Welcome Remarks*

Ladies and Gentlemen,

On behalf of the Reserve Bank of India and my own behalf, I extend a hearty welcome to you all to this conference on Managing Capital Flows, in this great city of Mumbai. As you know the conference is co-sponsored by Reserve Bank of India and Asian Development Bank (ADB). Mumbai is not only the commercial hub of India but also has a rich heritage. I hope you will have some time to experience the vibrancy of Mumbai.

2. Turning to today's conference, there could be no two opinions about the topicality of the theme. What is worrying is that the volatility in capital flows has increased significantly in the recent years particularly since 2008 crisis. Capital flows management is therefore one of the biggest challenges for policy makers particularly in emerging and developing economies. Capital flows are a complex phenomenon having both benefits and costs. Their role in enhancing the domestic investment and the potential to trigger financial crisis can be seen as the two sides of the same coin.

3. Capital flow management has been perceived to be challenging particularly in the context of Mundell's 'impossible trinity' of fixed exchange rate, independent monetary policy and open capital account. All the three cannot be pursued simultaneously, and at least one should be sacrificed. Which one has to be sacrificed? Well, it depends upon country-specific situation and available policy options. This reminds me of an old adage in Hindu mythology, which is somewhat similar to impossible trinity: that the idols of Brahma (the creator), Vishnu (the preserver), and Shiva (the destroyer) cannot be kept under the same roof! Among three, who should be kept out? There is no rule or convention. It is left to the choice of individual households and their belief and faith.

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* By Deepak Mohanty, Executive Director at the RBI-ADB Conference on Managing Capital Flows at Mumbai, November 19-20, 2012.

4. Be that as it may, world view on capital flows and capital controls has swung in both directions since the days of Bretton Woods. In the 1940s, while Keynes and White, the architects of Bretton Woods, favoured capital controls, there were others who had opposite views. Until recently, the wisdom of 'Washington Consensus' favoured capital account liberalisation and free capital flows. The Asian Crisis put the idea of full capital account liberalisation on the back burner. Further, the recent crisis of 2008 has also led to a rethinking on the issue of capital flows. It seems that international opinion is moving towards acceptance of capital controls both at the source and the destination, if the situation so warrants.

5. In India, as some of you may be aware, 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.

6. Nevertheless, capital flows to India remained volatile especially in the last few years. Portfolio flows dominated by Foreign Institutional Investors (FIIs) showed large swings having implications for liquidity, besides complicating monetary and exchange rate management. More frequent changes in the direction and variation in capital flows have been a matter of concern in the context of a widening current account deficit. Our policy response to handle capital flows quite often had to switch mode quickly from addressing excessive inflows to sudden outflows.

7. I hope this conference would provide further insight into how to handle capital flows. I am sure that we will benefit immensely from the deliberations. I see that there

are a number of good papers, country presentations and panel discussions which will throw more light on the subject. The collaboration with the ADB has brought more EDE and Asian perspective which will provide useful policy inputs to sharpen our skills to better manage capital flows.

8. I once again extend my hearty welcome to you all and wish you a nice stay in Mumbai.

Thank You.