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FOREIGN EXCHANGE MANAGEMENT ACT

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Introduction

In an increasingly globalised economy, the movement of capital across national borders has become as significant as the movement of goods and services. International trade, foreign investment, overseas remittances and cross border financial transactions have become integral to economic growth, making an effective legal framework for regulating foreign exchange indispensable. According to the Reserve Bank of India, India's foreign exchange reserves crossed USD 700 billion in 2025, reflecting the country's expanding integration with the global financial system and highlighting the importance of a stable regulatory regime governing foreign exchange transactions.

To regulate this rapidly evolving financial landscape, Parliament enacted the Foreign Exchange Management Act, 1999 (FEMA), which came into force on 1 June 2000. The Act replaced the Foreign Exchange Regulation Act, 1973 (FERA), marking a significant shift from a control oriented regime to one based on management and facilitation. Unlike FERA, which treated most violations as criminal offences, FEMA adopts a civil regulatory framework intended to facilitate external trade and payments while ensuring the orderly development and maintenance of India's foreign exchange market.

The legislative intent behind FEMA is clearly reflected in its Preamble, which states that it is "*An Act to consolidate and amend the law relating to foreign exchange with the objective of facilitating external trade and payments and for promoting the orderly development and maintenance of foreign exchange market in India.*" This shift reflected the broader economic

reforms initiated after the liberalisation of the Indian economy in 1991 and recognised that foreign exchange regulation should encourage economic growth while maintaining financial stability.

Against this backdrop, this article analyses the legal framework of the Foreign Exchange Management Act, 1999, examines its key provisions, evaluates the role of the Reserve Bank of India in its implementation, and discusses the contemporary challenges associated with regulating foreign exchange in an increasingly digital and interconnected global economy.

From Regulation to Management: The Evolution of India's Foreign Exchange Law

The legal regulation of foreign exchange in India has undergone a significant transformation alongside the country's economic development. Prior to economic liberalisation, India adopted a highly restrictive approach towards foreign exchange management owing to persistent shortages of foreign currency and a tightly controlled economic system. To regulate the inflow and outflow of foreign exchange, Parliament enacted the Foreign Exchange Regulation Act, 1973 (FERA), which came into force at a time when India's foreign exchange reserves were limited and strict governmental control over foreign currency transactions was considered necessary to protect the national economy.

FERA was enacted with the primary objective of conserving the country's scarce foreign exchange resources. It imposed stringent restrictions on foreign exchange transactions, foreign investments and payments involving persons resident outside India. The legislation was regulatory in the strictest sense, with most contraventions being treated as criminal offences carrying severe penalties, including imprisonment. The burden of proving innocence also largely rested upon the accused, reflecting the control oriented philosophy that characterised India's economic policies during that period.

However, the economic landscape changed considerably following the balance of payments crisis of 1991. Faced with dwindling foreign exchange reserves and mounting external debt, India initiated a series of structural economic reforms aimed at liberalising trade, encouraging foreign investment and integrating the Indian economy with global markets. As foreign investment increased and international financial transactions became more frequent, the

restrictive provisions of FERA were increasingly viewed as inconsistent with the objectives of a liberalised economy.

Recognising the need for a more facilitative legal framework, Parliament enacted the Foreign Exchange Management Act, 1999 (FEMA), which came into force on 1 June 2000, replacing FERA. Unlike its predecessor, FEMA shifted the legislative focus from strict regulation and control to the management and facilitation of foreign exchange. The Preamble of the Act itself reflects this change by emphasising the facilitation of external trade and payments and the orderly development and maintenance of the foreign exchange market in India. The replacement of FERA with FEMA therefore marked not merely a legislative amendment but a fundamental shift in India's approach towards foreign exchange governance, balancing economic liberalisation with regulatory oversight.

The distinction between the two legislations is perhaps best reflected in the nature of their enforcement mechanisms. While violations under FERA generally attracted criminal liability, contraventions under FEMA are treated primarily as civil offences, with penalties largely taking the form of monetary fines and adjudicatory proceedings. This transition signifies Parliament's recognition that foreign exchange regulation in a liberalised economy should facilitate legitimate commercial activity while ensuring compliance through proportionate regulatory measures rather than criminal sanctions.

The Legal Framework of the Foreign Exchange Management Act, 1999

The Foreign Exchange Management Act, 1999 establishes a comprehensive legal framework for regulating foreign exchange transactions in India while simultaneously facilitating external trade and promoting an orderly foreign exchange market. Unlike its predecessor, which was primarily designed to control foreign exchange, FEMA adopts a management oriented approach that seeks to balance economic liberalisation with financial stability. The Act entrusts the Reserve Bank of India (RBI) with the responsibility of regulating foreign exchange transactions, while empowering the Central Government to frame policies and rules in areas specifically entrusted to it under the Act.

The legislative foundation of FEMA is primarily contained in Sections 3, 4, 5, 6 and 10, which collectively regulate foreign exchange transactions, distinguish between current and capital account transactions, and establish the institutional framework for implementation. One of the most significant provisions is Section 3, which places restrictions on dealings in foreign exchange except through authorised persons. It provides that, save as otherwise provided under the Act or with the permission of the Reserve Bank of India, no person shall deal in or transfer foreign exchange or foreign security to any person other than an authorised person, make payments to persons resident outside India, or receive such payments except through authorised channels. By routing foreign exchange transactions through authorised entities, Parliament intended to ensure regulatory oversight, transparency and effective monitoring of cross border financial flows.

The Act further distinguishes between current account transactions and capital account transactions, a distinction that forms the cornerstone of India's foreign exchange management regime. Under Section 5, current account transactions are generally permitted, subject to reasonable restrictions imposed by the Central Government in consultation with the Reserve Bank of India. This liberal approach reflects India's commitment to facilitating international trade, education, travel and other legitimate cross border payments. In contrast, Section 6 empowers the Reserve Bank of India to regulate capital account transactions, recognising that unrestricted movement of capital may have significant implications for exchange rate stability, monetary policy and the country's overall financial system.

Another significant feature of FEMA is the recognition of Authorised Persons under Section 10. Banks, financial institutions and other entities authorised by the Reserve Bank of India function as intermediaries through whom foreign exchange transactions are conducted. By conferring regulatory responsibilities upon authorised dealers, the Act creates a decentralised yet closely supervised mechanism for implementing foreign exchange regulations while ensuring compliance with RBI directions and notifications.

Unlike the criminal enforcement model adopted under FERA, FEMA primarily treats contraventions as civil offences. Section 13 empowers the designated authorities to impose monetary penalties for violations of the Act and, where necessary, direct confiscation of the

currency, security or property involved in the contravention. This shift from criminal prosecution to civil adjudication reflects Parliament's intention to encourage voluntary compliance while maintaining an effective regulatory framework capable of addressing violations through proportionate enforcement measures.

The relationship between FEMA and judicial interpretation has also contributed significantly to the development of India's foreign exchange jurisprudence. In *Vijay Karia v. Prysmian Cavi E Sistemi SRL* (2020), the Supreme Court observed that not every violation of FEMA automatically renders a transaction contrary to the fundamental public policy of India. The judgment recognised FEMA as a regulatory statute intended to manage foreign exchange rather than prohibit legitimate commercial transactions, thereby reinforcing the Act's facilitative character in a liberalised economy.

Together, these provisions demonstrate that FEMA is not merely a regulatory statute governing foreign currency transactions. Rather, it represents a carefully designed legal framework that seeks to facilitate international commerce, attract foreign investment and preserve macroeconomic stability while ensuring that cross border financial transactions remain subject to appropriate regulatory supervision.

Contemporary Challenges in Foreign Exchange Regulation

Despite providing a modern and flexible legal framework for regulating foreign exchange, the Foreign Exchange Management Act, 1999 faces several contemporary challenges arising from technological advancements, global financial integration and evolving international regulatory standards. While the Act was enacted to facilitate external trade and maintain the orderly development of India's foreign exchange market, the rapid transformation of cross border financial transactions has created regulatory concerns that were largely unforeseen when the legislation was introduced.

One of the most significant challenges is the emergence of digital assets and virtual digital currencies. The increasing use of cryptocurrencies and blockchain based payment systems has complicated the regulation of cross border financial transactions, as such transactions frequently operate outside conventional banking channels supervised by the Reserve Bank of India.

Although India has adopted a cautious regulatory approach towards virtual digital assets, the absence of a comprehensive statutory framework governing their cross border movement continues to pose challenges for the effective enforcement of FEMA.

Another important challenge concerns the regulation of cross border investments and capital flows. Global financial markets are increasingly interconnected, enabling foreign portfolio investments and overseas direct investments to move rapidly across jurisdictions. While these investments contribute significantly to economic growth, they also expose the domestic economy to sudden capital outflows during periods of global economic uncertainty. Maintaining an appropriate balance between facilitating investment and safeguarding macroeconomic stability therefore remains one of the most important objectives of India's foreign exchange regulatory framework.

The growth of the digital economy and cross border e commerce has further expanded the scope of foreign exchange regulation. International transactions involving digital services, online marketplaces and technology platforms frequently involve complex payment structures spanning multiple jurisdictions. Ensuring compliance with FEMA while facilitating innovation and digital commerce has consequently become an increasingly demanding task for regulators.

The implementation of FEMA also depends heavily upon effective coordination between the Reserve Bank of India, the Directorate of Enforcement, authorised dealers, financial institutions and other regulatory agencies. As financial transactions become more sophisticated and transnational in nature, greater institutional cooperation, technological integration and information sharing are essential for detecting violations without imposing unnecessary compliance burdens upon legitimate businesses and investors.

Finally, India's foreign exchange framework must continuously adapt to changing international financial standards and geopolitical developments. Global initiatives relating to anti money laundering, counter terrorism financing, financial transparency and sanctions compliance require domestic regulations to evolve alongside international best practices. At the same time, geopolitical conflicts, supply chain disruptions and fluctuations in global capital markets have increased the importance of maintaining adequate foreign exchange reserves and a resilient regulatory framework capable of responding to external economic shocks.

The continuing effectiveness of FEMA will therefore depend upon its ability to remain sufficiently flexible to accommodate technological innovation and global financial integration while preserving the regulatory safeguards necessary to protect India's economic and financial stability.

Conclusion

The Foreign Exchange Management Act, 1999 represents one of the most significant legal reforms introduced in India's post-liberalisation economic framework. By replacing the restrictive regime under the Foreign Exchange Regulation Act, 1973, Parliament shifted the focus from strict governmental control over foreign exchange to a regulatory framework that facilitates international trade, encourages foreign investment and promotes the orderly development of the foreign exchange market. Through the combined role of the Central Government, the Reserve Bank of India and authorised persons, FEMA seeks to maintain a balance between economic liberalisation and financial stability.

Over the last two decades, the Act has largely succeeded in creating a flexible legal framework capable of supporting India's growing integration with the global economy. At the same time, the emergence of digital financial technologies, increasing cross border capital flows and evolving international regulatory standards continue to test the adaptability of the existing legal regime. These developments highlight the need for continuous policy refinement without undermining the fundamental objective of facilitating legitimate international financial transactions.

As India's economy becomes increasingly interconnected with global markets, the effectiveness of FEMA will depend not only on robust enforcement but also on its ability to evolve alongside technological innovation and changing patterns of international finance. A responsive and forward looking foreign exchange regulatory framework will remain essential for safeguarding financial stability while enabling India to strengthen its position in the global economy.

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