GOLD APPETITE & GOLD POLICY IN INDIA
SOME REFLECTIONS

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INTRODUCTION

1._My reflections will cover three broad areas:
{A}The high and persistent gold appetite in India and the medium term outlook for its continuance.
{B} Gold Policy and some improvements needed.
{C} The Gold Deposit Scheme and some innovations needed to add to its sex appeal.

2. My country, India, is complex. Some foreigners, after a one-week maiden visit, are tempted to rush in to write a long essay on India's society, which thousands of their readers may acclaim as full of deep insights. However, after a yearlong stay the same experts fear to tread and admit that they could not fathom the society. I venture to write in all humility and would be happy to be corrected.

3. Gold has always been important to all Indians. To satisfy their perennial appetite for gold Indians have all along been paying a very high price, probably to the joy of all other interests in the gold industry worldwide. Nevertheless, India is also the well-known largest consumer of gold. Year after year, Indians absorb nearly a quarter of the world's new gold. Thus surely India too is very crucial for the world's gold economy, though it is not getting the mileage that it deserves out of its dominant position in the World of Gold. India's gold policy should be directed to help the country assert its position.

{A} India's Gold Appetite

4. I can understand and appreciate entirely that there is such a great practical interest about India's gold appetite since times immemorial. Will it continue in future as well? How far? How long?

5. In my view, the appetite is neither due to any pervading sense of insecurity nor due to foreign domination. Foreign rulers have time and again attacked India and plundered massive quantities of gold from India's kings and masses. But the appetite continued as Indians, kings and the masses, started building up their wealth all over again.

6. The root is probably in several less-known factors. Easily the most significant is the very large favourable balance of trade, which India enjoyed with the rest of the world for centuries and centuries. In my initially frustrating effort to delve into the past, I came across quite a few writings of British and other western authors of yesteryears that brought this point tellingly.
7. Here are a few of the many sketchy references that deserve mention in the main text of this paper:

1. Walter Hamilton: A Geographical, Statistical and Historical Description of Hindoustan and Adjacent Countries. {The East India Gazetteers; Published 1820}; {Reprinted, Oriental Publishers, New Delhi, 1971.}
2. Brooks Adams: The Law of Civilisation and Decay. { Reprinted, Vintage Books New York, 1943.} {Copyright, Macmillan, 1896}
3. George Forster: Travels in the Northern Parts of India in 1782 &1783.
4. Francois Bernier: Travels in the Mogul Empire, 1656-68.{ Translated on the basis of Irving Brock's version and annotated by Archibald Constable,1891. Second edition revised by Vincent A. Smith; Humphrey Milford, Oxford University Press, 1914}

5. Torrens W M: Empire in India, How We Came by It? A Book of Confessions.{First published, Trubner & Co. London, 1872. Reprinted 1923}
6. Some essays and writings of Macaulay.
{I am indebted to Dr Vinayak Purohit for these and other references as well as for some useful discussions. One of his signed articles, 'Gold Once Again in Limelight' first attracted my attention. It was published in a monthly 'MANKIND' (June 1999}, which he also edits. Subsequently he showed several references to me, of which a few are mentioned above. Readers who have any more stamina left for this subject, will be well advised to contact him.}

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8. Quotations can be boring and repetitive. However here are three brief extracts by way of a sample:
"Of Gold and Silver the Hindoustan has always been very great. As the inhabitants sell much and buy little, the balance is consequently in their favour."{Hamilton}

"Gold and silver, after circulating in every quarter of the globe, came at length to be swallowed up, lost in some measure, in Hindoustan. Of the quantity drawn from America and dispersed among the different European States, a part finds its way, through various channels, to Turkey, and a part passes into Persia. The productions of the Indies are equally important to Turkey and Persia. Thus, it happens that these countries are under the necessity of sending a portion of their gold and silver to Hindoustan by the vessels which arrive every year in the Mousem, or the season of the winds, at these celebrated ports, laden with goods from that country. Let it also be borne in mind that all the Indian vessels, whether they belong to the Indians themselves or to the Dutch or English or Portuguese, bring back to Hindoustan from these countries a large quantity of the precious metals"...{Bernier}

"From times immemorial, the Oriental custom has been to hoard. From the Moguls blazing with Golconda diamonds to the peasant starving on his wretched pittance, every Hindoo had, in former days, a treasure stored away against a day of trouble. Year by year a stream of bullion had flowed from America to Europe and from Europe to the East. There it had vanished completely....These hoards, the savings of millions of human beings for centuries, the English seized and took to London. What the value of this treasure was, no man can estimate. But it must have been many millions of pounds- a vast sum in proportion to the stock of precious metals then owned by Europeans... Upon the plundering of India, there can be no better authority than Macaulay. He has told how after (the battle of) Plassey a 'shower of wealth' started falling. Macaulay also describes the huge and lavish acquisitions of Bengal's treasures by Lord Clive"..{Adams)

9. In a footnote, Adams writes, rather severely: "Macaulay's essays have been the subject of much recent adverse criticism; but in regard to the plundering of Hindoustan , nothing of consequence has been brought forward against him. All recent historical work relating to India must be taken with suspicion. The whole official influence has been turned to distorting evidence in order to make a case for the government."

10. It seems thus clear that for centuries, if not for millennia, India produced goods of all sorts that were in great demand all over the world. India produced them well in excess of her own needs and therefore exported large quantities. The world however seemed to be producing precious little that Indians needed but they did not produce themselves-- except of course the precious metal viz. gold. Therefore, they accepted gold in settlement.

11. John Stuart Mill said in one his famous statements: 'Capital is the accumulated stock of human labour.' For Indians - peasants, workers, artisans and all- this gold represented the only enduring capital, which they could accumulate by producing more than what they needed to satisfy their day-to-day needs. In comparison to gold, the only other assets they could build, viz. cattle and a house, were far less permanent, far less marketable, and far less mobile. Moreover, they saw everybody in society around them - including the kings and all the kings' men- using gold and silver for adornment.

12. The point regarding mobility of gold had an added significance. Society then was largely rural and pastoral. Attacks from outsiders, not only from the foreigners outside India, but also from other kings from within the country, were probably accepted as a sad fact of life. People had to flee, leave their home and their cattle behind and set up shop elsewhere. Very often, they were just robbed of their cattle. However, most of their gold was either taken with them where they moved; or it was buried in some places which none else knew about. If and when they returned they, and they alone, had access to their gold--their one asset of universal acceptance. Gold was their fully convertible currency on current account as well as capital account, if you please.

13. The case for gold was made. It was a cast iron, impregnable case, which stood the test of time for Indians for centuries after centuries. Gold jewellery and gold ornaments of the family passed through generations and became a symbol of family pride. One day, gold became a part their blood. It will not be easy to separate the blood from the gold.

14. In the post-independence era, a new element seems to have emerged. Unaccounted money has now become an unfortunate factor to reckon with. Though this vast subject is of considerable professional interest to me, any discussion of its magnitude, causes and outlook is well beyond the scope of this Paper. Suffice it to mention that according to many serious analysts, unaccounted money to the extent of at least 10% of GDP is generated in the system every year. The GDP in 1999-2000 is estimated to be roughly about Rs. 20,000 billion {US $450 billion}. For various reasons, gold bars and heavy gold jewellery appear to have become a preferred medium of holding one's ill-gotten wealth within the country. If there were no unaccounted money generated in the country, the demand for new gold would certainly be seriously curtailed. But then..

15. What then is the 50-year outlook? There are several imponderables. One can speculate on only a few of them:

16. Many other mobile and marketable assets are now available. In fact, gold dominated in the past partly because there were no paper assets.
Gold then was the common man's foreign exchange. Give him some truly convertible foreign currency, and he will probably give up some of his gold.

17. On the other hand, with hallmarking, transparency, and better market information, gold is less risky to hold now. If people chose to hold gold despite these risks in the past, their appetite would be sharper with the risks curtailed.
It would be unrealistic to expect zero unaccounted money in any system. Even if its significance is cut to size over time, since the economy continues to grow, any sizable reduction in the nominal quantum of unaccounted money will be slow to be achieved.
18. Considering these and other factors, I venture to suggest that in the next fifty years or so, there will be no erosion in India's gold appetite.

{B} India's Gold Policy.

19. From 1962 to 1989, we in India followed a zero-merit gold policy as embodied in the infamous Gold Control Rules. The rationale behind the policy was two fold: First, gold was a non-productive asset and so its use should be banned. Secondly, there would be in India, a perennial shortage of foreign exchange. Therefore, people should not be allowed to keep so much idle foreign exchange, which is what their gold holdings were.

20. The rationale may or may not be justified. For myself I too believe that today gold is an idle non-productive asset for any tiny personal portfolio. {Perhaps I am making a virtue out of necessity. Luckily, my wife, the gem that she is, says that she too has accepted this view!}. However, I can be ignored possibly as an eccentric exception. Indians may seem to differ in everything: in religion, caste, language, life style, eating habits, spending and saving habits, types of homes, dress, economic status and so on. But if there is one thing that binds all Indians, it is the lure of gold. Everyone possesses some gold, and he (more so, she) wants not only to preserve it , but also to own and possess yet some more: "Yeh Dil Maange More"

21. Against this perspective, it was altogether incorrect to force on the people a view opposed to their centuries-old practices. Sure enough therefore, people kept on buying gold as they did before the enforcement of the controls. What was a perfectly legitimate activity, became illegal overnight, turning millions of law-abiding citizens suddenly into law-breakers. Unscrupulous elements in the chain made millions and the citizens, the consumers of gold, lost any recourse to law against them.

22. Sanity did not return until 1989, when the then Finance Minister Prof Madhu Dandavate, made a beginning and scrapped all controls on internal trade in gold. In i992, Dr Manmohan Singh, the new finance Minister, carried the reforms much further by allowing imports of gold under certain parameters.

23. The reforms process has thus already set in. To consolidate the gains I recommend the following further improvements:

(i) Forward trading in gold should be resumed. Permitting non-transferable and transferable specific delivery contracts should make an immediate beginning.

(ii) The wealth tax on gold is a distortion. It should be scrapped forthwith.

{iii} Imports of gold are allowed under baggage rules and under SIL. They should also be allowed by foreign tourists, by Indian tourists returning and even by the foreign institutional investors, from their own foreign exchange. These imports will be self - limiting. For example, if the net FII flows are, say, $4bi. in a year, that would be the maximum value of gold that could be imported under that head.

(iv} Import duty should be rolled back to Rs 220 per 10 gms. for imports in categories specified in item {iii} above, where a draw down of India's official foreign exchange reserves is not involved. There should be no reduction of the present import duty of Rs 400 per 10 gms. for imports under the (misconceived) OGL scheme

(v} Permitting OGL imports of gold with a zero or a nominal duty is nothing short of full capital account convertibility of the rupee. India should not hanker after the full CAC. CAC is good. However, let it come in its own time.

{C} Gold Deposit Scheme

24. Will the Gold Deposit Scheme (GDS) succeed? The reply to this question in turn raises another question: What is the criterion of success? The general thinking seems to be that if at

least 100 tonnes of gold is deposited countrywide in the first year of its operation, the GDS should be considered a success. If the GDS is to be retained as an on-going scheme, and as a non- amnesty scheme, the prospects of it's being a success on the above criterion are, in my view, extremely dim.

25. It is also worth noting that the Finance Minister in his Budget speech had announced the GDS on Feb 27, 1999, primarily as a measure of conserving foreign exchange. India's foreign currency assets then were about $27.5bi. They have increased by about $4.5 bi. in a year and now stand at about $32 bi. The rupee has also stayed reasonably stable and firm. I am doubtful if in these circumstances the government is equally concerned today about conserving foreign exchange.

26. Nevertheless, I would like to suggest a few innovations in the GDS to improve the prospects of its success:

(i)The gold depositor should be given the option of receiving on the spot a part of the value of his deposited gold in fully convertible US dollars. After all, the depositor is parting with a fully convertible asset. The banks can share a part with him.

(ii)Like the Swiss kinebars, the banks should offer a pre-fixed minimum buy- back price at maturity.

(iii)The procedural jungle, particularly in respect of assay, refining etc needs to be considerably simplified. For example, most depositors like to have a deposit receipt across the counter. However, banks seem to insist that all gold deposited in any form will be sent abroad for refining, before any final receipt is given. As a practical way out, banks should themselves open a neighbouring window to sell approved gold, which can be instantly exchanged with a deposit receipt.

(iv)The requirement mentioned above, that all deposited gold would be invariably sent abroad for assay and refining, is curious. That can only help the foreign refiners, and that is a pity. India should expeditiously encourage the setting up of state-of-the-art refineries in India. The world's largest consumer deserves it.

Concluding..

28. Before concluding, I should express my appreciation that the LBMA has decided to open a new class of 'International Associate Members.' I note that these 'Associates' will be required to fulfil the same high criteria of eligibility as are applicable to LBMA's full members. They will have no voting rights, but will be entitled to many of the other benefits available to the full members. The LBMA is clearly responding to emerging realities. May be, a day will not be far when there will be an MBMA {Mumbai Bullion Market Association}, and the MBMA too will open a similar new class of 'International Associate Members'.

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(Note: The LBMA had organised its first ever 'International Precious Metal Conference' in Dubai, February 19-21, 2000. I had the pleasure of being an invited speaker for this subject. This Paper is the primary source of my speech on Feb.21. I am grateful to the LBMA for their invitation and to several friends and experts who helped me. I am alone responsible for the many inadequacies that must have remained.--Author)