UNIT 7 EXCHANGE CONTROL REGULATIONS

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7.0 OBJECTIVES

After studying this unit, you should be able to:

- explain the objectives of exchange control;
- describe the principal provisions of Foreign Exchange Regulation Act 1973, amended in 1993 and 1995;
- discuss the requirements of Foreign Exchange Regulation Act in export-import business; and
- explain the documentation and related procedures in export-import transactions in terms of the requirements of Foreign Exchange Regulation Act.

7.1 INTRODUCTION

You have learnt various methods of payment in the export business in Unit 6. Exchange Control is another important area of international trade. The term exchange control applies to the rules and regulations designed to regulate transactions involving foreign exchange. The objective of the exchange control is primarily to regulate the demand for foreign exchange for various purposes within the limits set by available supply. Exchange control becomes necessary when the country's external reserves are not adequate for meeting its current and potential requirements. In this unit you will learn the objectives of exchange control and various provisions of Foreign Exchange Regulation Act 1973. The amended version of this act known as Foreign Exchange Regulation (Amendment) Act, 1993 which has been further amended by Finance Act, 1995 will be discussed at great length. You will also learn the documentation and related procedures of Foreign Exchange Regulation Act.

7.2 FOREIGN EXCHANGE

Foreign exchange, as defined under Foreign Exchange Regulation Act, 1973 is foreign currency and includes:

i) all deposits, credit and balances payable in foreign currency
ii) any drafts, traveller's cheques, letters of credit and bills of exchange expressed or drawn in Indian currency but payable in any foreign currency and,
iii) any instrument payable at the option of the drawee or holder thereof or any other party thereto, either in Indian currency or foreign currency or partly in one and partly in the other.

Foreign exchange accrues out of foreign exchange transactions. The regulation and control of foreign exchange implies, therefore, regulation and control of foreign exchange transactions.

Foreign Exchange Transactions

A foreign exchange transaction is ultimately the purchase or sale of one national currency against another arising out of import or export of goods and services, foreign remittances and foreign travel both inward and outward, etc. The goods refer to raw materials, intermediary or finished products capital goods, etc., comprising the visible items of a country's foreign trade. Services refer to shipping, air travel, insurance, banking, supply of technical know-how, consultancy, transfer of capital by way of lending and or investment, interest on such capital and dividends on such investment, tourists income and expenses, cost of Indian students abroad and of foreign students in India, gifts and donations, remittances, etc., which taken together comprise the invisible items of a country's foreign trade. **A foreign exchange transaction is thus transfer of purchasing power, i.e. acquisition or parting with the right to wealth in a foreign country.** As you must be knowing that the foreign exchange is precious for a country. Hence, government regulate and control the foreign exchange transactions. Let us learn what exchange control is ?

Exchange Control : Exchange control means official intervention with the foreign exchange of a country. It is a system of rationing foreign exchange among competing demands for it, effected by controlling the receipts and payments thereof. The control of receipts aims at centralising the country's means of external payments in a common pool in the hands of its monetary authorities. Reserve Bank of India is the monetary authority in India. It facilitates judicious use of foreign exchange. The control of payments aims at restraining the demand for foreign exchange broadly in consonance with the national interests within the limits of available resources.

7.3 OBJECTIVES OF EXCHANGE CONTROL

Most of the developing countries including India, found it necessary to continue exchange control introduced during the Second World War on a systematic and long-term basis. Exchange control became essential in view of the substantial requirements of foreign exchange for the planned developmental effort undertaken by them. Over the years, the scope of exchange control in India has steadily widened. The regulations have become progressively more elaborate with the increasing foreign exchange outlays under successive Five Year Plans and the relative inadequate earnings of foreign exchange. During the span of more than 40 years that the control has remained in force, appraisals and reviews of policies and procedures have been undertaken periodically and modifications made as and when considered necessary.

In specific terms, the broad objective of the exchange control are:

1) to prevent flight of capital
2) to ensure the availability of sufficient foreign exchange for specific purposes such as meeting the international commitments
3) to stabilize the external value of the domestic currency, and
4) to insulate the economy from external economic pressures.

You should note that **the basic objective of exchange control in India is conservation of the foreign exchange resources and proper utilisation thereof in the interest of economic development of the country.**

7.4 STATUTORY BASIS

Exchange control was introduced in India with the outbreak of second World War on September 3, 1939. This was done by virtue of the emergency powers derived under the financial provisions of the Defence of India Rules. The main purpose was to conserve the non-sterling area currencies and utilise them for essential purposes. India was a part of British Empire, hence, it was basically introduced to boost up the war-efforts of the United Kingdom's Government.

When India became independent, she was having large foreign exchange balances held in her favour in London. The UK Government was impoverished as a result of the war and freeze the balances. India was in dire need for foreign exchange to meet the developmental requirements of the country. India's sources of foreign exchange were limited to exports of a few traditional items only, such as tea, jute, gunny, etc. The income from exports, even when supplemented by large borrowings from abroad, fell far short of the total requirement. This resulted in huge deficits in her balance of payments. Hence, it became essential to conserve the country's scarce foreign exchange resources.

Thus, the foreign exchange control became essential to make the most prudent use of the foreign exchange resources. It was, therefore, decided to place the control on a statutory basis and the Foreign Exchange Regulation Act of 1947 was enacted. The act, which came into force on March 25, 1947, was valid initially for five years only. In 1952, its life was extended till the end of 1957 and it was finally placed on a permanent basis in 1957. The act empowered the Reserve Bank and in certain cases the Central Government to control and regulate dealings in foreign exchange. This includes payments outside India, export and import of currency notes and bullion, transfer of securities between residents and non-residents, acquisition of foreign securities, etc. The act was later replaced by a more comprehensive legislation. The new Foreign Exchange Regulation act, 1973, came into force on January 1, 1974. While the basic structure of the 1973 act is the same as that of 1947 act, certain new provisions have been introduced besides amendment to some of the provisions of the earlier act. The bank has now been vested with additional powers to regulate the exchange process. This includes the investments and the trading, commercial and industrial activities in India of foreign companies (other than banking companies), foreign nationals and non-resident individuals; commercial property abroad and the non resident individuals. Commercial and industrial activities abroad by residents have also been brought under the control. Further the FERA 1973 has been substantially amended by the Foreign Exchange Regulation (Amendment) Act, 1993. It has been again amended by the Finance Act, 1995.

7.4.1 Administration of the Act

The exchange control policy is determined in India by the Ministry of Finance, Government of India on the basis of The Foreign Exchange Regulation Act, 1973 (amended in 1993 and 1995). The Act is administered by the Reserve Bank in accordance with the general policy laid down by the Central Government in consultation with the Bank. The Central Government is empowered to give to the Reserve Bank such general or special directions as it thinks fit. The Bank is obliged to comply with these directions in the discharge of its functions under the act.

Exchange control is also related to and supplemented by trade control. India's foreign trade (exports and imports) is regulated under the provisions of the Foreign Trade (Development and Regulation) Act, 1992 and Foreign Trade (Regulation) Rules, 1993. Trade control is concerned with the physical transfer of goods whereas exchange control involves related financial transactions. Exchange control is more comprehensive and covers not only exports and imports but invisibles and capital transactions as well. Thus, a close coordination is maintained in the administration of the two controls. The customs authorities have also an important role to play in the administration of certain aspects of exchange control for example valuation of exports. Hence, a close contact is maintained with them.

For enforcing the provision of Foreign Exchange Regulation Act, and dealing with prosecutions and adjudication for evasion or contravention of the regulation, there is a separate machinery. This is known as Directors of Enforcement, with headquarter in New Delhi and branches in all important places in the country. The central Government may appoint such persons as it thinks fit to be officers of Enforcement.

Purchase and sale of foreign exchange can be effected only by authorised dealers duly licensed by the Reserve Bank. These licences are generally granted only to commercial banks. However, in recent years licences have been given to some State Corporative Banks as well. Restricted licences have been granted to Industrial Development Bank of India and Export Import Bank. Licences have also been granted to certain established firms, hotels, and other organisations for dealing in foreign currency notes, coins and travellers cheques. They are called Money Changers.

7.4.2 Scope of the Act

The Foreign Exchange Regulation Act covers the types of transaction having international financial implications. Broadly the Exchange Control regulates the following transactions:

1) Purchase and sale of and other dealings in foreign exchange and maintenance of balances at foreign centres.
2) Procedures for realisation of proceeds of exports.
3) Payments to non-residents or to their accounts in India.
4) Transfer of securities between residents and non-residents and acquisition and holdings of foreign securities.
5) Foreign travel with exchange.
6) Export and Import of currency, cheques, drafts, travellers cheques and other financial instruments, securities, etc.
7) Activities in India of branches of foreign firms and companies and foreign nations.
8) Foreign direct investment in India including investment by non-resident Indian nationals/ persons of Indian origin and corporate bodies predominantly owned by such persons.
9) Appointment of non-residents and foreign nationals and foreign companies as agents in India.
10) Setting up of Joint ventures/subsidiaries outside India by Indian companies.
11) Acquisition, holding and disposal of immovable property in India by foreign nationals and foreign companies.
12) Acquisition, holding and disposal of immovable property outside India by Indian nationals resident in India.

Check Your Progress A

1. What do you mean by foreign exchange ?

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2. What is exchange control ?

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3. Distinguish between trade control and exchange control ?

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7.5 FOREIGN EXCHANGE REGULATION CONCERNING EXPORTS

Export of goods is the most important foreign exchange earner for the country and the law provides that foreign exchange in payment of exported goods must be realised in full and with utmost promptness. Exporters are required to give a declaration for almost all exports to realise export proceeds within the prescribed period. The amended FERA (Foreign Exchange and Regulation Act, 1993) allows import and export of gold and silver under the provisions of export - import policy of the Government of India. The bringing in or taking out of personal Jewellery by travellers would be regulated by customs Act and Baggage rules. Import and export of any Indian currency or foreign exchange is prohibited except with the general or special permission of the Reserve Bank.

Exchange control procedures envisage to ensure that no foreign exchange arising out of exports from India is lost. The important provisions include declaration of exports on prescribed forms, realisation of export proceeds in permitted methods, permitted currencies prescribed period and prescribed manner. Let us discuss them in detail.

7.5.1 Prohibition of Export

Export of all goods either directly or indirectly to any place outside India other than Nepal and Bhutan is prohibited unless the exporter furnishes to the prescribed authority a declaration in the prescribed form. It should be supported by such evidences as may be prescribed or so specified and true in all material particulars.

The prohibition shall not apply to the export of:

i) Trade samples supplied free of payment.
ii) Personal effects of travellers, whether accompanied or unaccompanied.
iii) Ship's store, transhipment cargo and goods shipped under the orders of the Central Government in this behalf of or the military, naval or air force authorities in India for military, naval or air force requirements.
iv) Goods despatched by air freight and accompanied by a declaration by the sender that they are not more than ten thousand rupees in value and that despatch does not involve any transaction in foreign exchange.
v) Goods despatched by air freight and covered by a certificate issued by an authorised dealer that their export does not involve any transaction in foreign exchange.
vi) Goods export of which in the opinion of Reserve Bank does not involve any transaction in foreign exchange.

7.5.2 Export Declaration

Every exporter must make a true declaration in the prescribed form. The declaration is mandatory and include:
i) the full export value of the goods; or
ii) 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 goods in the overseas market.

The declaration should be supported by an affirmation by the exporters to realise the required export proceeds. Exporter's affirmation has been made mandatory that the full export value declared is the same as contracted with the foreign importer. Any other invoicing or over-invoicing may attract penal provisions under the FERA act.

7.5.3 Permitted Methods

Export payment must be received in a currency appropriate to the country of final place of destination of the goods as declared on GR, etc., forms. Reserve Bank has granted permission for receiving payments for exports directly by exporters from their buyers in certain conditions.

Authorised dealers should receive remittances from foreign countries (other than Nepal and Bhutan) or obtain reimbursement from their branches and correspondents in these countries against payments due for exports from India. The other payments receivables should also conform these methods of payment indicated below:

i) All countries other than member countries in the Asian Clearing Union (except Nepal), Bangladesh, Myanmar Islamic, Republic of Iran, Pakistan and Sri Lanka : Payment may be received in rupees from the account of a bank situated in any country in this group or payment may be received in any permitted currency.

ii) Member countries in the Asian Clearing Union (except Nepal), Bangladesh, Myanmar Islamic, Republic of Iran, Pakistan and Sri Lanka : payment may be received for all eligible current transactions of debit to the ACU (Asian Clearing Union) dollar account in India of a bank of the participating country in which the other party to the transaction is resident, or by credit to the ACU dollar account of the authorised dealer maintained with the correspondent bank in the other participating country. In other cases payment may be received in any permitted currency.

7.5.4 Permitted Currencies

The payment in foreign trade may be received or made in a foreign currency which is freely convertible. A freely convertible currency is permitted by the rules and regulations of the country concerned to be converted into major reserve currencies like U.S Dollar, Pound Sterling and for which a fairly active market exists for dealings against the major currencies. Authorised dealer may maintain balances and positions in any permitted currency. Authorised dealers may also maintain positions in European Currency Unit (ECU) of the European Monetary System.

7.5.5 Prescribed Period

The amount representing the full export value of the goods exported shall be realised and be paid to the authorised dealer when it is due. **The amount should be realised either on the due date for the payment or within six months from the date of shipment of the goods whichever is earlier.** The period is extended to fifteen months where the goods are exported to a warehouse established outside India with the permission of the Reserve Bank. For exports to CIS countries and other East European countries Reserve Bank may permit realisation period upto 12 months. The Reserve Bank may extend the period of six months/ twelve months or fifteen months if sufficient and reasonable causes are shown by the exporters.

7.5.6 Prescribed Manner

The manner in which the export proceeds are to be realised include:

i) Payment should be received through an authorised dealer except in cases where general specific permission has been granted by Reserve Bank to receive the payment directly.
ii) Payment should be received in permitted currency.
iii) Payment should be received as per approved methods of payment.

Authorised dealers maintained with correspondent banks in the other participants case for imports into India from any of the ACU countries (except Nepal).

Check Your Progress B

1. What do you mean by permitted currencies ?

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2. What is the prescribed period for realisation of export proceeds ?

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3. State whether following statements are True or False ?
   i) Exchange Control refers to official intervention with the foreign exchange of a country.
   ii) India's exchange control policy is determined by the Ministry of Commerce, Government of India.
   iii) Purchase and sale of foreign exchange can be effected only by authorised dealers.
   iv) Export payment should be realised within six months from the date of shipment of goods.
   v) US Dollar is not a permitted currency.

7.6 EXPORT DECLARATION FORMS

All exports to which the requirement of declaration applies must be declared on appropriate forms. These forms are as follows:

- GR form (in duplicate): It is used to export to all countries otherwise than by post.
- PP form (in duplicate): It is used to export to all countries by parcel post, except when made on value payable on delivery basis
- VP/COD form (Single copy): It is used to export to all countries by parcel post, under arrangements to realise proceeds through postal channels on value payable or cash on delivery basis.
- Softex form (triplicate): It is used to export computer software in non-physical form.

Procedures for Furnishing the Forms

The declaration form GR (in duplicate) shall be submitted in duplicate to the commissioner of Customs. After duly verifying and authenticating the declaration form the Commissioner of Customs will forward the original form to the nearest office of the Reserve Bank. The duplicate form is handedover to the exporter for being submitted to the authorised dealer with whom the export documents are negotiated.

The declaration form PP (in duplicate) shall be submitted to the authorised dealer in foreign exchange named in the form. The authorised dealer shall countersign on the form and handover the original form to the exporter. The exporter will submit the form to the postal authorities through which the goods are being despatched. The postal authorities after despatch of the goods, shall forward the declaration form to the nearest office of the Reserve Bank. On realisation of export proceeds the authorised dealer shall after due certification submit the duplicate form to the nearest office of the Reserve Bank.

The declaration form VP/COD (single copy) shall be submitted to the postal authority with the relative parcel at the time of despatch. The postal authority shall send the form to the nearest office of the Reserve Bank.

Export of Computer Software

Export of Computer Software in physical form is done on GR/PP forms. Export of computer software in non-physical form should be declared on SOFTEX form. The SOFTEX form is submitted in triplicate. Each exporter will have to designate a single branch of an authorised dealer to whom the export documents are submitted. Valuation of exports will be done by officials authorised by the Department of Electronics, Government of India. After verifying all the three copies of SOFTEX forms, the official will directly forward the original copy to the office of Reserve Bank under whose jurisdiction the exporter falls. The certified duplicate SOFTEX forms will be returned to the exporters together with all supporting documents and bills drawn on overseas buyers. The triplicate copy will be retained by the designated official for record to the Department of Electronics.

The exporters have to submit the documents pertaining to export within 21 days from the date of export to the authorised dealer mentioned in the relevant declaration form unless the Reserve Bank authorises otherwise.

Check Your Progress C

1. What is Softex form ?

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2. Name three export declaration forms ?

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3. State whether following Statements are true or false ?
   i) Exporters are permitted to retain upto 25% of the receipts from export of goods in foreign currency account with an authorised dealer in India.
   ii) Export payment can be received in any currency.
   iii) Any amount may be allowed for payment towards the agency commission on exports.
   iv) FERA act allows taking or sending out Indian currency abroad.
   v) Export of securities to any place outside India requires permission of Reserve Bank.

4. Fill in the Blanks.
   i) Export of goods or services outside India other than Nepal and Bhutan is .... unless the exporter furnishes declaration form.
   ii) The Softex form is submitted in ....
   iii) For exports to CIS Countries and other East European Countries,Reserve Bank may permit realisation period upto ...... months.
   iv) Taking out of personal Jewellery from India by travellers is regulated under ....
   v) Acquisition or parting with the right to wealth in a foreign country is known as...........

(Answer (i) Prohibited (ii) triplicate (iii) 12 (iv) Baggage rules (v) foreign exchange transaction.

7.7 OTHER PROVISIONS

You have learnt that export payment should be received within the prescribed period and prescribed manner. It should be received in permitted currencies and permitted methods. Let us now discuss various other provisions related to the export exchange regulations.

7.7.1 Remittances Connected with Exports

Exporters are permitted to retain upto 25% (50% in the case of EOUs located in EPZ/ Software Technology Parks/Electronics Hardware Technology Parks) of the receipts from export of goods in a foreign currency account with an authorised dealer in India. This account is known as Exchange Earners Foreign Currency (EEFC) account. According to the Monetary Policy (announced on October 22, 1997), Exporters are allowed to retain 50% of their exchange earnings in the EEFC account as against the earlier 25%. The account may be maintained in any permitted currency and in any form (current, savings without cheque facility or term deposit account). The balances in these accounts may be utilised for all bonafide payments of the account holder. Exporters maintain Foreign Currency Accounts are not allowed to maintain EEFC accounts.

7.7.2 Agency Commission on Exports

Authorised dealers may allow payment of commission, either by remmittance or by deduction from invoice value, on application submitted by the exporter. The application should contain details about export particulars. The remittance may be allowed subject to the following conditions.

i) Amount of commission has been declared on GR/PP/SOFTEX form and accepted by customs authorities or the exporter has submitted a no objection certificate from customs authorities or Department of Electronics, Government of India as the case may be.

ii) Rate of Commission do not exceed 12.5% of invoice value.
iii) Commission sought to be remitted is not on export of a canalised item, project exports or exports financed under lines of credit extended by Government of India or EXIM Bank. This may also be allowed on exports made by Indian partners towards equity participation in an overseas Joint Venture/wholly owned subsidiary.
iv) The relative shipment has already been made.

7.7.3 Export Claims

Authorised dealers are permitted to remit export claims by exporters on application by letter. The application contains particulars such as Reserve Bank Code Number, GR/PP form number, date of shipment, name of commodity, invoice value, name and address of claimant nature and amount of claim as also documentary evidence in support of the claim provided:

i) the amount does not exceed 15% of invoice value.
ii) the relative export proceeds have already been realised and repatriated to India. In case of exporters who have been in the export business for more than three years, remittances may be allowed without any percentage ceiling, provided -
   i. the exporter is not on the Exporter's caution list of Reserve Bank , and
   ii. his track record is satisfactory.

In all such cases of remittances, the exporter should be advised to surrender proportionate incentives, if any, received by him.

Other remittances: Authorised dealers may effect, on behalf of their exporter constituents, remittances connected with exports like controlling charges, expenses incurred on dishonoured/unaccepted bills, legal expenses related to trade disputes, testing charges, etc. Exporters are expected to submit supporting documents for these remittances.

7.7.4 Despatch of Goods not Involving Foreign Exchange

The despatch of certain goods does not involve foreign exchange, for example, Gift parcels. In this case, GR/PP form is not applicable to exports by air freight and post parcel. Authorised dealers should certify that the exports do not involve any transaction in foreign exchange. This can be done in following cases:

i) export is made by post parcel or air-freight
ii) authorised dealer is satisfied that the export does not involve any transaction in foreign exchange and
iii) the value of shipment does not exceed Rs.25,000

7.7.5 Export of Jewellery, Indian Currency, Foreign Exchange, Securities, etc.

Taking out of personal Jewellery from India by travellers is regulated under the Baggage Rules framed by the Ministry of Commerce under the Export-Import Policy.

Export of currency : FERA Act prohibits taking or sending out Indian currency notes and coins from India without general or special permission of Reserve bank.

Export of Foreign Exchange: Export of foreign exchange in any form including currency notes or bank notes, other than foreign exchange obtained from an authorised dealer or authorised money-changer by the person exporting is prohibited unless it is covered by a general or special permission of Reserve Bank.

Export of Securities: Export of Securities to any place outside India requires permission of Reserve Bank.

7.8 LET US SUM UP

Exchange control applies to all the rules and regulations designed to regulate transactions involving foreign exchange. The basic objective of exchange control is conservation of the foreign exchange resources and their proper utilisation in the interest of economic development of the country. Exchange control is governed by the Foreign Exchange Regulation Act, 1973. This act has been substantially amended by the Foreign Exchange Regulation (Amendment) Act, 1993. It has been further amended by the Finance Act, 1995. The act is administered by the Reserve Bank of India in accordance with the general policy laid down by the Central Government. According to the provisions of the act, purchase and sale of foreign exchange can be effected only by authorised dealers, duly licensed by the Reserve Bank.

The law provides that foreign exchange related to the exported goods or services must be realised in full and with utmost promptness. Exporters are required to give declaration for all exports to realise export proceeds within the prescribed period. The important provisions include: declaration of exports on prescribed forms, realisation of export proceeds in permitted methods, permitted currencies, prescribed period and prescribed manner. The forms on which exports are declared include: GR form, PP form, VP/COD form and Softex form. Other provisions discussed regarding export exchange regulations are: remittances connected with exports, Agency commission on exports, Export claims, Despatch of goods not involving foreign exchange, export of jewellery, Indian currency, foreign exchange, securities, etc. Import and export of gold and silver have been allowed under the provision of export-import policy of the Government of India. The travellers personal jewellery shall be regulated under customs act and Baggage rules. Import and export of any Indian currency or foreign exchange is prohibited except with the permission of the Reserve Bank.

7.9 KEY WORDS

Authorised Dealers: Commercial Banks licensed to deal in foreign currencies.

Exchange Control: The rules and regulations applicable to all transactions involving foreign exchange.

GR Form : A form of declaration for exports by any mode except post to all countries other than Nepal and Bhutan. It is required to be submitted in duplicate to the custom authorities.

Permitted Currencies : Currencies approved by the Reserve Bank for maintaining balances and position by the authorised dealers.

PP Form : A form of declaration for all postal exports to all countries other than Nepal and Bhutan.

Softex Form : A form of declaration used to export computer software in non-physical form.

7.10 ANSWERS TO CHECK YOUR PROGRESS

B. 3 i) True (ii) False (iii) True (iv) True (v) False

C. 3 i) True (ii) False (iii) False (iv) False (v) True

4 i) Prohibited (ii) Triplicate (iii) 12 (iv) Baggage rules (v) Foreign Exchange Transaction

7.11 TERMINAL QUESTIONS

1) What do you mean by exchange control ? Describe the broad objectives of exchange control.
2) How foreign Exchange Regulation Act is administered in India ? Describe the scope of this act.
3) Describe the provisions of foreign exchange regulation concerning exports.
4) All exports to which the requirement of declaration applies must be declared on appropriate forms. Discuss. Explain the procedures for furnishing the forms.
5) Write short notes on:
   i) Agency Commission on Exports
   ii) Export Claims
   iii) Permitted Currencies
   iv) Permitted methods for realisation of Export Proceeds
   v) Prescribed period for realisation of Export proceeds

Note : These questions and exercises will help you to understand the unit better. Try to write answers for them. But do not send your answers to the University. These are for your practice only.