APPENDIX E

Administering Exchange Controls

by C.J. Batliwalla

This appendix details the involvement of the Reserve Bank as the primary agent of the government in the design and implementation of exchange control policy during 1951–1967. The growth of the control system, brought about by the inconvertibility of the pound sterling in the post-war period and the changes necessitated in the control measures following the return to sterling convertibility forms one aspect of this story. But the other and more important aspect is the adaptation of the control regime to the stresses and strains imposed by the development process on the country's foreign exchange reserves and earnings.

Exchange control was first introduced in India at the outbreak of the second world war in September 1939 and its pattern was set by the Defence of India Rules and a regular stream of addenda and amendments to them. At first, many, including officials at the Finance Department of the Government of India, hoped that it would be possible to dispense with the system of controls when the war ended. Reality proved otherwise. On the termination of hostilities, it was found that the pent-up demand for imported goods precipitated a deficit in India's external payments. While India had large accumulated sterling balances with which to finance the deficit, the UK regulated withdrawals closely because of the sterling area's own tenuous balance of payments position. Thus in March 1947, legislation in the form of the Foreign Exchange Regulation Act (FERA) was passed to put exchange control regulations on a statutory footing, and brought into force the same month. Initially valid for five years, the Act was extended for another five years in 1952, and put on a permanent footing under rather different circumstances in 1957. Thereafter as the development process gained momentum, the scope and intensity of exchange controls, which by then came to be regarded as an essential instrument of national economic policy, widened. By the middle of the second five-year plan, sterling balances had reached a level which left virtually no cushion for development purposes. With India's limited foreign

exchange resources having to be husbanded carefully to finance essential imports and service the growing volume of external debt, a special responsibility devolved on the Exchange Control Department (ECD). Initially, the department was headed directly by the Governor (who was the ex-officio Controller). P.J. Jeejeebhoy became the Deputy Controller in 1949. Jeejeebhoy was assisted by D.N. Maluste who became the Controller when that position was formally separated.

The ultimate controlling authority in India was the Finance Ministry, which was also responsible for policy. But the day-to-day administration of exchange control was in the hands of the Reserve Bank. Unlike the UK, where the central bank operated on delegated authority, in the Indian case the Reserve Bank was vested with statutory authority to administer FERA and had powers to act on its own. The government had the overriding power to formulate policy. But as its adviser, the Bank was also closely involved in making policy.

Both in size and importance, the Exchange Control Department was a striking presence at the Reserve Bank. In the fifties, the number of persons employed solely for exchange control work was around 160. The Reserve Bank delegates a large measure of authority to commercial banks, both Indian and foreign, and the bulk of foreign exchange transactions are routed through these 'authorized dealers', who in 1967 numbered forty. Despite this, in the sixties, the strength of the ECD had grown to around 300.

The Foreign Exchange Regulation Act lays down that foreign exchange transactions should not be based on exchange rates for the rupee other than those authorized by the Reserve Bank. Under the prevailing IMF system, a member country was required to express the par value of its currency in terms of gold or the US dollar, and was required to maintain the exchange rate of its currency within a narrow band of not more than one per cent on either side of its par value. The par value of the rupee originally conveyed to the IMF by India was 4.145 grains of fine gold per rupee. Being a part of the sterling area, India decided to follow the sterling when the latter was devalued in September 1949. Consequently, while the rupee-sterling parity remained unchanged (at Rs 13.33 to the pound sterling), the new par value was fixed at 2.880 grains of fine gold (or 21 cents) per rupee. The Bank supported the rupee-sterling rate by buying spot sterling from authorized dealers at 18 pence per rupee and selling sterling at the rate of $17^{63}/_{64}$ pence. The rate for forward sterling was lower by another $^{1}/_{64}$ pence per rupee. Until the British currency went decimal, there were 20 shillings to the pound. A shilling equalled 12 pence. The rates at which sterling was bought and sold to the public were fixed by authorized dealers in line with the Bank's general policies. To facilitate

coordination and better supervision of foreign exchange transactions, the Bank recognized the Foreign Exchange Dealers' Association of India (FEDAI), which comprised the authorized dealers, as the banking system's representative body in all discussions with it. Authorized dealers were required to abide by the rate schedule for the sterling published by the FEDAI, but were permitted to quote their own rates for all other currencies. When the London market reopened, they were allowed to carry out spot and forward transactions in other permitted currencies in that market. The Reserve Bank also permitted authorized dealers to make payments in US and Canadian dollars for imports from those countries and cover their transactions in these currencies. These and other changes mentioned above were among the first steps towards developing a foreign exchange market in this country.

Sterling Area Control

India was, along with other countries of the commonwealth, a member of the sterling area. In general, there were few restrictions on capital flows within the area. However, each member of the area was autonomous, and the Indian control, for instance, was at liberty to impose its own regulations. This it did when, after the war, it slapped exchange control on certain remittances from the so-called Scheduled Territories. Remittances from Pakistan were initially excluded from this restriction, but they too came under this regulatory net in February 1951. The effect of this measure was that fresh investments in India from other countries in the group were now regulated. Another departure came in the form of powers taken by the Indian authorities to control, when necessary, the export of capital. However, conversion of various sterling area currencies within the group continued unrestricted.

There were many changes in the geographical composition of the sterling area over the seventeen years covered by this volume. A key feature of sterling area membership was that member countries pooled their resources of foreign exchange, kept their foreign exchange reserves in sterling, and maintained exchange rate stability with each other. The rate of exchange was, however, determined by each member country. India had no independent dollar reserves and relied, as many other adherents to sterling area arrangements, on London for dollars. Nor was leaving the sterling area a realistic option since it would result in greater immobilization of balances in the 'blocked' No. 2 account. Therefore, though it had many features India would have preferred to see amended, it never actively pursued alternatives to sterling area arrangements.

Although the 1947 experiment at sterling convertibility failed, it did not result in the demise of transferable accounts which remained central to the

sterling area exchange control system. Following the brush with convertibility, transfers between these accounts were permitted, but not transfers of sterling in these accounts into US dollars. This system continued in existence for the greater part of the fifties but was widened over time. As a member of the sterling area, India was required to keep in step with changes in the domain of transferable accounts which, with minor exceptions, it replicated.

Throughout the fifties, efforts were on to unify and free all non-resident sterling outside the dollar area and to have a single transferable area for the entire non-dollar world. As a first step towards general simplification of non-resident sterling and following the changes effected by Britain, Indian regulations were amended in March 1954 to widen transferability and usability of sterling held by non-residents and the transferable account area itself to include all countries, except those in the American account area, viz. Turkey, Iran, and Hungary. The latter countries were brought into the fold later. Balances in these accounts could be transferred freely for any purpose—current or capital—within the area.

In February 1955, Britain began allowing intervention in transferable sterling to check the tendency for the latter to go to a heavy discount. Taking advantage of this development and assisted by the favourable foreign exchange position, four months later in June, the Reserve Bank decided to allow Authorized Dealers (ADs) to deal in foreign currencies other than US and Canadian dollars, the pound sterling and the Pakistan rupee, at market related rates, provided the rates for spot transactions were at or between the official buying and selling rates of the Bank of England. (From September 1956, this facility was extended to cover the US and Canadian dollars.) ADs were also permitted to deal in forward contracts. This move marked the beginning of a foreign exchange market in India. In June 1956, arbitrage facilities in certain European currencies were extended to Indian banks. This relaxation enabled authorized banks in India to conclude spot and forward transactions, for periods up to six months.

In December 1958, the British authorities decided to merge transferable and official sterling. India too, followed suit by merging American Accounts with Transferable Accounts and designating the new group as Convertible Accounts. There were now three categories of external accounts: convertible, bilateral and 'scheduled territories', and the term 'transferable account' disappeared from the Indian exchange control vocabulary.

Administering Export Controls

While the government framed the country's trade policy, often in close consultation with the Bank, it fell to the latter to implement the prescribed

methods of payment for imports and oversee the repatriation of proceeds of exports. Exchange control was made applicable to all exports, whether or not the items exported belonged to restricted categories. The role of the Reserve Bank was principally to ensure that the foreign exchange proceeds of exports were repatriated in full within the period specified by the Bank and through an approved method.

The customs authorities had the task of scrutinizing the validity and genuineness of export shipments. The formality to be completed by the exporter included the completion of the GR and other forms in quadruplicate (later triplicate).[1] The original form was submitted to the customs authorities, and its duplicate and triplicate copies to the bank handling the export documents. These forms enabled the Bank to keep a watch on the repatriation of export proceeds by 'marrying' the duplicate forms with the triplicates to arrive at an estimate of outstanding export receipts. Exporters and authorized dealers preferred looser regulations, particularly regarding methods of finance and GR formalities for low value export transactions. When such suggestions were made in 1957, the Bank felt that waiving the GR formality for low value exports would diminish its powers of surveillance over foreign exchange transactions. Much better, the Bank felt, to abolish quantitative restrictions on exports, if the object was to boost India's export earnings. Quantitative restrictions on exports, the Bank's economists argued, did little to offset inflationary pressures in the economy while they cost the country vitally required earnings of foreign exchange. Following the Bank's advice, quantitative controls on several exports were lifted during 1957–58.

With the deterioration in India's external accounts in the mid-1960s, the Bank took steps to secure speedier realization of export proceeds. From 1965, a stricter watch was instituted to see that proceeds of non-credit exports were repatriated within six months. The Bank generally refused to extend this period, or allowed extensions only reluctantly. In a few cases, exporters were even advised to reimport their exports or dispose of them at the best available

[1] The following forms were prescribed for declaring exports: GR1—for declaring shipments generally; GR2—for declaring shipments to countries outside the sterling area financed under guarantee by the UK agents of the exporters; GR3—for shipments, proceeds of which were permitted to be retained abroad for specified uses; GRX—for shipments to countries, exports to which were permitted only against advance payment or an irrevocable letter of credit; EP and EP1—adaptations of GR1 and GR3 forms, respectively, for declaring shipments to Pakistan and Afghanistan in respect of which a period of three months was prescribed for realization of proceeds; PP—for declaring exports by Post Parcel generally; VP/COD—for declaring exports by Post, where parcels were sent on 'Value Payable' and 'Cash on Delivery' basis, respectively.

price. The vigilance machinery was also tightened, and authorized dealers were instructed to report overdue cases to the Bank.

Proceeds of exports made on deferred payment basis were allowed to be repatriated in five years subject to prior approval by the Bank. But such exports carried exchange risks. The problem of providing cover against such risks was raised repeatedly during our period, and the Bank was asked by the government to work out a suitable scheme early in 1967. Both then and subsequently, there was a clash of viewpoints at Mint Road. The Exchange Control Department opposed the idea of the Reserve Bank arranging or participating in forward cover and cited the worldwide practice of deferred credits being extended in the currency of the exporting country; the economists, in particular V.G. Pendharkar, were in favour of a more active role by the Bank. The Bank's resistance yielded to consistent pressures from the government and from within. However, because of turbulence in the international currency markets, a detailed plan for covering deferred credits which it prepared in 1971 could not be implemented until May 1974. The Bank administered the scheme in the initial stages before it was taken over by the Export Credit and Guarantee Corporation (ECGC).

Administering Import Controls

For the greater part of the period covered by this volume, India's import policy was highly restrictive, and licensing and controls embraced all import activity. Intending importers were first required to obtain a licence from the Chief Controller of Imports and Exports. Licences were issued in duplicate, one copy of which served as an authority for making remittance in foreign exchange in payment for the import. No letter of credit could be opened or remittance of payment effected without producing the exchange control copy of the relative licence. Remittance for imports on Open General Licence (OGL) for which no specific licence was given, was made on production of documentary evidence of import. The Bank's role in this area was to ensure that exchange was utilized for the authorized purpose and that there were no disguised exports of capital. Payments had generally to be made in the currency of the country from which the imports originated or were to be credited to a non-resident rupee account in India held by a bank resident in that country. While exercising no detailed supervision, the Bank kept a general watch over payments through a variety of forms completed by remitters, which authorized dealers submitted to it.

With the growth of bilateral and multilateral external assistance, the Bank also became engrossed in devising payments procedures for goods imported against World Bank/IDA loans, and country assistance. Beginning in the

early 1960s, the Bank was equally involved in devising the accounting and payments procedures for goods imported under rupee payment arrangements. To avoid the accumulation of short-term foreign exchange liabilities, the Bank also endeavoured to ensure that capital goods were imported against long-term deferred credits.

As import and exchange controls grew more stringent and increasing reliance was placed on bilateral and deferred payment approaches, strains and frictions became apparent in the administration of the control apparatus. For example, in the late 1950s, there was an impression in London that licences were more easily available to import goods to India against payment in rupees. This impression, which was created by the existence of rupee accounts of countries with whom India had bilateral clearing arrangements and was fostered by some Indian importers, led to suggestions that India operated a system of blocked rupees, and that exporters abroad could get rid of these rupees by selling them at a discount. Several British banks, it appears, approached Pendharkar, the London Manager of the Reserve Bank, and the Indian High Commissioner inviting their attention to such alleged practices, and seeking clarifications. Despite official denials, reports about the possibility of doing import transactions via the system of blocked rupees persisted. Such reports brought home to the Indian authorities that the mechanism of blocked rupee accounts of non-residents was open to abuse. By early 1962, international traffic in the blocked rupees of bilateral clearing arrangement countries appeared to have reached serious proportions, and officials in London invited Pendharkar's attention to the flood of enquiries which suggested both a widening of the range of commodities under negotiation and a steep rise in the amount that could apparently be handled. The apparent modus operandi for such transactions was that rupees paid into one of the east European clearing accounts were offered to potential buyers in third countries at discounts ranging from 5 to 25 per cent.

As evidence of abuse of rupee payment arrangements continued to flow in, the Exchange Control Department suggested that the Finance Ministry issue a suitable clarificatory press note clearing the misconceptions and explaining that all payments to foreigners, whether in Indian rupees in India or foreign currencies abroad, were payments in foreign exchange. While there was some debate over whether the government or the Bank should issue such a statement, it soon became clear that no press note or notification would help to bring a problem of this kind under control without perversely adding to restrictions on the use to which bilateral rupees could be put. Besides, the source of the abuse lay in the inability of the east European countries to meet licensed import orders from India from their own sources. A possible solution lay in

paying greater attention, when agreements were finalized, to the actual availability of imports from these countries out of their own production, and enforcing rigorous scrutiny of larger imports from them. A fresh circular was therefore issued by the Finance Ministry outlining the procedure for entering into contracts for the import of goods and services against payment in blocked rupees.

From the early sixties, the Bank began to improve its techniques for monitoring the payments situation and refining its forecasting tools and techniques. Arrangements were made for compiling special tabulations giving licence-wise data for imports. A separate section (the Foreign Aid Forecasting Section) was created which, in collaboration with ECD, was made responsible for preparing regular forecasts and estimates of India's balance of payments. These estimates provided the input for the government's foreign exchange budget, and became an important policy tool both for the Reserve Bank and the government. These arrangements also gave the Bank something of an early warning capability about likely reserve outflows during years when India's foreign exchange reserves stood barely above the minimum statutory level.

The necessity for the Bank to develop such techniques was reinforced when it was asked by the Finance Ministry in 1964 to assist in 'mechanizing' import licence statistics. What, on the face of it, appeared to be a routine request for organizational assistance, quickly became a major source of embarrassment to the Bank. Its examination revealed a number of irregularities in the maintenance of licence-wise records, in particular that licences were issued to the private sector much in excess of the availability of foreign exchange. This discovery rendered the foreign exchange budget exercise entirely suspect. Its examination also revealed that there were no proper records of licences issued, utilized, and outstanding, nor were details available of infructuous, cancelled, or revalidated licences. The Bank saw this as the major source of discrepancy in its balance of payments estimates and forecasts. Overhauling the import policy system was, however, a long-drawn-out affair. The first step was to provide a format based on which the data could be maintained and mechanized to arrive at the quantum of outstanding licences. This the Bank soon did.

Foreign Exchange for Travel Abroad

The 1960s saw a gradual but persistent tightening of foreign exchange regulations pertaining to foreign travel by Indian residents to the point where the administration of the regulations became somewhat arbitrary. Foreign travel was undertaken for a variety of purposes, and all categories of travel required prior approval. The Bank was the focal point through which all

applications were cleared on an individual basis, and approvals were granted on the principle of essentiality.

Travel for Pleasure

Until 1956, pleasure travel by Indian residents was administered through a basic quota which, at first, was released once in three years. Later it was enhanced and relaxed to once in two years. No exchange was, however, released for visits to hard currency areas. With the deterioration in the foreign exchange situation after 1956, the Bank was forced to review its policy, and in January 1957 it took the draconian decision to ban all pleasure travel by withdrawing the basic quota of foreign exchange for such travel. The denial of the travel quota, coupled with the gradual tightening of release of foreign exchange for other types of travel, drove some residents to finance their travels through illegal channels, including compensatory payment arrangements. This led to diversion of normal foreign exchange earnings by way of export proceeds and private remittances, and deflected tourist traffic to foreign carriers.

The adverse movement in invisible earnings from 1961-62 led the Division of International Finance of the Economic Department to estimate that the leakage of foreign exchange into unauthorized channels ran annually into about Rs 50 crores. The Division's study put the problem down to excess demand for gold and consumer goods, and restrictions on the availability of exchange for foreign travel. While little could be done about the former, further regulation of foreign travel was resorted to in June 1962.

The Bank's view at this time was that the freedom to book a passage without any release of foreign exchange contributed to a major part of the leakage of foreign exchange. In fact, according to the Governor, P.C. Bhattacharyya, 'exchange control had broken down in this field altogether'. It was the Bank's assessment that nearly 60 per cent of Indian nationals travelling overseas did so without obtaining any exchange from the Bank. Secondly, there were cases where exchange was released for travel and the official allotment was supplemented through illegal sources. Thirdly, the 'guest scheme' was a source of abuse as it allowed persons to proceed to the US with nominal amounts of legally procured foreign exchange. The existence of such lacunae rendered the control instrument ineffective and made a mockery of controls. The Bank's suggestion was to abolish the 'guest scheme' and ban all travel without exchange authorization, if exchange controls were really to serve their intended purpose.

The Bank's proposals were accepted in June 1962 and announced by the Finance Minister in Parliament later the same month. The notorious 'P' form was the principal outcome of the Bank's recommendation. To mitigate hardship

You Said It

By LAXMAN

How I got my 'P' form?—Well, I was lucky—My husband who's abroad has fallen seriously ill!

– *ToI*, 16 July 1963

to workers moving to neighbouring countries, deck passengers alone were exempt from 'P' form formalities.

The object of the 'P' form was to screen overseas hospitality and ensure that it did not result in compensating payment transactions. By weeding out obvious cases of infringement, the 'P' form became a convenient tool to curb a good deal of 'undesirable' travel. The immediate reaction to the restriction was a rush to advance travel plans. In a bid to outwit the government, operators in Calcutta were reported to have expedited foreign exchange deals, and there was apparently considerable selling of foreign currencies at 'fantastic rates'. But this was a shortlived phenomenon.

The records of the Reserve Bank of India reveal that a number of organizations and individuals approached the Government to seek a waiver of the new formalities. Nor was there any dearth of human ingenuity to circumvent them. But exchange control officials exercised great care in verifying the

genuineness of invitations before issuing their clearances. The stringent scrutiny of 'P' form applications no doubt caused hardship to travellers. In 1967, L.K. Jha, who succeeded Bhattacharyya as Governor, apprehended that the validity of the 'P' form was open to challenge in a court of law. In particular, he wondered whether the Bank could refuse permission to travel abroad when the journey involved no foreign exchange or when an air ticket was paid for by a host abroad. He also feared that the stricter policy for granting permission to women travelling in their own right as business executives and the stipulation that they could not use blanket permits of exchange without prior approval of the Bank, could be challenged on the ground of discrimination.

As a result of the examination which followed Jha's note, several ad hoc decisions were taken after 1967 to soften the procedure and make it less irksome and rigid. The 'P' form lingered on for several years thereafter, but by enlarging the list of approved relatives, introducing the Foreign Travel Scheme in 1970, and recognizing the hospitality of friends, the regulation was watered down. Finally, in 1978 'P' form control was abolished.

Business Travel

The Bank remained the focal point for the clearance of all business travel. Overall, the policy of release of exchange was tight, and although a reasonable degree of flexibility characterized the exchange control operations of the Reserve Bank, its task was a difficult one. There were constant demands for reconsidering rejection or for additional releases of foreign exchange. Often, the government too backed such demands. In 1953, there were complaints that Indian businesses suffered from the denial of dollar exchange for travel to the USA and Canada. The Finance Minister asked the Bank to adopt a more liberal attitude, while the Finance Ministry asked it to send a monthly report on rejected cases. It also queried the embargo on wives of businessmen accompanying their husbands, and wanted the daily allowance of $40 per day for the USA raised. Finally, the government asked to be consulted on all doubtful cases. Piqued by the communication, the Bank undertook a survey of applications for dollar exchange in the past three years and concluded that out of 380 applications, only 47 cases were rejected either because the particulars supplied were inadequate, or because the proposed trips were only exploratory and existing rules did not permit them. It also maintained that the Indian daily allowance of $40 per day, which compared favourably with that allowed by the United Kingdom, was adequate. As regards wives accompanying their husbands to the US, the government was reminded that no such facilities needed to be given under the general regulations obtaining within the sterling area. The Bank also rejected the government's demand for

You Said It

By LAXMAN

You've twenty years' experience in a travel agency? So sorry, we can't offer you a job. You must understand our chief business is banking!

– *ToI*, 7 July 1962

monthly reports. While the government could prescribe the conditions for releasing exchange, the Bank could not function as the administrative authority unless it had the discretion to approve or reject applications. If, however, the government wished to review the Bank's decisions, it could itself take over the administration of exchange control. The government did not press its suggestions in the face of Mint Road's resistance to them. However, while exchange controllers at the Bank opposed the submission of monthly reports, the Governor offered to provide data on a quarterly basis to the government.

In the early sixties, the scheme to issue blanket permits for release of exchange was instituted to enable businessmen to undertake trips for export promotion without having to apply to the Reserve Bank for exchange for each such tour. At first, the facility was confined to recognized export houses wishing to explore new markets for non-traditional commodities and to large

exporters of non-traditional goods. In July 1963 it was extended to cover large export houses engaged in traditional commodities.

Medical Treatment Abroad

Specific permission of the Bank was required to travel abroad for medical treatment. Such permission was rarely denied. The Bank knew that it was not competent to decide on the nature of the ailment or the type of treatment required, and generally relied on the recommendation and certification of the Presidency Surgeon or the Chief Medical Officer of the state.

Training and Higher Studies Abroad

Policy on the release of exchange for higher education abroad was determined by the Ministry of Finance, in consultation with the Ministry of Education, but its implementation was assigned to the Reserve Bank. The courses qualifying for release of exchange were laid down by the government. Prior to June 1957, exchange for education was liberally granted. Thereafter in consultation with the Bank, the government decided to take immediate action to curtail foreign expenditure on studies abroad. The new guideline was to release exchange to students taking up university education or higher technical courses abroad, and who had secured at least 50 per cent

Interviewing applicants for foreign exchange, February 1958

marks. No exchange was released for children going to schools abroad or to those wishing to take up the Bar examination, secretarial courses, languages, domestic sciences, music, tailoring, and drawing. In practice, the 50 per cent marks rule was rigidly followed. However, several students who had secured a higher percentage in their chosen area of specialization failed to meet this overall requirement. Recognizing the absurdity of applying the rule rigidly when several courses of study were not available in India, the Bank approached the Finance Ministry to be allowed some discretion in the matter. In June 1957, the government appointed an expert committee to review the educational remittances policy, based on which it was decided to release exchange for all degree courses except in medicine and diploma courses in subjects such as languages, accountancy, apprenticeship training, and factory training. Seven subjects—bar-at-law, secretarial training, domestic science, tailoring, fashion designing, photography, and ballet dancing—continued to be on the banned list.

The Bank was not comfortable administering the new policy, since it was not very clear-cut and gave rise to a number of ambiguities. It was also forced to make too many references to the government for clarification, and found conflicting decisions emerging from New Delhi. Following discussions with the government, a more coherent policy for the release of exchange for studies was evolved, whose thrust was to weed out mediocre talent and ensure that exchange was released only for courses that would enhance the availability of technical skills required for a developing economy.

Pilgrimage

The large number of Haj and Ziarat pilgrims from India necessitated evolving an appropriate payments mechanism as part of the restrictive foreign travel policy. Government policy was to allow religious travel on the basis of foreign exchange released to pilgrims at scales fixed in consultation with the Reserve Bank. Earlier, there were no restrictions on the number of pilgrims who went on Haj, but with the withdrawal of the basic travel quota from January 1957, only a limited number of persons were allowed each year to proceed on these pilgrimages. Prior to 1959, banks in Saudi Arabia accepted Indian currency notes from Haj pilgrims, and these were subsequently redeemed by the Bank. But abuse of this facility led to the introduction of special Haj notes in May 1959. After the Gulf countries introduced their own currencies, the rationale for the special Haj notes disappeared and these were withdrawn. From 1964, a revised arrangement was worked out by the Reserve Bank with the State

Bank who made available to pilgrims, through their correspondents at Jeddah, Saudi riyals equivalent of the rupees surrendered by them at the time of departure.

Emigration Facilities

Under exchange control regulations in force in 1947, Indian nationals wishing to take up permanent residence in sterling area countries were allowed to transfer their assets, in full, at the time of emigration. There were however limits set by UK on the transfer of assets by those who wanted to migrate to the non-sterling and dollar areas. Initially, the annual outgo on account of migration, of Rs 1.25 crores to Rs 1.50 crores, was regarded as sustainable. But in 1957, as the weakness in the balance of payments became a prominent feature of the economic landscape, the Governor, H.V.R. Iengar, felt something had to be done to restrict unwarranted outflow on this account, and recommended restricting the facility to a maximum of Rs 2 lakhs per family. This proposal was implemented from July 1957. But a further tightening of the limits for capital transfer facilities soon became inevitable. By March 1960, a uniform limit of Rs 50,000 was fixed per family, irrespective of the country of emigration. In June 1962, even the lower remittance limit was at first suspended, and later withdrawn. The Bank favoured a complete ban on transfer of assets by Indian nationals, but the government remained sceptical about singling out capital remittances for the axe while doing nothing about current remittances. Jha, for instance, argued that a poor man taking out his entire capital might place much less of a burden on the reserves than a rich man taking only his income out annually. Asking the Bank to consider both aspects of remittances by migrants, he urged it to undertake a study of the pattern of remittances by types of emigrants to find out whether a more liberal policy on remittances would prove more onerous. Devising a policy based on making judgements about the motives for migration did not appeal to the Bank, since it would create more problems than it solved, more so as policy on migration was made by the Ministry of External Affairs. As a pure balance of payments operation, the Bank preferred to stick to a common yardstick or rule for all types of migrants.

The difficult foreign exchange situation also necessitated a further cut in the ceiling imposed on capital repatriation by foreign nationals from Rs 1,25,000 to Rs 75,000 per migrant in June 1962. The Bank's guidelines in this area of control were specific and there was little ambiguity in their interpretation or application except in one or two odd instances, where pressure was exerted by the government on the Bank to revise its decision. But the Bank stood its ground.

Control of Investment Abroad

Establishing Subsidiaries Abroad

At the time of the enactment of the Foreign Exchange Regulation Act in 1947, the main focus of section 13 was to regulate the export of securities rather than control investments abroad by residents. This was in keeping with the prevailing corporate situation in which companies operating in India but incorporated in the UK maintained dual registers, one in each country. However, by 1950, instances came to light of persons and firms resident in India acquiring business interests in foreign countries or forming subsidiaries abroad through clandestine means. The absence of any restrictions on the purchase of shares in foreign companies or on the formation of subsidiaries abroad by residents provided a convenient loophole, with the result the Bank was unable to exercise control over their activities. To plug this loophole, in March 1950, the Reserve Bank suggested to the government that the scope of section 13 of FERA be enlarged through an amendment to cover acquisition and dealings in foreign securities by residents and to make its prior approval mandatory for such transactions. Despite the lacuna in the regulation, the Bank allowed resident firms and companies to open branches abroad, but turned down requests for opening subsidiaries abroad. The Bank's reluctance stemmed from the fact that subsidiaries were governed by the laws of the country in which they operated and so were outside the jurisdiction of the Indian authorities. An overseas branch of an Indian company, on the other hand, was amenable to Reserve Bank control. However, in August 1950 the government gave up this hard line and displayed a new willingness to entertain requests for establishing subsidiaries abroad. Such requests were confined to large business houses in India. An initial release of exchange up to £5,000 was allowed, but further releases were made subject to the business house furnishing to the Bank an account of its financial operations and an undertaking to repatriate profits. The Bank was aware that UK provisions in this regard were more liberal but the Bank felt that before India could afford to be as liberal as the UK, the government should arm itself with powers to control the operations of overseas subsidiaries in order to ensure that their operations did not become 'free zones' in the exchange control system.

After several informal meetings between officials of the government and the Reserve Bank, a memorandum proposing the relevant amendments was placed before the Committee of the Central Board of the Reserve Bank in November 1950. Although a formal proposal for amending FERA was sent to

the government in December, the bill could not be introduced in the Lok Sabha for almost a year owing to a heavy legislative agenda. In the circumstances, the expedient of an Ordinance was resorted to, to bring activities of subsidiaries established abroad by Indian residents into the exchange control net. This was subsequently replaced by the Foreign Exchange Regulation (Amendment) Act, 1952 which was passed by the Lok Sabha in February 1952 and received Presidential assent the same month.

Foreign Bank Accounts and Portfolio Investments

Prior to July 1947, Indian residents were allowed to maintain and operate sterling and sterling area currency accounts without restriction. Restrictions were, however, applicable to the acquisition and holding of dollar balances. But with the implementation of five-year plans and the growing need to husband foreign exchange resources, direct controls were introduced to regulate such capital outflows.

FERA placed an embargo on all capital remittances outside India. The Bank, in turn, issued a notification in July 1947 cancelling the general permission given earlier for transactions in sterling and sterling area currencies, while authorizing the maintenance of existing accounts in those currencies by persons domiciled and resident in India. This meant that maintenance and operation of foreign currency balance by individuals, resident and domiciled in India, was restricted except in the case of accounts opened prior to July 1947 (referred to as pre-zero accounts). Even in the latter case, through a clarification put out by the Bank in September 1953, only payments could be made without prior approval, and fresh credits required its permission. Later in the decade there was a further tightening of these regulations. It was decided to mop up foreign currency balances held by residents, and the Government of India put out a notification in September 1958 requiring all foreign currency balances except balances held in pre-zero accounts to be surrendered within one month. There was some confusion and misunderstanding about permitted operations on the pre-zero accounts, so that in April 1960, the Bank clarified that persons holding pre-zero accounts in sterling and sterling area currencies could utilize their balances without its prior approval and that surrender requirements were not applicable to them or to those who opened accounts after July 1947 with its permission. These clarifications were of little avail, and the Bank suspected that a number of foreign currency accounts were in existence without its approval—some wilfully and others out of ignorance. Through a press note an attempt was made by the Bank to collect information on holdings of foreign currency balances, based on which in April 1962, it was decided to allow holders of

pre-zero accounts to utilize the balances. Holders of accounts opened after the September 1961 notification were advised to close them and repatriate the balance, or face penal action.

Yet another aspect of the control structure related to foreign portfolio investments by residents. In the late 1940s, the policy on portfolio investment abroad in shares and securities by residents was a liberal one. But in June 1957, the Bank withdrew the permission earlier accorded to residents to acquire sterling shares in the London market of companies exclusively operating in India and maintaining dual share registers. Three months later in September, by an amendment to section 13(1) of FERA, the Bank's permission was made compulsory for acquiring, holding, and disposing of foreign securities. Shares of sterling companies held on Indian registers by Indian residents were not covered by the amendment. By December 1962, the permission earlier available to invest earnings abroad was withdrawn and it was made obligatory for Indians with foreign portfolio investment to repatriate their earnings and the maturity proceeds when such investments were liquidated. In October 1963, a limited facility to switch investment to longer-dated securities with improved yields was crafted, but eligibility to reinvest sale proceeds was confined to shares and securities with maturities extending beyond ten years. Proceeds of sales of securities of shorter maturities were required to be repatriated.

Regulating Foreign Investment

Before Independence, foreign capital in India was almost entirely of British origin, and was concentrated in tea plantations, jute, mining, and services, or was associated with the development of railways and utilities. In the years following Independence, there was a gradual shift in the pattern, nature, and fields of investment. To illustrate, earlier investments were in branches or wholly-owned subsidiaries, whereas after 1955, joint ventures with Indian participation increased. Another feature of the later period was the preference for participation by residents in companies in which the foreign stake was the major one. An important change of policy towards foreign investment came with the Industrial Policy Resolution of April 1948 whereby pre-Independence investments were assured fair treatment and no restrictions were imposed affecting their activities, but entry for new companies was granted on a selective basis and on an evaluation of their likely contribution to the Indian economy. Proposals were viewed more favourably if the foreign corporation made provision for local equity participation and its investment was in accordance with the priorities and pattern of development envisaged under the plans. However, there were no

rigid predetermined spheres yet for foreign investment and no rigid rules as to the extent of foreign participation. Each investment was screened and evaluated on its own merits.

Attracting foreign business investment on such criteria influenced the style of regulation of the Bank. The latter also reflected the Finance Ministry's interventionist approach, and its extreme sensitivity to the threat of external investors invading captive and protected consumer markets or key sectors. In principle, the entry of foreign investment was encouraged in the field of manufacturing and in industries for which adequate capacity did not already exist in the country. Ordinarily, foreign investment was not permitted in trading, financial, or commercial concerns. The usefulness of a foreign investment proposal was judged on criteria such as its likely contribution to import substitution or export promotion, promotion of industries where domestic capital was inadequate or reluctant in coming forth, or where domestic technical know-how was not available or not of a high order. Provision for training Indian personnel for technical and administrative posts in enterprises established with foreign capital participation was made a precondition for approval. Subject to these considerations, foreign capital, once admitted, enjoyed equality of treatment in regard to rights and obligations. Remittance of profits, dividend, and interest earned by foreign investors was allowed freely. Repatriation of existing foreign investment was permitted, except for older investments from countries outside the sterling area, but even here, projects approved after January 1950 were entitled to free repatriation facilities. Compensation on fair and equitable terms was assured for enterprises acquired by the State.

Although repatriation policy guidelines were quite explicit, by the late 1960s the Bank began to harbour doubts about the justification for them. For instance, a number of dollar investors wanted to sell their business interests and repatriate the proceeds. Being American companies, investments in which were made before 1947, the Bank was not obliged to allow sale proceeds to be repatriated. But Governor Jha felt that in the conditions prevailing in 1968, it would be difficult to justify a discriminatory policy. The policy for old sterling companies was made when there was justifiable ground for treating the dollar as a hard currency in comparison with sterling. It was also an outcome of agreements over sterling balances, under which capital repatriation within the sterling area was free and was debited to the No. 2 account. But much had happened since then, and Jha was uneasy about continuing a discriminatory policy in the changed conditions. He was also aware that a simple extension of sterling area treatment to dollar investors could mean loss of foreign exchange and suggested to the government

the via media of allowing old investments, whether dollar or sterling, to be repatriated in instalments spread over five years.

Operationally, requests for repatriation were cleared by the government while remittances on account of profits and dividends were approved by the Reserve Bank. In September 1957, the Government of India entered into a convertibility guarantee agreement with the US government under which the latter offered against a small premium, guaranteed payment in dollars of profits and capital which the investors wished to transfer home but were prevented from doing by exchange restrictions in the host country. This agreement was intended to clear the way for a larger flow of foreign investment from the dollar area.

Although policy on foreign direct investment was fairly explicit, in practice it posed numerous irritants for investors. The Industrial Policy Resolution envisaged entry and exchange barriers administered through a meaningful screening process. The latter soon became a formidable obstacle for investors, who were required to secure clearances from various ministries and departments. Formal authorization under FERA was then handled by the Reserve Bank. In addition, those bringing capital in had also to seek permission from the Controller of Capital Issues if the total issued capital was Rs 10 lakhs or more. This was later raised to Rs 25 lakhs or more. Such procedures caused considerable frustration to investors, so that foreign investment in business enterprises during our period was, at best, modest.

The extent of foreign control of Indian assets and the magnitude of the country's external liabilities were aspects of considerable importance from the point of view of exchange control arrangements. Information on inflows, portfolio investment overseas, and foreign ownership was made available by the Bank through periodic surveys of foreign assets and liabilities. The first such comprehensive census involving an analysis of over 30,000 returns was undertaken as at the end of June 1948, and subsequent surveys gave a picture of the country's international investment position as at the end of December 1953, 1955, 1961, and 1968. But the system of periodical surveys involved considerable labour for the public and effort to the Bank, and their results became available only after an appreciable time-lag. Hence, in addition to the survey from 1956, the Economic Department of the Bank undertook annual assessments based on some limited information furnished by foreign-controlled companies. These annual exercises were useful in assessing changes in liabilities arising from direct investments and provided continuity to the results derived from infrequent surveys. The surveys and assessments helped shed light on the financing of industry, the size of the assets, earnings and distribution of profits, and the pattern of foreign participation. Not only did the survey

results become important tools for decision-making in operating the restrictive system, they helped fill gaps in the capital account of the balance of payments relating to investments through goods and services, and retained earnings, thereby helping the Bank to refine its payments data as well.

By the mid-1960s, there was intense public discussion about the policy aspects of foreign collaboration. In 1965, the Bank planned its first survey on 'Foreign Collaboration'. As the foreword to the publication indicated, 'it was not directed to an elucidation of the pros and cons of possible policy adjustments'. The data were intended to assist a factual and objective assessment of financial and technical collaboration agreements in force. The Bank did not wish to be seen to be spearheading a debate over whether or not foreign collaboration was beneficial to the country. It realized that any such assessment required a proper examination of progress made in production, employment, exports, and technology in general, and of import substitution in particular. Therefore, the survey concentrated on contributing towards a better understanding of the issues involved and strove to heighten public awareness by providing authentic data on the key features of foreign collaboration agreements.

The Reserve Bank played a limited role in regulating foreign investment. Clearance of collaboration proposals required the prior approval of the government. Each proposal was considered on its merits, having regard to plan priorities, existing capacity in the country, and future requirements. Inflow control was achieved by the most direct means available, by restricting foreign collaboration to those cases which brought into the country technical know-how not adequately available indigenously, for developing new lines of production, or where domestic capital was inadequate or not forthcoming, or where a collaboration project assisted in reducing pressure on the balance of payments. The cost of imported capital equipment set the minimum amount financed through foreign equity participation or loans. On the other hand, majority control was generally expected to remain in Indian hands. Apart from the above considerations, the terms for technical collaboration were also vetted by the government. Royalty payments were usually limited to 5 per cent of net sales, subject to tax, and the duration of royalty agreements was not allowed to exceed ten years.

These elaborate rules on foreign investment and their administration by the central government on a case-by-case basis led a study team set up by the Administrative Reforms Commission (1967), to conclude that too many obstacles and restrictions were being placed in the way of securing foreign collaboration. The government sought the views of the Governor on these

findings. Bhattacharyya advised against any change in the existing policy on royalties and argued in favour of the existing method under which payment of royalty was not encouraged where the foreign investor had a share in equity investment. Jha, who soon succeeded him, agreed generally with Bhattacharyya, but also suggested that the government should be more liberal in approving the payment of a certain percentage of the value of the product as royalty, since this would be much cheaper than importing the entire article. Much of the idle capacity in the engineering industry, he argued, could be harnessed to the task of import substitution, if the requisite designs, drawings, and know-how were imported.

Between 1948 and 1958, foreign collaboration approvals averaged fifty each year. But as the manufacturing sector made inroads into technologically intensive areas, recourse to foreign collaboration increased. The attractions of a protected market led a number of foreign companies to seek entry for setting up manufacturing capacities in the country, and the number of approvals climbed to over 300 per year between 1959 and 1965. In all, 2,200 foreign collaboration agreements were cleared between January 1948 and March 1964. On the remittance front, outflows on dividends increased from Rs 7.1 crores in 1956–57 to Rs 28.8 crores in 1966–67, while remittances of royalties grew from Rs 1.2 crores to over Rs 5 crores. Remittances of technical fees went up from Rs 3.6 crores in 1964–65 to over Rs 10 crores in 1966–67.

Non-Residents' Investment in India

Throughout the period 1955–1967, official policy was to encourage the inflow of remittances from Indians residing abroad. Even though limited facilities were offered to attract inflows, reconversion of such funds into free foreign exchange was severely restricted. To facilitate inflows, in June 1958, a few procedural changes were made, but with little success. Apprehensive that unscrupulous elements would exploit them, the Bank tightened procedures for telegraphic transfers and demand drafts. In the upshot, non-residents, who operated via rupee drafts, opted for sterling drafts, thereby reducing the inflow of funds. The new rules were abandoned within eight months.

Around 1960, political instability in East Africa triggered requests from Indians resident there to open different types of bank accounts in India. The Reserve Bank reacted to the requests positively, and in October 1960 accorded general permission for such bank accounts. In November 1964, to popularize and encourage investments by non-residents in units and in shares of limited companies, permission was given to export units and shares, provided they were bought with funds remitted from abroad.

In the years that followed, the extent of control by non-residents of their Indian assets was frequently discussed within the Bank and with the government. In August 1967, the Finance Ministry had in hand a comprehensive review of investments by non-residents of Indian origin in private limited companies. For the first time, guidelines with greater precision were spelt out and made public. The policy provided for ownership and control of such enterprises by non-residents of Indian origin, by allowing investment of over 51 per cent in industrial concerns with minimum paid-up capital of Rs 10 lakhs provided no repatriation of capital, dividend, or profits was proposed. Such investments were not, however, allowed in trading or service ventures. Different rules were applied to public limited companies where ownership and control were allowed even on a repatriation basis.

The Bank also helped to design and administer the National Defence Remittance Scheme which was unveiled in October 1965. The scheme was partly an adaptation of proposals the Bank had been discussing with the Fund for some weeks prior to the outbreak of hostilities with Pakistan in September 1965. Introduced in the wake of these hostilities which led to the suspension of external assistance to India, the scheme fetched Rs 70 crores of foreign exchange until June 1966 when it was discontinued following the devaluation of the rupee, and helped pull the country back from the brink of defaulting on its external obligations during these critical months.

Regulating Authorized Dealers

In terms of the powers conferred upon it by FERA, the Reserve Bank licensed several foreign and Indian banks, including Thomas Cook & Co. (a travel agency with a long history of providing exchange services) to deal in foreign exchange. As authorized dealers, these banks could deal in foreign currencies, open and maintain accounts in such currencies, approve applications from residents for purchase of foreign currencies, and maintain rupee accounts in the names of non-residents. In 1960, to facilitate proper reporting, the Exchange Control Department designed, in consultation with the Economic Department, the 'R' returns which besides simplifying the procedure, provided for the transparency of key figures needed for policy formulation.

Prior to July 1958 there were two exchange dealers' associations—one each representing exchange banks and Indian banks. But as the latter's operations in foreign exchange expanded, the Bank felt that it would be desirable to form a single association uniting all authorized dealers. A new association called the Foreign Exchange Dealers' Association of India (FEDAI) came into being in August 1958 with the explicit objective of bringing about

uniformity in the rates offered by different authorized dealers thereby avoiding unhealthy competition amongst them, and ensuring uniform service to clients.

The 1960s were marked by some relaxations in the inward flow of remittances and tighter controls on outward payments. Prior to 1964, authorized dealers were permitted to freely avail of loans and overdrafts from branches and correspondents in the sterling area without prior clearance from the Reserve Bank. In the absence of suitable regulation, it was found that there was a tendency for larger recourse by authorized dealers to such borrowing and that this tended to dilute the Bank's control over credit. So from December 1964, the general approval to bring in funds from abroad was modified and authorized dealers were required to obtain the Reserve Bank's approval for availing of loans and overdrafts from overseas branches and correspondents in excess of Rs 20 lakhs. From here on, all requests for bringing in funds were treated on merit, and some flexibility was employed to ensure that genuine productive activities financed by them did not go unmet. This measure, which originated in the tight monetary policy of the period, represented the first instance in which monetary and exchange control policies operated in tandem.

In September 1965 the requirement for prior approval was withdrawn, provided the loan or overdraft was taken to purchase rupees from the Reserve Bank for financing normal business operations in India. In addition, repayment of such borrowing was permitted if (1) the authorized dealer had no outstanding borrowing either from the Bank or other banks in India, and (2) the local inter-bank call money rate was less than the Treasury Bill rate of the week. Foreign banks operating in India were perturbed by these restrictions and conditions. In a letter to Bhattacharyya, the Chairman of the Calcutta Exchange Banks' Association suggested that the new restrictions could force exchange banks to refuse new business and lead to a fall in exports. But the Bank was in no mood to yield, with the Economic Adviser, Pendharkar, commenting that exchange banks were overextended anyway and could do well to curtail some business. The argument of the exchange banks that since they had limited local resources and were unable to mobilize increased deposits, they could not maintain their current level of advances except through borrowings from their offices abroad, was countered by the Reserve Bank advising them that they could turn to it for accommodation in the busy season. Nor was the Bank convinced that recourse to external funds took place only in exceptional circumstances. In the Bank's perception, short-term flows of this nature created strains on the country's slender reserves. The Bank's senior officials set their faces against conceding the demand of the exchange banks and allowing them to bring in funds or take them out without restriction. Bhattacharyya endorsed the official thinking but, while

agreeing not to waive the first conditionality, suggested waiving the second condition or making it an alternative to the first. The Deputy Governor, B.N. Adarkar, in his search for a way of doing this, came up with the suggestion of replacing the second condition by another (as an additional, not alternative, condition), viz. that the exchange bank should repay the overdraft out of the proceeds of the export bills negotiated. The advantage of instituting such a requirement was that it would not cause a net draft on the reserves. In the end, however, only the first requirement was retained, and the second one regarding inter-bank call money rate being lower than the treasury bill rate was withdrawn from November 1965. However, the September 1965 measure (A.D. 26) endured for several decades as the basis for regulating banking capital flows to and from India.

Enforcing FERA

As originally enacted, the Foreign Exchange Regulation Act had not envisaged the creation of an independent agency to enforce its penal provisions and bring offenders to book. Overall powers in this regard were vested in the government, while the Reserve Bank administered the legislation. Through another administrative arrangement, a small cell located in the Exchange Control Department was assigned, in collaboration with the government and the police, to look after the work relating to enforcement, including the responsibility for initiating action against those violating FERA. But as violations grew in scope and magnitude and the number of cases increased phenomenally, the need for a specialized agency with independent identity and armed with wider powers became apparent. The Bank was relieved of this responsibility, when in April 1956 the Government set up an independent Enforcement Unit in the Economic Affairs Department of the Finance Ministry. However, the anomalous position continued, in which the Reserve Bank or the Directorate of Enforcement acted as both prosecutor and judge simultaneously.

Based on the difficulties experienced in the operation and enforcement of FERA, in March 1950 the Bank suggested amending sections 4, 9, 19, and 23 of the Act. Amendments to sections 4 and 9 were intended to put the onus on the persons acquiring foreign exchange to prove that they had not contravened FERA, whereas the amendment to section 23 was intended to give discretionary powers to the court trying contravention cases to confiscate other assets held by the accused, in addition to any sentence of imprisonment or fine. The amendment to section 19 sought to strengthen the existing provision by widening the powers of the government and the Bank to compel the accused to make available all documentary evidence.

In its informal meetings and correspondence with the government, the Bank canvassed the need for these amendments, but the former was reluctant to accept amendments to sections 4 and 9 in principle, as they sought to put the burden of proof on the accused. The Reserve Bank's proposals had the effect of admitting, as evidence against a defendant, written statements of third parties in foreign countries who could not be called to give evidence before a court of law. The Law Ministry was not in favour of stretching the principle contained in the Indian Evidence Act to enable courts and the prosecution to accept a statement by such third parties without giving the accused an opportunity to cross-examine them. The Bank's legal advisers too, expressed some doubts about the acceptance of a rule which made the court a mere instrument to punish a person found guilty by the Bank. But the Deputy Controller of Exchange, P.J. Jeejeebhoy, argued that the proof of any unauthorized acquisition or retention of foreign exchange was normally contained in an admission by the party or a bank statement or other documents such as personal diaries or memoranda, and these sufficed to confirm the existence of unauthorized funds outside India. The Bank, in certain cases, had been successful in unearthing such evidence but had not been able to make use of it due to the limitations imposed by the Evidence Act. Unless something was done to enable courts to 'admit, as proved, documentary evidence secured directly by the Bank from the defendant', there was no point in it undertaking investigation to uncover evidence. The government remained sceptical about using such evidence, but following consultations with the Law Ministry, it was proposed that there should be no objection, legal or otherwise, to a special rule of evidence for the purpose of FERA, by which a court might presume the authenticity of documents seized or produced by the accused himself. Encouraged by this response, the Bank, in consultation with its legal advisers, sent the necessary amendments to the Ministry of Finance.

The bill containing the amendments was cleared by the Committee of the Central Board of the Bank in November 1950, but owing to a heavy legislative agenda there was little prospect of its introduction in the Lok Sabha till December 1951. Recourse was therefore taken to a Presidential Ordinance entitled 'the Foreign Exchange Regulation (Amendment) Ordinance, 1951' which, with slight reordering of the sections as originally proposed by the Bank, was promulgated on 27 December 1951. The Lok Sabha passed the amendment bill in February 1952 after a brief discussion and it received the President's assent the same month. The opportunity was also taken to extend FERA's validity up to December 1957.

While the Bank favoured legislative amendments to bring the guilty more effectively to book, the Ministry of Finance had other ideas, including a

provision for compounding offences and settling them out of court. Ministry officials had some notion that such a provision would induce persons to readily hand over incriminating documents. The Law Ministry, to whom the matter was referred, felt compounding offences under FERA would not be in the public interest, for the object of the legislation was not to collect revenue. A revenue law like the Income Tax Act could appropriately provide for compounding of offences in suitable cases, but not so FERA where prohibitions and penalties were aimed at controlling the import, export and acquisition of foreign exchange. According to section 345 of the Code of Criminal Procedure, compoundable offences were really those offences which were against an individual rather than against the State. FERA offences were against the State and compounding them would dilute the deterrent effect of the Act's penal provisions.

The Bank too resisted the proposal to compound FERA offences, as it felt that the mere imposition of penalty was not a sufficient deterrent; contravention of FERA was a criminal offence and guilty persons should be prosecuted and suffer the penalties prescribed under it. In its view, enforcement provisions could not be subordinated to considerations which dominated the collection of revenues. The very essence of the legislation, which was to bring under control all available holdings of foreign exchange, would be lost if the entire holding was not brought under control. The Bank also questioned the status of the foreign exchange that would be left to the share of the illegal holder and warned that it would amount to an 'approved holding' liable to be treated thereafter as such. Subsequent holders of this exchange would also have to be exempted and such holdings could, in course of time, become a shelter for economic offenders. In the face of such strong arguments against compounding, the Finance Ministry decided in 1952 not to pursue the suggestion any further.

This, however, was not the end of the story. In April 1957 the Ministry of Finance sent the Reserve Bank a list of proposed amendments to FERA. Most of the amendments were of a technical nature and were suggested by the Reserve Bank. Others suggested by the government did not raise major issues, except a new clause under which the government proposed to acquire powers to compound exchange violations. Despite the Bank's objections and a resolution of the Committee of the Central Board which expressed reservations, the government introduced the bill with the compounding provision in the Lok Sabha in August 1957. There was some parliamentary opposition to the clause, but the bill was passed without much difficulty on the very day it was introduced and received the assent of the President in September 1957. The vesting of powers for compounding exchange control cases in the hands of the Enforcement Directorate was seen by the Bank as a step away from

bringing the guilty to book. However, citing difficulties encountered in enforcing FERA provisions, the Enforcement Directorate came up with further proposals to amend the Act in 1961. These proposals, which were further modified in 1964, strengthened the powers of the directorate to deal with FERA offenders.

Conclusion

Post-Independence exchange control policies were shaped by the Bank and the Finance Ministry. Consequently, the role of the Bank, which was mainly responsible for administering these policies, expanded in size and scope. Exchange control policies grew more restrictive and detailed over the period covered by this volume. The astonishingly rapid growth of controls had, by the mid-1960s, led to a situation where the public knocked at the Bank's doors with questions of bewildering complexity, which might relate often to trivial sums of foreign exchange. By the end of the decade, the need to restructure and reorganize the exchange control mechanism had become amply clear, but it was equally evident that controls were there to stay in the foreseeable future.

Additional Unpublished Sources

ECS.1	Policy—General
ECS.1.A(i)	Remittances outside India—Travel Policy
ECS.4	Import Control Policy
ECS.21	Securities—Restriction on Sale of
ECS.21.A	Purchases of Sterling Shares by Indian Nationals
ECS.21.B	Investment of Overseas Indians in Indian Securities—Report of Shri Adarkar
ECS.21.C	National Defence Remittance Scheme
ECS.47	Indian Exchange Act—FERA
P&C.47	'P' Form Statutory Rules
P&C.76	Forward Exchange Cover to Exports on D.P. Basis
ECS.79	Sterling Area Dollar Pool