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Commentary

An overview on capital markets and capital controls

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DESCRIPTION

A bank is a type of financial institution that accepts public deposits and develops demand deposits while also issuing loans. The bank's lending activities could be carried out directly or indirectly through capital markets. In contrast to a money market, where short-term debt is purchased and sold, a capital market is a financial market where long-term debt or equity-backed securities are bought and sold. Savers' money is channeled through capital markets to those who can put it to good use in the long run, such as businesses or governments making long-term investments.

The majority of capital market transactions are administered by financial institutions or government and corporate treasury departments, however some can be accessed directly by the general people. Various private companies offer browser-based services that allow users to purchase shares and, in some cases, bonds on secondary markets. There are thousands of these systems, the majority of which serve only a small portion of the entire capital markets. Stock exchanges, investment banks and government departments are among the organizations that host the systems.

Capital controls

Capital controls are government-imposed procedures intended at regulating capital account transactions or capital market transactions in which one of the counter-parties is located outside of the country. Capital controls aim to ensure that the macroeconomic effects of capital markets do not have a negative impact, whereas domestic regulatory authorities try to ensure that capital market participants trade fairly with one another, and sometimes to ensure that institutions like banks do not take excessive risks. Most advanced countries prefer to use capital controls sparingly, if at all, because allowing markets to operate freely is, in theory, a win-win situation for all parties involved such like the investors are free to seek maximum returns, and countries benefit from investments that develop their industry and infrastructure. However, capital market activities can also have a net negative effect; for example, during a financial crisis, a nation's foreign-exchange reserves may be depleted, leaving it unable to pay for critical imports. On the other hand, if a country receives too much capital, it may see a spike in inflation and the value of its currency, making its exports uncompetitive. Foreign exchange reserves are cash as well as other reserve assets kept by a central bank or other monetary authority and used to support the country's balance of payments, impact the foreign exchange rate of its own currency, and preserve market confidence. The term "foreign exchange reserves" sometimes known as "forex reserves" or "FX reserves" which refers to the amount of money held in foreign exchange capital controls are used by countries like India to ensure that its citizens' money is invested domestically rather than abroad.

Capital controls are residency-based restrictions such as transaction fees, other constraints, or outright prohibitions that a country's government might use to regulate capital movements into and out of its capital account. These actions might be taken at the national level, by sector (typically the financial sector) or per industry. They may apply to all flows or distinguish between them based on the type or length of the flow. Exchange controls, which prevent or limit buying and selling of a national currency at market rates, volume caps on the international sale or purchase of various financial assets, transaction taxes, such as the proposed Tobin tax on currency exchanges, minimum stay requirements, mandatory approval requirements, or even limits on the amount of money a private citizen is allowed to remove from the country, are all examples of capital controls. There have been several changes in opinion about whether capital controls are useful and when they should be used.

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