



A Study on Gold policy initiatives and Effectiveness in India

KEYWORDS

Gold, Gold Policy, Gold Policy in India, Gold policy initiatives.

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ABSTRACT India has an ambivalent relationship with gold. For consumers, gold is a prized asset, cherished as both an adornment and an investment. For the government, gold is a major contributor to the current account deficit, a challenge that needs to be addressed. Gold has always been an integral part of the socio-economic ethos of the Indian household. As a commodity, it has always carried with it the tendency of invoking a sense of cultural and sentimental attachment, making its consumption and investment in India very different from that of other countries. In India, gold has, through generations, remained an obvious and natural choice of saving of all households. Gold has never been an easy product around which policy could be formulated. Policies around gold (and to some extent business plans and financial innovations related to gold) have all largely been based on a couple of assumptions; (a) Demand for gold in India will never wane; (b) People in India will not part with their gold easily; (c) Women are sentimentally attached to their jewellery and hence will not part with it; (d) If given a choice between cash or gold, Indian people will opt for gold. At various points of Indian history, one or all of these assumptions have been true. The purpose of this report is to re-examine gold policies and their effectiveness and build a case for formulating a comprehensive public policy on gold. And this study concluded that, drive the standardization of gold so that buyers and sellers can have faith in both the quality and price of their products. Introduce guidelines for compulsory quality certification of all forms of gold to encourage accountability and foster an environment of trust. Establish a Gold Exchange to ensure pricing standardization, increase transparency and improve supply and demand analysis. Establish a Gold Board to manage imports, encourage exports and drive development of necessary infrastructure. Allow Indian banks to use gold as part of their liquidity reserves. This would incentivise them to introduce gold-based savings products.

Gold policy and Government Initiatives in India

India has traditionally been the largest consumer of gold in the world and the government has adopted a range of measures to manage this consumption. Here, we look at policy initiatives in India over the past six decades and analyse their effectiveness.

To provide an international perspective, we then look at other countries to see how they have tried to monetise gold and the results of their endeavors.

Gold Policy in India

The Indian government's interest in the gold market dates back to independence. To better understand the differing approaches taken and their respective consequences, this report assesses policies taken from 1947 to the present day.

The researcher has divided this period into four Stages.

Stage One

During the first phase, 1947-1962, policies were largely geared towards controlling the gold market in India. The stated objective behind a restrictive approach to gold was, to wean people away from gold, to regulate supply of gold, to reduce smuggling, to reduce the demand for gold and to reduce the domestic price of gold.

- Foreign Exchange Regulation Act (FERA) introduced in 1947
- Nationalisation of Kolar gold mine at Mysore took place in 1956
- Replacement of the proportional reserve system with the minimum reserve system for currency issue in 1956
- First Gold Bond Scheme introduced in 1962

Stage Two

A restrictive approach persisted between 1963 and 1989. The Gold (Control) Act was introduced in 1968 and several

restraints were placed on the gold business:

- Manufacturing gold jewellery above 14 carat purity was prohibited
- Ceilings were placed on individual holdings of gold jewellery
- Jewellers were obliged to maintain records of all business transactions

At the same time, however, the government tried to mobilise gold by issuing gold bonds, gold auction schemes and through the Voluntary Disclosure of Income and Wealth (Amendment) Ordinance (1975). These efforts were designed to control the budget deficit, meet contingency needs and reduce gold smuggling in India.

- Gold Control Rules (1963)
- Gold (Control) Act (1968)
- Gold Bonds 1980 (March, 1965)
- National Defence Gold Bonds 1980 (October, 1965)
- Voluntary Disclosure of Income and Wealth (Amendment) Ordinance (1975)
- Gold auctions (1978)

Stage Three

Between 1990 and 2006, a different approach was adopted as the government introduced measures to deregulate the gold industry.

First, the Gold (Control) Act was repealed. Smuggling had proliferated in India during the previous decades. Now the liberalisation of gold imports took priority. The NRI (non-resident Indian) scheme was introduced, alongside a Special Import License (SIL) scheme to facilitate entry of gold into India.

In 1997, seven banks were authorised as official importers

of gold. In 1999, the government tried to mobilise gold through the Gold Deposit Scheme (GDS), launched by State Bank of India to allow gold deposits at a specified interest rate.

Balance of Payment Crisis and Gold Mortgage by India

- Gold Control Act, 1968 repealed in June, 1990
- NRI Scheme introduced in March, 1992
- Scope of Special Import License (SIL) scheme expanded to include gold in April 1994
- Seven Banks authorised to import gold in August 1997
- Gold Deposit Scheme (GDS) launched by State Bank of India in 1999

Stage Four

The fourth phase began in 2007, just ahead of the global financial crisis. This phase has been marked by rising gold demand, rising imports, rising prices and a high current account deficit.

In 2007, demand totalled 796.1 tonnes. It peaked at 1022.3 tonnes in 2010, reduced slightly in subsequent years and reached 975 tonnes in 2013. At the same time, the gold price (per ten grams) almost trebled from ` 9223.7 in 2007 to ` 26440.2 in 2013. To try and curtail the current account deficit and reverse the depreciation of the rupee, the government has introduced restrictions on the gold market once more.

- Global recession of 2007 and its impact on gold demand
- 'Gold Demand' surge – Post recession
- Inelasticity of gold demand to its price
- Negative effect of gold demand on CAD
- Government initiatives – a negative approach to gold policy
 - o Prominent feature of phase II
 - o Is it counterproductive?

Table No.1 Overview of import tariffs and domestic taxes in India.

Date	Developments
17 th Jan 2012	Gold import duty double from 1% to 2%
16 th March 2012	Gold import duty doubled from 2% to 4%
21 st January 2013	Gold import duty doubled from 4% to 6%
22 nd January 2013	Duty on Raw gold doubled from 2.5% to 5%
28 th Feb 2013	CTT introduced on gold futures
18 th Mar 2013	RBI launches tax investigations on god coin sellers
13 th May 2013	Bank gold consignments restricted
4 th June 2013	Traders gold consignment restricted
4 th June 2013	Gold import only by outright cash payment
5 th June 2013	Gold import only by outright cash payment
27 th June 2013	Gold imports for consignments only for jewellery exports
22 nd July 2013	20% of the imports will be held in warehouse available for export with 75% withheld metal exported before fresh imports
13 th August 2013	Gold import duty increased from 8% to 10%
13 th August 2013	God excise duty increased from 7% to 9%
14 th August 2013	RBI bans gold coin imports and domestic buyers must pay cash

Source: Karvy Annual Commodity Report 2014 /BBA reports

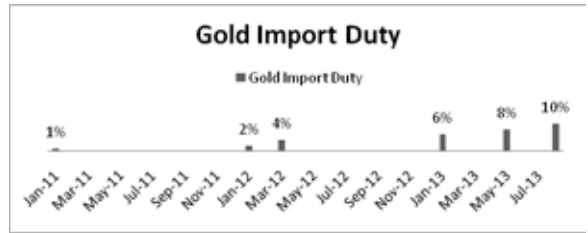


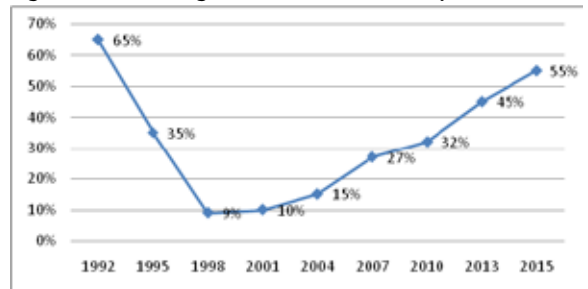
Figure 1: Percentage of Gold Imports Duty in India

Policies and effectiveness

India is the world's top buyer of gold, and the high duty has made illegal shipments profitable. The World Gold Council estimates that 175 tonnes of gold were smuggled into the country last year. Smuggling may rise in 2015 if import duties remain high.

Research indicates that successive attempts to curb demand for gold have proved ineffective. Restrictive import policies have had a limited effect on demand. Instead, they have led to increased smuggling. The gold smuggled into India between 1968 and 1995 varied from 10 to 217 tonnes per year. When the gold policy was liberalised, demand continued to rise but it was met primarily through official channels. Smuggling was curbed, the price differential between the domestic and international gold market narrowed and the government earned revenue through import tariffs and domestic taxes (Table No.1)

Figure 2: Percentage of Unofficial Gold Imports



The evidence suggests that the demand for gold is not curtailed by policy intervention. It would seem more appropriate to question whether an economically and traditionally significant asset like gold should continue to be treated in an ad-hoc manner by successive governments.

Perhaps the time is right to deliver a comprehensive gold policy for India, one which would accept India's affinity with gold and put that affinity to work for the good of consumers, the good of industry and the good of the economy.

"Assocham" said Smuggling of the yellow metal in India is likely to shoot up and introduction of mandatory PAN declaration on high-value gold purchases will dampen the industry. "In the absence of lower (import) duty, smuggling of the precious material would shoot up... The jewellery sector had been seeking a cut in the import duty, which will increase the supply of gold and also curb illegal imports."

Summery and Conclusion

- Indian households are holding around 22,000 tonnes of gold at home which is idle, This has an estimated value of more than \$1 trillion. Effective policy could unlock household gold and put it to work in the economy. Drive the standardization of gold so that buyers and sellers can have faith in both the quality and price of their products. Introduce guidelines for compulsory quality certification of all forms of gold to encourage accountability and foster an environment of trust. Establish a Gold Exchange to ensure pricing standardization, increase transparency and improve supply and demand analysis. Establish a Gold Board to manage imports, encourage exports and drive development of necessary infrastructure. Allow Indian banks to use gold as part of their liquidity reserves. This would incentivise them to introduce gold-based savings products.
- Develop an effective gold infrastructure with a focus on gold refineries and gold accreditation centers. Gold refineries will help to create gold bars of an inter-

nationally accepted standard. Accreditation centres will certify the purity of gold products.

- Create a standard price fix which should be valid throughout the country. Encourage the development of the gold jewellery industry. As the main exporter of gold in India, the industry should be given more prominence as well as benefits to promote the export of gold jewellery. Encourage banks to improve gold-based products through better marketing and easier process. The RBI should also incentivize banks to enhance investment products.

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