Chart 2.3). It is, however, pertinent to note that Reserve Bank's intervention in the foreign exchange market has been relatively small in terms of volume (less than 1 per cent during last few years), except during 2008-09. The Reserve Bank's gross market intervention as a per cent of turnover in the foreign exchange market was the highest in 2003-04 though in absolute terms the highest intervention was US\$ 84 billion in 2008-09 (Table 2.3). During October 2008 alone, when the contagion of the global financial crisis started affecting India, the RBI sold US\$ 20.6 billion in the foreign exchange market. This was the highest intervention till date during any particular month.

Chart 2.3: Sterilization Operation of the RBI



3. Trends in Exchange Rate

A look at the entire period since 1993 when we moved towards market determined exchange rates reveals that the Indian Rupee has generally depreciated against the dollar during the last 15 years except during the period 2003 to 2005 and during 2007-08 when the rupee had appreciated on account of dollar's global weakness and large capital inflows (Table 2.4). For the period as a whole, 1993-94 to 2007-08, the Indian Rupee has depreciated against the dollar. The rupee has also depreciated against other major international currencies. Another important feature has been the reduction in the volatility of the Indian exchange rate during last few years. Among all currencies worldwide, which are not on a nominal peg, and certainly among all emerging market economies, the volatility of the rupee-dollar rate has remained low. Moreover, the rupee in real terms generally witnessed stability over the years despite volatility in capital flows and trade flows (Table 2.5).

The various episodes of volatility of exchange rate of the rupee have been managed in a flexible and pragmatic manner. In line with the exchange rate policy, it has also been observed that the Indian rupee is moving along with the economic fundamentals in the post-reform period. Thus, as can be observed maintaining orderly market conditions have been the central theme of RBI's exchange rate policy. Despite several unexpected external and domestic developments, India's exchange rate performance is considered to be satisfactory. The Reserve Bank has generally reacted promptly and swiftly to exchange market pressures through a combination of monetary, regulatory measures along with direct and indirect interventions and has preferred to withdraw from the market as soon as orderly conditions are restored.

Moving forward, as India progresses towards full capital account convertibility and gets more and more integrated with the rest of the world, managing periods of volatility is bound to pose greater challenges in view of the impossible trinity of independent monetary policy, open capital account and exchange rate management. Preserving stability in the market would require more flexibility, adaptability and innovations with regard to the strategy for liquidity management as well as exchange rate management. Also, with the likely turnover in the foreign exchange market rising in future, further development of the foreign exchange market will be crucial to manage the associated risks.

Oxford book: In 1992, two more policy changes:

- Increased operational autonomy was given to the RBI in attainment of monetary policy objectives through the phasing out of automatic monetization of fiscal deficits. FRBM Act further restricted financing of fiscal deficit through purchase of government securities.
- US dollar was made both the reserve and intervention currency (prior – pound)

On current account deficit: India's trade and current account deficit worsened immediately after the nominal devaluation and till 1997. Thereafter, the trade deficit marginally improved before it increased sharply from 2003.

India moved away from pegged exchange rate to the Liberalized Exchange Rate Management System (LERMS) in 1992 and the market determined exchange rate regime in 1993 which is considered as an important structural change in the exchange rate market. With increased volatility in exchange rate and to mitigate the risk arising out of excess volatility, currency futures were introduced in India in 2008 which is considered as second important structural change. It is believed that the currency futures will help in hedging the exposures of exchange rate to unfavorable movements in exchange rate. The role of derivatives for risk taking and risk management cannot be understated by any means and it has increased significantly in recent times.

Has Increasing Globalisation Limited the Effectiveness of National Policies in India?

In the wake of the global financial crisis, financial globalisation has come under scrutiny once again.

Critiques: globalisation does not bring any additional gains than what can already come from free trade.

- In the context of increasing capital flows, it has been time and again pointed out by the critiques that gains from trade in goods (widgets) are of first order, while gains from trade in capital (dollars) are of second order, *a'la* Jagdish Bhagwati.
- Another observation has been that countries that have benefited most from free-market globalisation are not those that have embraced it wholeheartedly, but those that have adopted parts of it selectively. Open markets succeed only when embedded within social, legal and political institutions that provide them legitimacy by ensuring that the benefits of capitalism are broadly shared (Rodrik, 2011).

Benefits:

- Kose, et al.(2009) find that policies promoting sound macroeconomy, financial sector development, institutional quality and trade openness appear to help developing countries derive the benefits of financial integration.

However, a more recent concern has been: if globalisation is leading to a loss of national policy effectiveness?

Subbarao (2011) suggests that there is a need to find ways to maximise the benefits of globalisation while minimising its costs. While spillovers occur, we need to deal with them. A typical case has been QE2, which has both positive and negative externalities. Its announcement caused a double whammy on the EMEs through a

surge in capital inflows and a rise in commodity prices, both requiring them to tackle inflationary pressures. They put EMEs in a policy bind as higher interest rates to fight inflation could potentially intensify capital inflows further. QE2, however, also helped shore up US recovery, bringing back confidence in financial markets and ultimately helping EMEs through improved trade and capital account flows. Effectiveness of national economic policies goes down in such cases, especially if they are uncoordinated.

The impact of globalisation on national economic policy effectiveness is ultimately an empirical question. Our theoretical understanding of the channels through which national economies are linked is also inadequate. Yet, it would not be correct to say that domestic monetary, fiscal or exchange rate policy becomes redundant with increased openness. Trilemma in policy choice is a well known problem and needs to be managed by adopting less than corner solutions. In fact, under globalisation national policies can be more carefully calibrated and fine-tuned to serve national interests.

For instance, monetary policy takes on new importance under globalisation due to need to contain spillovers and their impact on nominal asset returns. The case for price stability as an optimal monetary rule becomes stronger. Even without nominal price rigidities, price stability is important because it enhances the risk sharing properties of nominal bonds (Devereux and Sutherlands, 2008). It is important to recognise that globalisation represents a shock to relative, not absolute prices. What happens to the general price level depends on what monetary policy makers then decide to do.

It has been argued that *de facto* openness has risen sharply in India and has implied a loss of monetary policy autonomy when exchange rate pegging was attempted (Shah and Patnaik, 2011). It is true that the exchange rate regime has evolved towards greater flexibility as a conscious policy choice, but this has been calibrated to the changing structure and dynamics of the economy without loss of monetary policy independence. Policies had supported this move over a period of time, *inter alia*, by capacity building to withstand volatility and shocks. It has increasingly allowed exchange rate to serve as a buffer, depreciating to help the economy when it was weak and appreciating to reduce excess demand when it was strong. In the past two years, there has been no significant foreign exchange market intervention. The small increase in the Reserve Bank's foreign exchange reserves mainly reflects various accruals, interest earnings and valuation changes. Increased exchange rate flexibility has also minimised the danger that foreign inflows would be attracted by "one-way bets" on appreciation, or that domestic firms would borrow excessively from abroad without hedging their exposure.

Globalisation is a phenomenon that has now acquired a force of its own. Policy interventions can best aim at a right policy mix to reap gains from it while minimising the risks. These gains dynamically can be significant. It may appear that growing global interdependence has increased the Indian economy's vulnerability to external demand and exchange rate shocks. However, misaligned exchange rates amidst balance of payment shocks had a much larger adverse impact on the Indian economy in the earlier crisis episodes. After the Indian economy has become integrated globally, a large shock in the form of a swing of US\$100 billion in total net capital inflows in a single year of peak of global crisis had been managed without too much impact on exchange rate, interest rates, external and internal balances.

Partial and full convertibility

Full current account convertibility has been since 1992, following end of LERM.

Capital Account Convertibility

Capital account convertibility (CAC) means freedom of currency conversion in relation to capital transactions in terms of inflows and outflows.

Why capital inflows are important?

- First, growth expectations drive capital flows. In turn, capital flows accelerate growth. If capital flows are well absorbed by the real economy and do not generate macro-economic or financial instabilities, they stay. Such capital flows augment growth over the long-run and may help income levels in developing economies converge towards the income levels in advanced economies.
- Second, capital is likely to be attracted towards countries with high productivity growth and higher marginal productivity of capital. However, in practice this is found to be not necessarily true.
- Third, what is generally missed is the fact that it is not just the net capital flows that drive growth, but also the gross capital flows contribute to growth. Gross capital flows contribute immensely to diffusion of technology and international knowledge flows.
- Fourth growth augmentation can also take place because capital flows enforce macro-economic discipline and force firms to improve governance. However, the impact of capital flows on growth ultimately depends on their being stable and less volatile. Durable capital flows bring durable growth, while non-durable and volatile capital flows not only bring about non-durable growth but also large output losses in cases of currency or banking crisis.

This however does not make a case for capital controls as in a globalised world capital account liberalisation is seen as a plus-sum game.

Recent crisis has brought the issue of capital flows to centre stage.

The policy approach in India to the issue of capital flows has evolved from the broader objective of maintaining financial and macroeconomic stability and not merely addressing the singular variable of exchange rate.

In net terms:

FDI – 17.5% (2010-11) and 32% (2011-12)

FII – 50% (2010-11) and 25% (2011-12)

FDI has doubled while FII has halved

Sixth, India's external sector policy had always believed in some form of management of our capital account with a preference for equity inflows, though there is now international recognition of this policy. This policy of cautious opening of the capital account has served us well as reflected in the stability of our BoP since the 1991 crisis. The composition of our capital account has shifted from almost entirely debt to predominantly equity.

Seventh, notwithstanding relative stability of our BoP, some stress has developed post-2008 global financial crisis as capital inflows have moderated in the face of expanding current account deficit. This is reflected in worsening of some of the vulnerability indicators of the external sector. Our dependence on private capital inflows to finance our current account deficit has increased. Moreover, we have to factor in uncertainties in the global financial markets. These developments call for vigorous domestic policy reforms with a greater emphasis on trade competitiveness and energy security so as to enhance the pull factor for FDI to reinforce our BoP.

Recommendations of Tarapore Committee 1, 1997

Following conditions are necessary for full convertibility on capital account:

1. Gross fiscal deficit to GDP ratio has to come down to 3.5% in 1999-2000.
2. A consolidated sinking fund has to be set up to meet government's debt repayment needs; to be financed by increased in RBI's profit transfer to the govt. and disinvestment proceeds.
3. Inflation rate should remain between an average 3-5 per cent for the 3-year period 1997-2000
4. Gross NPAs of the public sector banking system needs to be brought down to less than 5% by 2000.
5. Average effective CRR needs to be brought down to 3%
6. Forex reserves should be not less than 6 months import cover

The committee's report was not translated into any actions, only the following measures were undertaken:

1. Indian corporate was allowed full convertibility in an automatic route up to \$500m overseas ventures.
2. Indian corporate were allowed to prepay their ECB via automatic route if the loan is above \$500m
3. Individuals were allowed to invest in foreign assets, upto \$0.2m per year
4. Unlimited amount of gold was allowed to be imported

Second Tarapore Committee on Capital Account Convertibility, 2006

Suggested 3 phases of adopting the full convertibility:

- First phase in 2006-07
- Second phase in 2007-09
- Third phase by 2011

Recommendations:

- Ceiling for ECB should be raised for automatic approval
- NRI should be allowed to invest in capital markets
- NRI deposits should be given tax benefits
- Improvements in banking regulation
- FII should be prohibited from investing fresh money in Participatory notes
- Existing PN holders should be given an exit route to phase out completely the PN notes.

For more info: http://zeenews.india.com/news/finance-and-markets/tarapore-panel-recommends-5-year-roadmap-on-rupee-float_319587.html

The committee recommended meeting of the following preconditions:

- Meet the FRBM targets

- Instead of Fiscal Deficit measure, use Public Sector Borrowing Requirement (PSBR)² to judge the fiscal health
- Decouple monetary policy from debt programme of the government
- Establish a separate Public Debt Office independent of the RBI
- Execution of transparent and autonomous monetary policy free from the control of union government
- Carry out banking sector reforms
- Reduce GoI/ RBI share in equity capital of the PSU banks
- Achieve CAD as % of GDP less than 3%
- Forex reserves must meet not only the import requirements but also the liquidity risk, interest pay-out on external debt, and must ensure that India is not pushed to insolvency
- Raise ceiling on ECBs and remove end-use restrictions on ECBs
- Prohibit FII to bring further inflows under PN – in place of PN, introduce SEBI registered mutual funds

Should India go for fuller convertibility of rupee?

- There is some literature which supports a free capital account in the context of global integration, both in trade and finance, for enhancing growth and welfare. The perspective on CAC has, however, undergone some change following the experiences of emerging market economies (EMEs) in Asia and Latin America which went through currency and banking crises in the 1990s.
- Report by IMF, 2010 – notes the volatile capital flows played key role in emerging economies, both in increasing vulnerabilities and in transmitting shocks across borders.
- Cross country experience is not encouraging
 - The East Asian currency crisis began in Thailand in late June 1997 and afflicted other countries such as Malaysia, Indonesia, South Korea and the Philippines and lasted up to the last quarter of 1998. The major macroeconomic causes for the crisis were identified as: current account imbalances with concomitant savings-investment imbalance, overvalued exchange rates, high dependence upon potentially short-term capital flows.
 - The Mexican crisis in 1994–95 was caused by weaknesses in Mexico's economic position from an overvalued exchange rate, and current account deficit at 6.5 per cent of Gross Domestic Product (GDP) in 1993, financed largely by short-term capital inflows.
 - Argentina embarked on a currency board arrangement pegged to US dollar from April 1991 up to January 2002 which coupled with Argentina's persistent inability to reduce its high public and external debts, caused a recession-turned-depression during 1998-2001. This led Argentina to abandon the peg in January 2002, first devaluing and later floating its currency.
- FII flows have been highly volatile in India
- Debt creating inflows are high.
- Despite having no capital account convertibility, India and China have registered high sustainable growth rates in GDP
- India was not affected by the global financial crisis by any large magnitude – had we gone for full capital account convertibility, it could have been a problem

² Includes borrowings by government agencies. Rough indications point to the probability of the PSBR being about 3 per cent of GDP above the fiscal deficit.

- Developed countries introduced full convertibility as late as second half of 20th century, after maturing, attaining high PCI, integrating their economy with the rest of the world in a gradual manner
- India should aim to fulfill preconditions of Tarapore Committee and then debate on introducing FAC
- International experience:
 - While controls on capital inflows have proved somewhat effective in containing pressures on foreign exchange markets, the experiments with controls on outflows by the EMEs, particularly in crisis situations did not help in alleviating the exchange market pressures.
 - While controls to limit short-term inflows could be helpful in specific circumstances, such restrictions in force for longer-term entail costs.
 - In case of pressures arising out of capital outflows, the controls in the form of numerous restrictions on the banks' external transactions were not fully effective as they were circumvented in many instances.
 - Addressing internal and external imbalances such as high fiscal deficit, weakness in financial sector, CAD are very important – since in these cases, the various instruments of controls provided only temporary relief or contained the initial pressures on forex markets
 - Offshore markets for the domestic currency (e.g., NDF markets) proved to be an important source of speculation and in some instances control measures could not succeed.
 - In case of crises countries, the instruments deployed to control outflows were ultimately replaced by the abandonment of exchange rate band/peg in favour of float.

The cross-country experience with capital account liberalisation suggests that countries, including those which have an open capital account, do retain some regulations influencing inward and outward capital flows. The 2005 IMF Annual Report on Exchange Arrangement and Exchange Restrictions shows that while there is a general tendency among countries to lift controls on capital movement, most countries retain a variety of capital controls with specific provisions relating to banks and credit institutions and institutional investors

In India, we have “light” capital controls. The policy towards capital flows is one of carefully calibrated approach. We began liberalising the capital account in 1991. We view the capital account liberalisation as a “process” and not an “event”. The path of capital account liberalisation is well calibrated but is subject to change, depending upon the evolving domestic and international economic conditions. Why is this gradualist approach? We believe that the benefit of capital flows hinges on pace of liberalisation of the overall economy and market efficiency and in the absence of those, unfettered capital flows could endanger financial stability. Therefore, we are guided by the principle that process of capital account liberalisation should progress in tandem with reforms in the financial sector and real sector

That takes me to the second facet of global imbalances - capital flows. The problem of capital flows came centre stage in the aftermath of the quantitative easing by advanced economy central banks when the excess liquidity in the global system found its way into faster growing EMEs. The most high profile problems thrown up by capital flows, in excess of a country's absorptive capacity, are erosion of monetary policy effectiveness, currency appreciation and loss of competitiveness. Speculative capital flows could also lead to asset and commodity bubbles potentially threatening both financial and economic stability.