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   INTRODUCTION

   REVIEW OF LITERATURE

   NEED/IMPORTANCE OF THE STUDY

   STATEMENT OF THE PROBLEM

   OBJECTIVES

   HYPOTHESES

   RESEARCH METHODOLOGY

   RESULTS & DISCUSSION

   FINDINGS

   RECOMMENDATIONS/SUGGESTIONS

   CONCLUSIONS

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   APPENDIX/ANNEXURE

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CONTRIBUTIONS TO BOOKS

- Sharma T., Kwatra, G. (2008) Effectiveness of Social Advertising: A Study of Selected Campaigns, Corporate Social Responsibility, Edited by David Crowther & Nicholas Capaldi, Ashgate Research Companion to Corporate Social Responsibility, Chapter 15, pp 287-303.

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- Schemenner, R.W., Huber, J.C. and Cook, R.L. (1987), "Geographic Differences and the Location of New Manufacturing Facilities," Journal of Urban Economics, Vol. 21, No. 1, pp. 83-104.

CONFERENCE PAPERS

- Garg, Sambhav (2011): "Business Ethics" Paper presented at the Annual International Conference for the All India Management Association, New Delhi, India, 19–22 June.

UNPUBLISHED DISSERTATIONS AND THESES

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ONLINE RESOURCES

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- Garg, Bhavet (2011): Towards a New Natural Gas Policy, Political Weekly, Viewed on January 01, 2012 http://epw.in/user/viewabstract.jsp

A JOURNEY FROM FERA TO FEMA & ITS IMPACT ON FOREX

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ABSTRACT

This research topic is undertaken in order to understand provisions laid by FERA (Foreign Exchange Regulation Act) and the difficulty or problems faced by the individuals in abiding the provisions and also the problems faced by the government to raise foreign investment in the country. It was due to the stringent and aggressive provisions of FERA, that the need for introduction of FEMA (Foreign Exchange Management Act) was felt. After liberalization when the global markets were opened for trading and investing provisions of FERA was acting like obstacles in raising foreign currency. FEMA was introduced with the view to simplify provisions and encourage foreign investment in the country. This research paper focuses on introduction of FEMA which had a positive impact on foreign exchange (FOREX) as well as on money supply, Foreign Direct Investment (FDI) & Foreign Institutional Investors (FIIs).

KEYWORDS

FDI, FIIs, FEMA, FERA, FOREX.

INTRODUCTION: A JOURNEY FROM FERA TO FEMA

FERA in its existing form became ineffective, therefore, increasingly incompatible with the change in economic policy in the early 1990s. While the need for sustained husbandry of foreign exchange was recognized, there was an outcry for a less aggressive and mellower enactment, couched in milder language. Thus, the Foreign Exchange Management Act, 1999 (FEMA) came into being.

The scheme of FERA provided for obtaining Reserve Bank's permission either special or general, in respect of most of the regulations there under. The general permissions have been granted by Reserve Bank under these provisions in respect of various matters by issuing a large number of notifications from time to time since the Act came into force from 1st January 1974. Special permissions were granted upon the applicants submitting prescribed applications for the purpose. Thus, in order to understand the operative part of the regulations one had to refer to the Exchange Control Manual as well as the various notifications issued by RBI and the Central Government.

FEMA has brought about a sea change in this regard and except for section 3, which relates to dealing in foreign exchange, etc. no other provisions of FEMA stipulate obtaining RBI permission. It appears that this is a transition from the era of permissions to regulations. The emphasis of FEMA is on RBI laying down the regulations rather than granting permissions on case to case basis. This transition has also taken away the concept of **"exchange control"** and brought in the era of **"exchange management"**. In view of this change, the title of the legislation has rightly been changed to FEMA.

The preamble to FEMA lays down that the Act is to consolidate and amend the law relating to foreign exchange with the objective of facilitating external trade and payments and for promoting the orderly development and maintenance of foreign exchange market in India. As far as facilitating external trade is concerned, section 5 of the Act removes restrictions on drawal of foreign exchange for the purpose of current account transactions. As external trade i.e. import/export of goods & services involve transactions on current account, there will be no need for seeking RBI permissions in connection with remittances involving external trade. The need to remove restrictions on current account transactions was necessitated as the country had given notice to the IMF in August, 1994 that it had attained Article VIII status. This notice meant that no restrictions will be imposed on remittances of foreign exchange on account of current account transactions.

Section 5, however, contains a proviso that the Central Government may, in public interest and in consultation with the Reserve Bank, impose such reasonable restrictions for current account transactions as may be prescribed. It appears that this is an enabling provision for the Central Government to impose restrictions on current account transactions in case the situation warrants such restrictions probably due to foreign exchange crisis in future. This proviso seems to have been added keeping in view the lessons learnt by certain South-East Asian countries during the 1997-98 crisis which required stricter exchange controls till the crisis was over.

Similarly, section 7 retains controls on exporters. Though the preamble to FEMA talks about promoting the orderly development and maintenance of foreign exchange market in India, there are no specific provisions in the Act to attain this objective.

FERA contained 81 sections (some were deleted in the 1993 amendment of the Act) of which 32 sections related to operational part and the rest covered penal provisions, authority and powers of Enforcement Directorate, etc. FEMA contains 49 sections of which 12 sections cover operational part and the rest contravention, penalties, adjudication, appeals, enforcement directorate, etc. What was a full section under FERA seems to have been reduced to a sub-clause under FEMA in some cases.

For example,

(i) Section 13 of FERA provided for restrictions on import of foreign currency & foreign securities. Now this restriction is provided through a sub-clause 6(3)(g).

(ii) Section 25 of FERA provided for restrictions on Indian residents holding immovable properties outside India. Now the restriction is under sub-clause 6(4).

Reduction in the number of sections means nothing. Real quality of liberalization will be known when all notifications & circulars are finalized & published.

OBJECTIVES OF THE STUDY

- To understand provisions laid by FERA and the difficulty or problems faced by the individuals in abiding the provisions.
- To analyse the problems faced by the government to raise foreign investment in the country.
- To assess the need for introduction of FEMA.
- To analyse the impact of FEMA on FOREX, Money Supply, FDI & FIIs.

METHODOLOGY OF THE STUDY

This is a conceptual paper and the researcher has adopted the method of reviewing different research articles, research journals, and case studies, to collect data about FERA and FEMA which is consequently incorporated as a conceptual paper drafted by the researcher. The study is based on secondary sources of data only.

FERA- THE NAUGHTY ACT

An Act to consolidate and amend the law regulating certain payments, dealings in foreign exchange and securities, transactions indirectly affecting foreign exchange and the import and export of currency, for the conservation of the foreign exchange resources of the country and the proper utilization thereof in the interests of the economic development of the country.

(1) This Act may be called the Foreign Exchange Regulation Act, 1973.

(2) It extends to the whole of India.

(3) It applies also to all citizens of India outside India and to branches and agencies outside India of companies or bodies corporate, registered or incorporated in India.

(4) It shall come into force on such date as the Central Government may, by notification in the Official Gazette, appoint in this behalf:

Provided that different dates may be appointed for different provisions of this Act and any reference in any such provision to the commencement of this Act shall be construed as a reference to the coming into force of that provision.

NEED TO INTRODUCE FERA

a) FERA was introduced at a time when foreign exchange (FOREX) reserves of the country were low, FOREX being a scarce commodity.

b) FERA therefore proceeded on the presumption that all foreign exchange earned by Indian residents rightfully belonged to the Government of India and had to be collected and surrendered to the Reserve bank of India (RBI).

c) It regulated not only transactions in FOREX, but also all financial transactions with non-residents. FERA primarily prohibited all transactions, except to the extent permitted by general or specific permission by RBI.

OBJECTIVES OF FERA

The main objective of the FERA 1973 was to consolidate and amend the law regulating:

- Certain payments;
- Dealings in foreign exchange and securities;
- Transactions, indirectly affecting foreign exchange;
- Import and export of currency, for the conservation of the foreign exchange resources of the country;
- Proper utilization of foreign exchange, so as to promote the economic development of the country.

The basic purpose of FERA was:

a) To help RBI in maintaining exchange rate stability.

b) To conserve precious foreign exchange.

c) To prevent/regulate foreign business in India.

NEED FOR FEMA

The demand for new legislation was basically on two main counts. Firstly, The FERA was introduced in 1974 when India's foreign exchange reserves position was not satisfactory. It required stringent controls to conserve foreign exchange and to utilize in the best interest of the country. Very strict restrictions have outlived their utility in the current changed scenario. Secondly, there was a need to remove the draconian provisions of FERA and have a forward-looking legislation covering foreign exchange matters.

REPEAL OF DRACONIAN PROVISIONS UNDER FERA

The draconian regulations under FERA related to unbridled powers of Enforcement Directorate. These powers enabled Enforcement Directorate to arrest any person, search any premises, seize documents and start proceedings against any person for contravention of FERA or for preparations of contravention of FERA. The contravention under FERA was treated as criminal offence and the burden of proof was on the guilty.

NEED TO SCRAP FERA

a) The Foreign Exchange Regulation Act was replaced by the Foreign Exchange Management Act as it was an impediment in India's to go global.

b) India's foreign exchange transactions were governed under the Foreign Exchange Regulation Act until June 2000. This law had been enacted in 1973 when the Indian economy was facing a crisis and foreign exchange had become a precious commodity. But by the nineties, FERA had outlived its utility and was in fact, an impediment in India's effort to go global and compete with other developing countries.

c) Thus, there was a need to scrap FERA and the Foreign Exchange Management Act, 1999 came into effect on June 1, 2000. However some of the relevant progresses made, from FERA to FEMA, are as follows:

WITHDRAWAL OF FOREIGN EXCHANGE

Now, the restrictions on withdrawal of Foreign Exchange for the purpose of current account transactions, has been removed. However, the Central Government may, in public interest in consultation with the Reserve Bank impose such reasonable restrictions for current account transactions as may be prescribed.

FEMA has also by and large removed the restrictions on transactions in foreign Exchange on account of trade in goods, services except for retaining certain enabling provisions for the Central Government to impose reasonable restriction in public interest.

FEMA - THE NEED OF THE HOUR

The Foreign Exchange Regulation Act of 1973 (FERA) in India was repealed on 1st June, 2000. It was replaced by the **Foreign Exchange Management Act** (FEMA), which was passed in the winter session of Parliament in 1999. Enacted in 1973, in the backdrop of acute shortage of Foreign Exchange in the country, FERA had a controversial 27 year stint during which many bosses of the Indian Corporate world found themselves at the mercy of the Enforcement Directorate (E.D.). Any offense under FERA was a criminal offense liable to imprisonment, whereas FEMA seeks to make offenses relating to foreign exchange civil offenses. FEMA, which has replaced FERA, had become the need of the hour since FERA had become incompatible with the pro-liberalization policies of the Government of India. FEMA has brought a new management regime of Foreign Exchange consistent with the emerging frame work of the World Trade Organization (WTO). It is another matter that enactment of FEMA also brought with it Prevention of Money Laundering Act, 2002 which came into effect recently from 1st July, 2005 and the heat of which is yet to be felt as "Enforcement Directorate" would be investigating the cases under PMLA too.

Unlike other laws where everything is permitted unless specifically prohibited, under FERA nothing was permitted unless specifically permitted. Hence the tenor and tone of the Act was very drastic. It provided for imprisonment of even a very minor offence. Under FERA, a person was presumed guilty unless he proved himself innocent whereas under other laws, a person is presumed innocent unless he is proven guilty.

OBJECTIVES & EXTENT OF FEMA

The objective of the Act is to consolidate and amend the law relating to foreign exchange with the objective of facilitating external trade and payments and for promoting the orderly development and maintenance of foreign exchange market in India. FEMA extends to the whole of India. It applies to all branches, offices and agencies outside India owned or controlled by a person who is a resident of India and also to any contravention there under committed outside India by any person to whom this Act applies.

Except with the general or special permission of the Reserve Bank of India, no person can:-

- deal in or transfer any foreign exchange or foreign security to any person not being an authorized person;
- make any payment to or for the credit of any person resident outside India in any manner;
- receive otherwise through an authorized person, any payment by order or on behalf of any person resident outside India in any manner;
- reasonable restrictions for current account transactions as may be prescribed.

Any person may sell or draw foreign exchange to or from an authorized person for a capital account transaction. The Reserve Bank may, in consultation with the Central Government, specify :-

- any class or classes of capital account transactions which are permissible;
- the limit up to which foreign exchange shall be admissible for such transactions.

However, the Reserve Bank cannot impose any restriction on the drawing of foreign exchange for payments due on account of amortization of loans or for depreciation of direct investments in the ordinary course of business.

The Reserve Bank can, by regulations, prohibit, restrict or regulate the following -

- Transfer or issue of any foreign security by a person resident in India;
- Transfer or issue of any security by a person resident outside India;
- Transfer or issue of any security or foreign security by any branch, office or agency in India of a person resident outside India;
- Any borrowing or lending in foreign exchange in whatever form or by whatever name called;
- Any borrowing or tending in rupees in whatever form or by whatever name called between a person resident in India and a person resident outside India;
- Deposits between persons resident in India and persons resident outside India;
- Export, import or holding of currency or currency notes;
- Transfer of immovable property outside India, other than a lease not exceeding five years, by a person resident in India;
- Acquisition or transfer of immovable property in India, other than a lease not exceeding five years, by a person resident outside India;
- Giving of a guarantee or surety in respect of any debt, obligation or other liability incurred-
  i. by a person resident in India and owed to a person resident outside India or
  ii. by a person resident outside India.

A person, resident in India may hold, own, transfer or invest in foreign currency, foreign security or any immovable property situated outside India if such currency, security or property was acquired, held or owned by such person when he was resident outside India or inherited from a person who was resident outside India.

A person resident outside India may hold, own, transfer or invest in Indian currency, security or any immovable property situated in India if such currency, security or property was acquired, held or owned by such person when he was resident in India or inherited from a person who was resident in India.

The Reserve Bank may, by regulation, prohibit, restrict, or regulate establishment in India of a branch, office or other place of business by a person resident outside India, for carrying on any activity relating to such branch, office or other place of business. Every exporter of goods and services must:-

- Furnish to the Reserve Bank or to such other authority a declaration in such form and in such manner as may be specified, containing true and correct material particulars, including the amount representing the full export value or, if the full export value of the goods is not ascertainable at the time of export, the value which the exporter, having regard to the prevailing market conditions, expects to receive on the sale of the goods in a market outside India;
- Furnish to the Reserve Bank such other information as may be required by the Reserve Bank for the purpose of ensuring the realization of the export proceeds by such exporter. The Reserve Bank may, for the purpose of ensuring that the full export value of the goods or such reduced value of the goods as the Reserve Bank determines, having regard to the prevailing market-conditions, is received without any delay, direct any exporter to comply with such requirements as it deems fit. Where any amount of foreign exchange is due or has accrued to any person resident in India, such person shall take all reasonable steps to realize and repatriate to India such foreign exchange within such period and in such manner as may be specified by the Reserve Bank.

FEMA RULES & POLICIES

The Foreign Exchange Management Act, 1999 (FEMA) came into force with effect from June 1, 2000. With the introduction of the new Act in place of FERA, certain structural changes were brought in. The Act consolidates and amends the law relating to foreign exchange to facilitate external trade and payments, and to promote the orderly development and maintenance of foreign exchange in India.

From the **NRI perspective**, FEMA broadly covers all matters related to foreign exchange, investment avenues for NRIs such as immovable property, bank deposits, government bonds, investment in shares, units and other securities, and foreign direct investment in India.

FEMA vests with the Reserve Bank of India, the sole authority to grant general or special permission for all foreign exchange related activities mentioned above.

Section 2 - The Act here provides clarity on several definitions and terms used in the context of foreign exchange. Starting with the identification of the Non-resident Indian and Persons of Indian origin, it defines "foreign exchange" and "foreign security" in sections 2(n) and 2(o) respectively of the Act. It describes at length the foreign exchange facilities and where one can buy foreign exchange in India. FEMA defines an authorized dealer, and addresses the permissible exchange allowed for a business trip, for studies and medical treatment abroad, forex for foreign travel, the use of an international credit card, and remittance facility

Section 3 prohibits dealings in foreign exchange except through an authorized person. Similarly, without the prior approval of the RBI, no person can make any payment to any person resident outside India in any manner other than that prescribed by it. The Act restricts non-authorized persons from entering into any financial transaction in India as consideration for or in association with acquisition or creation or transfer of a right to acquire any asset outside India.

Section 4 restrains any person resident in India from acquiring, holding, owning, possessing or transferring any foreign exchange, foreign security or any immovable property situated outside India except as specifically provided in the Act.

Section 6 deals with capital account transactions. This section allows a person to draw or sell foreign exchange from or to an authorized person for a capital account transaction. RBI in consultation with the Central Government has issued various regulations on capital account transactions in terms of sub-section (2) and (3) of section 6.

Section 7 covers the export of goods and services. All exporters are required to furnish to the RBI or any other authority, a declaration regarding full export value.

Section 8 puts the responsibility of repatriation on the persons resident in India who have any amount of foreign exchange due or accrued in their favour to get the same realised and repatriated to India within the specific period and in the manner specified by the RBI.

The duties and liabilities of the Authorized Dealers have been dealt with in **Sections 10, 11 and 12**, while **Sections 13 to 15** cover penalties and enforcement of the orders of the Adjudicating Authority as well as the power to compound contraventions under the Act.

IMPACT OF FEMA ON FOREX

Until 1992 all foreign investments in India and the repatriation of foreign capital required previous approval of the government. The Foreign Exchange Regulation Act rarely allowed foreign majority holdings for foreign exchange in India. However, a new foreign investment policy announced in July 1991, declared automatic approval for foreign exchange in India for thirty-four industries. These industries were designated with high priority, up to an equivalent limit of 51%. The foreign exchange market in India is regulated by the Reserve Bank of India through the Exchange Control Department.

Initially the government required that a company's routine approval must rely on identical exports and dividend repatriation, but in May 1992 this requirement of foreign exchange in India was lifted, with an exception to low-priority sectors. In 1994 foreign and non resident Indian investors were permitted to repatriate not only their profits but also their capital for foreign exchange in India. Indian exporters are enjoying the freedom to use their export earnings as they find it suitable. However, transfer of capital abroad by Indian nationals is only allowed in particular circumstances, such as emigration. Foreign exchange in India is automatically made accessible for imports for which import licences are widely used.

Indian authorities are able to manage the exchange rate easily, only because foreign exchange transactions in India are so securely controlled. From 1975 to 1992 the rupee was coupled to a trade-weighted basket of currencies. In February 1992, the Indian government started to make the rupee convertible, and in March 1993 a single floating exchange rate in the market of foreign exchange in India was implemented. In July 1995, Rs 31.81 was worth US$1, as compared to Rs 7.86 in 1980, Rs 12.37 in 1985 and Rs 17.50 in 1990.

Since the onset of liberalization, foreign exchange markets in India have witnessed explosive growth in trading capacity. The importance of the exchange rate of foreign exchange in India for the Indian economy has also been far greater than ever before. While the Indian government has clearly adopted a flexible exchange rate regime, in practice the rupee is one of most resourceful tracker of the US dollar. The foreign exchange market in India is growing very rapidly, since the annual turnover of the market is more than $400 billion.

IMPACT OF FEMA ON MONEY SUPPLY

In context of the Indian financial system, the relevant factor is that the increase in foreign currency reserves as a result of the larger foreign inward remittances, lead to increase in money supply; finding its way into the money market and capital market through the banking system. Banks create credit and any inflow into the banking system gets multiplied by a factor. This factor depends on the reserves maintained by banks. If banks maintain an average reserve of 25%, any inflow into the banking system will increase money supply four times.

Similarly, any contraction of funds available with the banks will result in a four-fold reduction in money supply. Increase and decrease in the foreign exchange reserves of the country impact the financial system through increase or decrease in money supply.

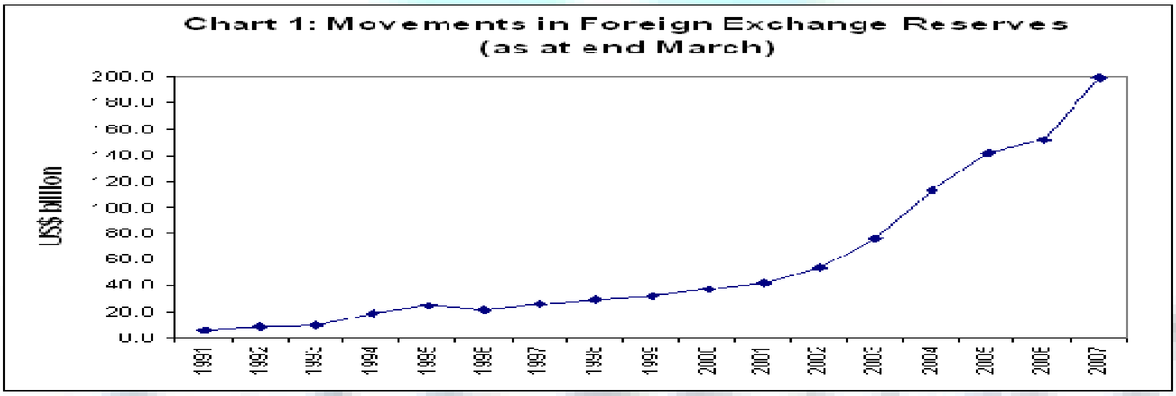
IMPACT OF FEMA ON FOREIGN DIRECT INVESTMENT [FDI] & FOREIGN INSTITUTIONAL INVESTORS [FIIs]

Another aspect of Foreign Exchange market is that apart from flows resulting from personal and trade remittances, banks and corporate borrow funds from abroad and foreign entities invest in Indian business entities, such as Foreign Direct Investment [FDI], foreign funds and Foreign Institutional Investors [FIIs] that invest in the Indian capital markets. These flows are large in magnitude and have a great impact on capital market and the exchange rate.

However, there is also the danger that if FIIs pull out, the stock markets could crash which in turn can adversely impact the economy. This danger is not only on account of the impact of share prices but also because of the impact on exchange rate, which can adversely affect foreign trade and consequently the price level in the country.

CONCLUSION

As a part of the ongoing process of economic liberalization relating to foreign investments and foreign trade in India and as a measure for closer interaction with the world economy the Foreign Exchange Regulation Act, 1973 (FERA) was reviewed in the year 1993 and several amendments were made therein. Further review of the FERA was undertaken by the Central Government of India in the light of subsequent developments and on account of the experience in relation to foreign trade and investment in India, the Central Government felt that instead of further amending the FERA, the better course would be to repeal the existing Act and to enact a new legislation in its place. In view of the same, the RBI was asked to suggest a new legislation based on the report submitted by a task force constituted for this purpose by the RBI recommending substantial changes in FERA. There has been a substantial increase in the Foreign Exchange Reserves of India. Especially after repulsion of FERA in 2000 there has been a tremendous surge in Foreign Exchange Reserves.



Since the year 1993, foreign trade has grown up. Development has taken place such as current account convertibility, liberalization in investments abroad, increased access to external commercial borrowings by Indian Companies and participation by foreign institutional investors in securities markets in India. Keeping in view these changes the Central Government of India has introduced the FEMA to repeal FERA. A marked digression from the general rule that the Accused is presumed to be innocent until proved guilty beyond reasonable doubt, is found in the FEMA. A presumption regarding documents, contained in this Bill is contrary to the general rules of evidence.

For example, when documents pertaining to a crime under FEMA are discovered the Court will presume that the contents of the documents are true and correct and will not go into the question whether the incriminating documents may have been forged. Thus, it becomes the responsibility of the Accused to prove, in case that the documents are fabricated. The main change between FERA and FEMA is in the approach. FERA seeks to regulate almost all the transactions involving foreign exchange and inbound/outbound investments. In FERA every provision is restrictive and starts with a negative proposition stating that whatever is mentioned in that section is prohibited unless the prior permission either general or special, as may be required in the specific case, of RBI is obtained. FERA provides that nothing can be done without RBI's permission. In comparison to this existing negative piece of legislation, the provision of FEMA has a positive approach. This can be found from the provisions of FEMA dealing with capital account transactions which are to be regulated. Unlike FERA which provides that these transactions cannot be entered into without prior permission of RBI, FEMA provides that any person may sell or draw foreign exchange for such transactions and then specifies the powers of the RBI to regulate the class or limits of such capital account transactions. Thus, the basic proposition in the proposed FEMA Bill is positive. FEMA classifies foreign exchange transactions into capital account transactions and current account transactions and amongst the two regulates the former more closely. Under FEMA residential status will not depend upon the intent of the person to reside in India but would depend upon the exact period of his stay in India. The provisions of the FEMA Bill aims at consolidating and amending the law relating to foreign exchange with the object of facilitating external trade and payments and for promoting the orderly payment and amendments in foreign exchange markets in India. The FEMA Bill empowers the RBI to authorize persons to deal in foreign securities specifying the conditions for the same. It also provides for a person resident in India in holding, owning, transferring or investing in foreign security and for a person resident outside India in holding, owning, transferring or investing in Indian Securities.

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