**Foreign Exchange Management Act 1999 (FEMA)**

* The Foreign Exchange Management Act, 1999 (FEMA) has been in force from 2000, thus replacing the old Foreign Exchange Regulation Act (FERA) 1973.
* **The main objective of FERA was conservation and proper utilization of the foreign exchange resources of the country**.
* It also control the conduct of business outside the country by Indian companies and in India by foreign companies.
* When a business enterprise imports goods from other countries, exports products to them or makes investments abroad, it deals in foreign exchange.
* **Foreign exchange means 'foreign currency'** and includes **deposits, credits and balances payable in any foreign currency** and secondly drafts, travellers, cheques, letters of credit or bills of exchange, expressed or drawn in Indian currency but payable in any foreign currency.
* The purpose of the Act is to **consolidate and amend the law relating to foreign exchange** with the objective of facilitating external trade and paymentss and for **promoting the systematic development and maintenance of foreign exchange market in India**.
* The objectives of FEMA are to facilitate external trade and payments and to promote the orderly development and maintenance of foreign exchange market.
* The Act has assigned an important role to the Reserve Bank of India (RBI) in the administration of FEMA. The rules, regulations and norms pertaining to several sections of the Act are laid down by the Reserve Bank of India, in consultation with the Central Government

Benefits of the Act

FERA was to control everything that was specified, relating to foreign exchange whereas **FEMA lay down that ‘everything other than what is expressly covered is not controlled'**. The **overriding objective of FERA was to regulate and minimize dealings in foreign exchange and foreign securities** while FEMA on the other hand aims to aid in creation of a liberal foreign exchange market in India.

This difference in terminology reflects seriousness of government towards deregulation of foreign exchange and promotion of free flow of international trade. To facilitate external trade is concerned; section 5 of the Act removes restrictions on withdrawal of foreign exchange for the purpose of current account transactions. As external trade i.e. imports / export of goods & services involve transactions on current account, there is no need for seeking RBI permissions in connection with remittances involving external trade.

Conclusion

FEMA permits only authorized person to deal in foreign exchange or foreign security. Such an authorized person, under the Act, means authorizeddealer, money changer, off-shore banking unit or any other person for the time being authorized by Reserve Bank. The Act thus prohibits any person who 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.

Enter 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 by any person is resident in India which acquires, hold, own, possess or transfer any foreign exchange, foreign security or any immovable property situated outside India.

# Balance of Payments: Meaning, Types and Equilibrium

#### **1. Meaning of Balance of Payments**:

the balance of payments is a comprehensive record of economic transactions of the residents of a country with the rest of the world during a given period of time i.e., it is defined as the systematic records of all economic transactions between the residents of foreign countries and the residents of the reporting countries during a given period of time.

Balance of payments is divided into two types accounts:

1. **Current** account consists of all transactions which relate to the current national income and current expenditure of the home country. It includes imports and exports of goods and services, expenses on travel, transportation, insurance, investment incomes and unilateral transfers.
2. **Capital** account relates to capital transactions i.e., transactions in financial assets which directly affect wealth and debt and as such, it includes only future income and not the current one. It includes borrowings and lending of capital including repayments of capital, purchase and sale of securities and other assets to and from foreigners, individuals as well as governments.

It is called **overall balance of payments when** both current and capital account are taken into consideration.

Balance of payments is like the Balance Sheet of a company.

**Balance of Payments is in equilibrium or not, it can be justified with this help of the three following test:**

**(i) Decrease in Foreign Exchange:**

If gold continuously flows from the country, it may be assumed that the balance of payments is in disequilibrium. At present the decrease in foreign exchange reserves of our country indicate such a situation.

**(ii) Increase in Foreign Debts and Loans**:

If the amount of foreign debts and loans increase, it indicates that the balance of payment of the country is in disequilibrium i.e., exports are less than imports.

**Following are the reasons for the cause of disequilibrium in the balance of payments:**

**(a) Domestic Inflation**

The greater bulk of balance of payments difficulties are the result of domestic inflation and the same can be corrected by disinflation i.e., eliminating the inflationary gap and reducing demand to the level of full employment. **It is possible by increasing exports and reducing imports**. Similarly halting of inflation and correction of exchange rate may also help in this regard.

**(b) Technological Changes**:

No doubt, these are **other significant reasons** for disequilibrium in balance of payments positions. It is quite known that every change in technology brings some comparative advantages which the other country tries to adjust, but the adjustment process itself brings a deficit in balance of payments.

Thus, the innovation, whatever form it is, invites disequilibrium. So, a new equilibrium requires either to reduce exports or to increase imports.

**(c) Short Supply:**

Disequilibrium of balance of payment arises due to a fall in supply. For example, due to industrial strike the sugar production of India fall which affect the supply and as a result there is a corresponding shortfall in exports and consequently increases the amount of imports which is the result of disequilibrium.

**(d) Fall in Demand or Structural Disequilibrium**:

Disequilibrium also arises out of a fall in demand of the export product. For example, if the demand of the Indian jute product decreases in the world due to a change in taste or what so ever, the resources which are engaged in jute production must be shifted to other lines of activity.

In such a situation, we are to restrict our imports and our resources must be diverted into another export line product. If **the same is not possible, there must be a structural disequilibrium in balance of payment position.**

Of the other causes, the deficit in current account due to the loss of service incomes creates disequilibrium position which may arise through the bankruptcy of direct investment abroad or nationalization etc.

**Methods of Correcting Disequilibrium in Balance of Payments**:

In order to **maintain a** country’s sound economic condition, its disequilibrium in balance of payment position (if any) must be corrected. Naturally, the reasons for creating such a situation **must be removed**. **Otherwise** if the situation continues for a long, the country will **exhaust its foreign exchange reserves**.

**If such a situation arises the country concerned will have to depreciate its currency below par**. We describe hereunder, certain measures to correct or improve the adverse balance of payments position.

**(a) Stimulating exports or to check imports**:

If there is a declining trend in exports, various steps must be taken to improve it. In other words, the total cost of the product must be brought down to encourage export which may **require cutting down of wages and rate** of interest etc. **Exports may be also encouraged by granting bounties to exporters and to manufactur­ers also**.

Similarly, imports must be discouraged by:

(i) Imposing import duty,

(ii) Prohibiting the product totally or

(iii) Adopting quota system,

(iv) Manufacturing the equivalent product within the country etc.

**(b) Depreciate the External Exchange value:**

Another measure to correct the disequilibrium is to depreciate the external (exchange) value of the home currency, which brings domestic goods cheaper to the foreigner. It must be remembered in this respect that the rate of exchange serves as an equilibrating factor between the balance of payments positions.

**(c) To deflate the Currency**:

It is quite known to us that if our currency contracts, no doubt, prices will fall which will check imports and stimulate exports, although the method of deflation is not even free from snags. Because, if **the prices of the** **product are forced to come down** **while the cost of the same is rigid**, these two do not follow suit. As a result, the country concerned may have to face a serious depression as well as unemployment.

**(d) Exchange Control**:

Under exchange control, all the exporters are directed to surrender their foreign exchange to the central bank or to sell it at the official rate to the government. Then it is rationed out among the licensed importers i.e., the government will allocate the scarce foreign exchange among the importers on the basis of some non-price criteria. No importer is allowed to import goods without a license. In this way, the balance of payment is to some extent rectified by reducing the imports.

**(e) Devaluation**:

**The effect of devaluation is almost same like depreciation**. In other words, when a currency is devalued its values are decreased in terms of foreign currency. It means, the foreigners can buy more goods than before with the same amount of currency which no doubt, stimulates exports and check imports.

Since the imports are discouraged and exports are encouraged, a time will come when the adverse balance of payment will be corrected and will turn in our favour. From the decision made so far, we can draw a conclusion about the correction of adverse balance of payment position on the basis of the judicious combination of the following:

(i) Adjustment of exchange rate (i.e. appreciation/depreciation of the home currency).

(ii) Movement of Capital (i.e., lending/borrowing abroad).

(iii) Fiscal and Monetary changes that affect prices and incomes.

(iv) Trade restrictions (quotas/tariffs).

Thus, in order to correct the adverse balance of payments no single method is found suitable. We should try to implement all the methods stated above although the application of the factor depends on the nature and type of disequilibrium in balance of payments, (e.g., exchange rate will play a significant role in structural --dis-equilibriums).

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**Liberalization, Privatization and Globalization in India**

The **economy of India had undergone significant policy shifts in the beginning of the 1990s**. This new model of economic reforms is commonly known as the LPG or Liberalisation, Privatisation and Globalisation model.

The primary objective of this model was **to make the economy of India the fastest developing economy** in

the world.

The economic reformation mainly took place in the **field of business, manufacturing, and financial services industries targeted at lifting the economy of the country** to a more proficient level.

These economic reforms had influenced the overall economic growth of the country in a significant manner.   
  
**Liberalisation**  
Liberalisation refers to the slackening of government regulations.

**Privatisation**

Privatisation refers to the participation of private entities in businesses and services and **transfer of ownership from the public sector (or government) to the private sector as well**.

**Globalisation**

Globalisation stands for the consolidation of the various economies of the world.

**LPG and the Economic Reform Policy of India**  
after its freedom on August 15, 1947, the Republic of India stuck to socialistic economic strategies.

In the 1980s, Rajiv Gandhi, Prime Minister of India, started a number of economic restructuring measures.

In 1991, the country experienced a balance of payments dilemma following the Gulf War and the downfall of the erstwhile Soviet Union.

Furthermore, the International Monetary Fund necessitated India to assume a sequence of systematic economic reorganisations. Consequently, the then Prime Minister of the country, P V Narasimha Rao initiated economic reforms. However, the Committee formed by him did not put into operation a number of reforms which the International Monetary Fund looked for.  
  
**Dr Manmohan Singh,was the Finance Minister of the Government of India. He assisted. Narasimha Rao and played a key role in implementing these reform policies.** 

**\Narasimha Rao Committee's Recommendations**  
The recommendations of the Narasimha Rao Committee were as follows:

* Bringing in the Security Regulations (Modified) and the SEBI Act of 1992 which rendered the legitimate power to the Securities Exchange Board of India to **record and control all the mediators in the capital market.**
* Doing away with the Controller of Capital matters in 1992 that determined the rates and number of stocks that companies were supposed to issue in the market.
* Launching of the National Stock Exchange in 1994 in the form of a computerised share buying and selling system which acted as a tool to influence **the restructuring of the other stock exchanges in the country**. By the year 1996, the National Stock Exchange surfaced as the biggest stock exchange in India.
* In 1992, the equity[**SHARE MARKET]** markets of the country were made available for investment through overseas corporate investors. The companies **were allowed to raise funds from overseas markets** through issuance of GDRs or **Global Depository Receipts**.
* Promoting FDI (Foreign Direct Investment) by means of raising the highest cap on the contribution of international capital in business ventures or partnerships to 51 per cent from 40 per cent. In high priority industries, 100 per cent international equity was allowed.
* Cutting down duties from a mean level of 85 per cent to 25 per cent, and withdrawing quantitative regulations. **The rupee or the official Indian currency was turned into an exchangeable currency on trading account.**
* Reorganisation of the methods for sanction of FDI in 35 sectors. The boundaries for international investment and involvement were demarcated.

The outcome of these reorganisations can be estimated by the fact that the overall amount of overseas investment (comprising portfolio investment, FDI, and investment collected from overseas equity capital markets ) rose to $5.3 billion in 1995-1996 in the country from a microscopic US $132 million in 1991-1992. Narasimha Rao started industrial guideline changes with the production zones. He did away with the License Raj, leaving just 18 sectors which required licensing. Control on industries was moderated. 

**Highlights of the LPG Policy**  
Given below are the salient highlights of the Liberalisation, Privatisation and Globalisation Policy in India:

* Foreign Technology Agreements
* Foreign Investment
* MRTP Act, 1969 (Amended)
* Industrial Licensing
* Deregulation
* Beginning of privatisation
* Opportunities for overseas trade
* Steps to regulate inflation
* Tax reforms

# Summary of India’s Industrial Policy

### Meaning of Industrial Policy:

Any government action aimed at affecting in­dustry may be considered to be part of indus­trial policy, which makes it a limitless field.

**On July 24, 1991**, Government of India announced its new industrial policy with an aim to correct the distortion and weakness of the Industrial Structure of the country that had developed in 4 decades; raise industrial efficiency to the international level; and accelerate industrial growth.

Salient Features of the new industrial policy 1991 are as follows:

**Government Monopoly** The number of industries reserved for public sector was reduced from 17 (as per 1956 policy) to only 8 industries viz. Arms and Ammunition, Atomic Energy, Coal, Mineral Oil,  Mining of Iron Ore, Manganese Ore, Gold, Silver, Mining of Copper, Lead, Zinc, Atomic Minerals and Railways. **Further, the policy had implied threat of closure of sick public sector enterprises to increase efficiency of the public sector.**

**Industrial Licensing Policy**: This policy abolished the Industrial licensing for all industries except for a short list of 18 industries. This list of 18 industries was further pruned in 1999 whereby the number **reduced to six** industries viz. drugs and pharmaceuticals, hazardous chemicals, explosives such as gun powder and detonating fuses, tobacco products, alcoholic drinks, and electronic, aerospace and defence equipment. The compulsion for obtaining prior approval for setting units in metros was also removed. However, in this policy, industries reserved for the small scale sector were continued to be so reserved.

**Foreign Investment and Capital**

This was the first Industrial policy in which foreign companies were allowed to have majority stake in India. In 47 high priority industries, up to 51% FDI was allowed. For export trading houses, FDI up to 74% was allowed.

It was promised that there will be no bottlenecks of any kind in this process provided that foreign equity covers the foreign exchange requirement for imported capital goods.

**A promise to carry out some amendments in Foreign Exchange Regulation Act (1973) was also made. (The act was later replaced by FEMA in 1999**

**A provision was made that in cases where imported capital goods are required, automatic clearance is given, provided there is foreign exchange** availability is ensured through foreign equity.

The government also established a special empowered board called **Foreign Investment Promotion Board** (FIPB) to **negotiate with international firms and approve FDI in selected areas.**

**Foreign Technology Agreements** Automatic permission was given for foreign technology agreements in high priority industries. Further, government eased hiring of foreign technicians.

**Review in Public Sector Investments** A promise was made to review the portfolio of public sector investments with a **view to focus the public sector on strategic, high-tech and essential infrastructure**. This indicated a disinvestment of the public sector.

The PSUs which were chronically sick and which are unlikely to be turned around were to be referred to the Board for Industrial and Financial Reconstruction (BIFR). It was promised that Boards of public sector companies would be made more professional and given greater powers.

**Amendments to MRTP Act**

The MRTP Act **will be amended** to remove the **threshold limits of assets** in **respect of MRTP companies** and dominant undertakings. This eliminates the requirement of prior approval of Central Government for **establishment of new undertakings, expansion of undertakings, merger, amalgamation and** takeover and **appointment of Directors under certain** c**ircumstances**. The MRTP Limit for was made **Rs. 100 Crore**. Currently, MRTP act is replaced by Competition Act 2002.

**National Renewal Fund to provide safety net for labourers** Via this policy**, the Government announced to establish a National Renewal Fund (NRF) to provide a social safety net to the labour.** This fund was established in 1992 and two **schemes were brought under this- first Voluntary Retirement Scheme (CRS) and another re-training scheme for rationalised workers in organised sector.** The fund monies would be used to make payments under these two schemes. This fund **was later abolished in 2000.**

**Outcomes of the Industrial Policy 1991**

* This policy made **Licence, Permit and Quota Raj** a thing of past.
* The 1991 policy **attempted to liberalise the econom**y by **removing bureaucratic hurdles in industrial growth.**
* The role **of public sector was limited**. **Only 2 sectors** were finally **left reserved for public sector**. This reduced burden on the government.
* A process of either transforming or selling off the sick units started. The process of disinvestment in PSUs also started.
* The policy provided easier entry of multinational companies, privatisation, removal of asset limit on MRTP companies, liberal licensing. All this resulted in increased competition that led to lower prices in many goods such as electronics prices.
* This brought **domestic as well as foreign investment** in **almost every sector** opened to private sector.
* The policy was followed by special efforts to increase exports. Concepts like Export Oriented Units **(EOU),** Export Processing Zones (**EPZ**), Agri-Export Zones (**AEZ**), Special Economic Zones (**SEZ**) and lately National Investment and Manufacturing Zones(NIMZ) emerged. All these have benefitted the export sector of the country.
* Gradually, a new act was passed for MSMEs in 2006 and a separate ministry was established to look into the problems of MSMEs. Government tried to provide better access to services and finance to MSMEs[**MINISTRY OF MICRO SMALL AND MEDIUM ENTERPRISE]**
* The abolition of industrial licensing, dismantling of price controls, dilution of reservations for small-scale industries and virtual abolition of the monopolies law, relaxation of restrictions on foreign investment, lowering of corporate and personal tax rates, removal of restrictions on managerial remuneration, etc. were very bold steps, all of which have enabled industry to blossom.