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**A DISCUSSION PAPER**

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# **GOLD MOBILISATION AS AN INSTRUMENT OF EXTERNAL ADJUSTMENT**

**Atul Sarma, A. Vasudevan, K. Kanagasabapathy,  
Ms. Mythili Narayan, Ms. Mohua Roy\***

## **SECTION I**

### **Introduction**

The critical role that gold can play in external adjustment, especially in a very short time frame, has been underscored when Indian authorities had to pledge gold in 1991 to shore up the level of foreign exchange reserves, as a precursor to undertaking a credible programme of external adjustment. This action, however, was not pre-meditated; it simply had to be taken to avoid defaults on external payments. An important lesson that one can learn out of this experience is that gold reserves are as good as foreign currency reserves and could be deployed for purposes of meeting short-term external payment gaps and more importantly for undertaking a comprehensive programme for sustained and stable economic growth.

### **The Framework**

In the Indian context, the process of acquisition of gold has resulted in loss of opportunities in two important directions. It caused in the first place diversion of household savings from

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productive assets. The consequential rise in demand for gold had to be met by supplies from abroad: it meant diversion of foreign currency reserves and a perennial disequilibrium in the foreign exchange market. This is reflected in the high gold price differentials between domestic and international markets as also increasingly higher levels of gold imports through unofficial channels.

This point can be made more clearly by using a simple macro-economic identity :

$$\text{CAD} = (T-G) + \{Sp - (Ip + \dot{B})\} = (X-M)$$

where

CAD = external current account deficit,

T = government revenues,

G = government expenditure,

Sp = savings of the private sector,

Ip = investment in the private sector,

$\dot{B}$  = net gold accumulation,

X = exports of goods and services, and

M = imports of goods and services.

The term (T-G) thus represents the fiscal deficit while the term  $\{Sp - (Ip + \dot{B})\}$  represents the private sector savings-investment gap. (X-M) is defined here in a comprehensive sense to include unofficial transactions. This identity clearly indicates that the acquisition of gold through unofficial channels would have an impact on current account deficit. This would clearly have an impact on net capital inflows, as can be shown below :

$$K = CAD \pm R$$

where K represents *net* capital inflows, and  $\pm R$ , change in foreign exchange reserves. Net capital inflows could arise on both official and private counts, and could lead to accretion/drawdown of reserves, directly and indirectly—indirectly because the foreign exchange used for importing gold through unofficial channels is a measure of loss of foreign exchange or of amount foregone<sup>1</sup> – after accounting for current account deficit. The important point to note here is that the external indebtedness of the country is attributable to the gold acquisition process as well.

This process has to be explicitly taken into account while devising corrective mechanisms. These mechanisms should have near-term as well as longer-term perspectives. The short-term objective is to mobilise gold already in the possession of the household sector and to use gold as a real good for releasing external constraints. The intrinsic value of gold as an instrument of releasing external constraints had never been recognised in any of the schemes devised in the past. The earlier schemes merely used gold for correcting fiscal imbalances.

The longer-term objective would be to narrow down the price differential between international and domestic markets, thus eliminating the incentive for unofficial imports and to influence the asset preference profile of households in favour of productive use of capital.

The Finance Minister has, while presenting the 1992-93 budget, announced that gold could be imported by non-resident Indians (NRIs) and Indians returning from abroad after a stay of six months, upto 5 kgs. per person on payment of a 15 per cent (modified subsequently to 10 per cent) *ad valorem* customs duty in foreign exchange. He has also announced that a gold bond would be introduced to mobilise gold from residents, and added that a scheme would be worked out by the Reserve Bank of India (RBI) and introduced shortly.

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1. For quantification of the foreign exchange loss on account of gold smuggling, see Annexure II.

These ideas are far too brief to capture the wide gamut of issues that surround the question of use of gold for adjustment and growth. This study is intended to devise a set of instruments along with institutions, keeping in view the characteristics of the phenomenon as specified above.

The study is arranged as follows : Sections II and III cover respectively the demand for gold and sources of supply of gold and the factors influencing them. Section IV presents certain aspects relating to gold mobilisation. Section V brings out the economics of the use of gold as a real good for external adjustment together with the analytical considerations underlying the different options for gold use. Section VI provides a framework for institutional mechanism. Section VII draws the major conclusions of the study.

## **SECTION II**

### **Demand for Gold and Factors Influencing It**

The effective social demand for gold has broadly three components: first is the demand for gold as a final good; second as an intermediate good, i.e., for industrial uses; and third as a liquid asset since it provides an implicit return in terms of value appreciation, and it can be stored with ease and convenience without any depreciation. Most of the demand arises on account of the first and third components since there has been very little demand for industrial uses. A significant part of demand as a store of value is attributable to black income generation since gold in small quantities can conceal large wealth.

The demands for gold as a final good and as a store of value are inextricably linked and thus cannot be easily distinguished from one another. A complex interaction of different possible motives for gold preference<sup>1</sup> has indeed led to the excess demand for gold.

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1. These motives are common for both rural and urban households.

Of the possible motives, first is the desire to derive personal satisfaction or utility from wearing jewellery. Secondly, there is the need to comply with the demands of social or religious functions. Moreover, the size of gold holdings often determine social prestige and economic standing, especially in smaller-village-communities, and as such the wealth motive holds a significant influence on the demand for gold. Third is the advantage of holding large wealth in smaller quantities. This motive is further accentuated by gold's easy exchangeability or liquidity. Finally, gold as a store of value is preferred since its value usually does not erode but appreciates over time. This property of gold provides a hedge against inflation.

Of all the motives, the liquidity, storability, wealth and rate of return considerations are predominant. Traditionally, money-lenders and indigenous bankers have been active in providing loans against gold. A number of modern commercial banks too, especially in southern parts of India, have, till recently, provided significant amounts as loans against gold. But, as commercial banks gradually reduced their loans against gold in order to make more productive use of their loanable funds, the liquidity aspect has now been pushed outside the purview of the organised system of financial transactions.

The rate of return calculated on the basis of the gold price appreciation is essentially an implicit concept. If one adds to it the premium attributable to liquidity and wealth aspects for gold holdings, the total implicit rate of return on gold would be sizeable. It had been comparable to the rate of return on bank deposits, in view of the administered interest rate structure. It may be added, however, that despite the higher equity returns in the 'eighties, household preference for gold has not decelerated.

The difficulty in decomposing different components of demand emanating out of different motives, necessitates considering the demand for gold in aggregate terms. At the aggregate level the higher demand was responded to by a rising supply. Since

domestic production is very limited, around two tonnes per annum, which figure remained almost constant over the last decade, the rising demand was accompanied by soaring illegal imports. Thus, the rising quantity of smuggled gold together with large differentials between the domestic and international prices would clearly indicate the excess demand for gold.

### **Factors influencing demand for gold**

From the policy point of view, it would be necessary to identify major factors influencing demand. First of all, the movement of gold prices can be expected to be an important determining variable.

Secondly, it is possible to argue that the increase in irrigation, and technological change in agriculture through mechanisation and high-yielding varieties, in particular of crops like rice, wheat, cotton, sugarcane and groundnut have generated larger marketable surplus and thus the rural surplus and a highly skewed rural income distribution. This, in turn, is one of the leading factors contributing to additional demand for gold. To represent this factor we use as proxy the fertilizer consumption.

Thirdly, much of black income/wealth generation contributing to choice of gold as a store of value, looks like originating in the services sector,<sup>2</sup> like real estate and public sector, rather than in the commodity-producing sectors. Hence, income from the services sector can be treated as a determining variable.

Fourthly, since the asset demand of gold is likely to be influenced by the rate of return of alternative financial assets like bank deposits, units of Unit Trust, small savings, etc., a weighted return on alternative assets could be considered as another influencing factor.

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2. See for details, the study on 'Aspects of Black Economy in India', by the National Institute of Public Finance and Policy (NIPFP), (1985).

Fifthly, demand for gold as a final good also depends upon prices of other commodities. An increase in general price level has two effects: first, it reduces the purchasing power available for acquisition of jewellery and secondly, it reduces the real return on gold. Both ways, it will have a depressing effect on this component of demand. On the other hand, inflation redistributes income in favour of non-wage income earners. This, in turn, makes the income distribution more skewed. With incremental income of non-wage earners, the demand for gold as a store of value can be expected to rise. Despite the opposite effects, on the whole, the latter effect seems to be stronger than the former since the excess demand for gold persists as reflected in the rising differential between domestic and international prices.

The above hypotheses regarding the factors influencing demand for gold were tested by estimating regression equations in a double-log form for the period 1980-81 to 1990-91. The results are presented in Table-9. Among the variables, the 'rate of return on representative financial assets' did not yield the expected sign nor is it significant. This could perhaps be due to the fact of the prevalence of administered interest rate regime, which is reflected in near-constancy in return during the sample period. Hence this variable was dropped.

Secondly, the own-price elasticity turned out to be positive and significant, contrary to the theoretical expectation. The gold demand and the gold price at Bombay were found to be highly and positively correlated. This is, however, plausible on the ground of price expectations. We have not used a lagged variable because of the limited number of observations. If we drop the own- price variable, the demand was found to be elastic to both service sector income and fertilizer consumption indicating that both rural surplus (represented by the proxy of fertiliser consumption) and service sector income (representing black-income generation) have contributed to acquisition of gold. The gold demand, however, was found to be negatively elastic to 'increase in wholesale price index' as expected.

The empirical evidence clearly indicates the need to pursue policies that reduce the demand for gold emanating from the services and surplus rural sectors. It underscores the need for creating appropriate infrastructure and avenues for deploying rural surplus. Also necessary steps have to be taken to improve rural income distribution through measures such as land reforms and effective agricultural taxation, and to plug the loopholes causing black-income generation.

## SECTION III

### Sources of Supply

#### **Stock of gold**

The main economic effects that arise from changes in the supply of gold should be seen against the base quantum of gold that is already in existence in the economy. Table 1 which gives details of stocks in India for some cumulative periods of time from 1831, shows that the stock of gold in India at end-1940, was placed at 2,300 tonnes. During the 'forties net imports of gold amounted to 311 tonnes. It is at the end of the 'forties that imports of gold were banned.<sup>1</sup> As a result, imports through unofficial channels began to flourish. Unauthorised imports of 653 tonnes between 1950 and 1957 had bolstered the stocks to an estimated 3,264 tonnes at the end of 1957.

Illegal imports continued to take place at growing rates in most years thereafter. On an average, it worked out at 107.4 tonnes per annum during 1981 to 1991. As a result, the stock of gold accumulated and stood at as much as 7,214 tonnes at the end of 1991. If the gold stocks of around 351 tonnes with the Reserve Bank of India is also included, the total gold stocks in the country would amount to around 7,565 tonnes at the end of 1991.

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<sup>1</sup> For a historical account of official policies relating to gold, see Annexure I.

## Sources of Supply

The supply of gold in India arises mainly from domestic production and illegal imports or smuggled gold. Scrap gold, which is not an additional supply, nevertheless augments market availability.

The main producers of gold, Bharat Gold Mines Ltd. (BGML), Hutt Gold Mines Ltd. (HGML) and Hindustan Copper Ltd. (HCL) together produce, as Table 2 shows, about two tonnes annually. This has been the case for the last two decades. There are no known gold reserves in the country worth mentioning.

Recycling of scrap gold arises from melting down of the old jewellery. Such molten metal is often brought back to title (correct caratage) by adding to it small amounts of new gold so that it could be fabricated again. Table 3 gives estimates of scrap gold which hover around 50-60 tonnes a year.

As gold imports, except for specified uses, were banned, until the announcement in the 1992-93 budget, all the gold that entered India from outside the country should be regarded as smuggled gold. The gold which was allowed through official channels was limited to specific purposes (for exports). State Bank of India (SBI) and Handloom and Handicraft Export Council (HHEC) were the main agencies which imported gold toward jewellery-making for export purposes.<sup>2</sup> Table 4 gives details in this regard. In the last five years, such imports ranged between 3.2 tonnes in 1987-88 and 8.3 tonnes in 1989-90. Such imports, however, would have no impact on the domestic availability of gold.

Smuggled gold has been of fairly sizeable amount and was around

2. It may be mentioned in this context that a part of the gold which was seized and eventually confiscated was sold to RBI till September 1990. Between October 1990 and April 1992 confiscated gold was sold to SBI for sale to jewellery exporters. Confiscated gold aggregated 69 tonnes over the period 1968-69 to 1990-91.

170 tonnes<sup>3</sup> per annum in recent years, as may be seen from Table 5. From the table it may also be seen that in the 'eighties it increased substantially compared to that in the 'seventies.<sup>4</sup> The amount of foreign exchange involved in the import of gold through unofficial channels varied from \$ 2.2 billion to \$ 1.75 billion in the years between 1989 and 1991. A detailed estimate of foreign exchange loss on account of smuggled gold is given in Annexure II.

Smuggling of gold is widely recognised as a lucrative source of income because gold commands a high premium in the domestic market compared to its price abroad. Table 6 which reports prices prevalent in Bombay and London markets in the 'eighties shows that the differential in prices in the two markets was around 50 to 70 percent in recent years, with Bombay price being higher than the London price. The table also shows that over time the annual average differential had been fluctuating in the range of about 33 per cent in 1981, and 67 per cent in 1985. (See graph in p.11). The existence as well as the tendency for the domestic and international price differentials to remain very high at well above 40 per cent is an important evidence of excess demand for gold in India.

### **Pattern of gold use**

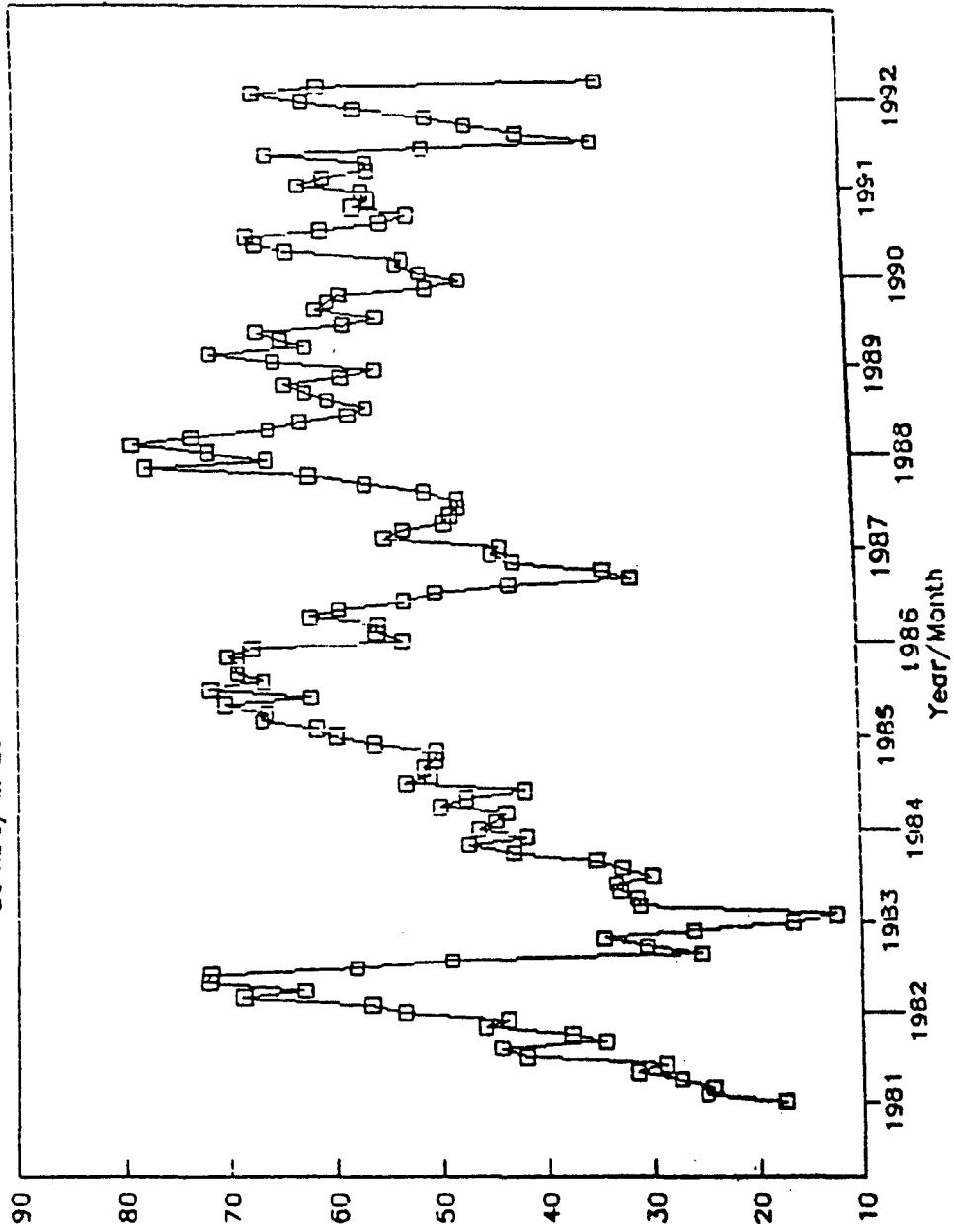
The domestic absorption of gold is largely by households, although there are also such uses as export of jewellery and industrial input. The household sector absorption again could be categorised into two : one in the form of jewellery and the other in non-jewellery form. According to authoritative sources, fabrication of jewellery for domestic consumption has been the major form of use of gold in India. Table 7 gives figures about fabrication of gold including scrap use for the period 1986-1990 in India and in some other countries. Considering the fact that India's *per capita* income

3. Some other estimates place this figure at a still higher level. For instance, the World Gold Council Middle East Directorate put it at 240 tonnes in 1990 (*Economic Times*, July 5, 1990).

4. The smuggled gold in the form of jewellery is reported to have accounted for 20 tonnes in the year 1991.

Monthly Percentage Spread in Gold Price

Bombay & London Markets : 1981-1992



Percentage Spread

is very low, the amount of gold that is under fabrication has been phenomenally large. Gold fabrication in USA and Japan too had been significantly high, but lower than that of India in the last year for which statistics are available.

The industrial use of gold has shown some spurt in the last two years. The main users of gold are the electronics sector, dentistry, coating of spectacle frames, pen barrels, wrist watches and medicines (Table 8).

Non-jewellery holdings of gold by households are said to be mostly in the form of bars. With the repeal of the Gold Control Act, 1968, in 1990 there has been, it is reported, a sharp increase in the purchase of gold bars. Although holdings of imported bars are illegal, domestically produced bars, coins and medals could be purchased and many new refineries in major cities have begun to produce these items. This is indicative of the fact that gold is preferred largely for its 'store of value' function rather than for jewellery making.

### **Factors influencing supply**

As discussed, the high differentials between domestic and international prices of gold act as an inducement for smuggling gold with the objective of earning large income in rupee terms. Therefore, this could be treated as an important variable influencing the flow of smuggled gold.

Large smuggling of gold is operationally feasible only if the foreign exchange can be obtained outside the legal foreign exchange market. Hawala market provides this channel. The hawala premium can therefore be reasonably expected to reflect the demand for foreign exchange for smuggling gold, it being the major commodity for illegal imports.

Transaction of foreign exchange in the hawala market can be expected to depend on the availability of foreign exchange provided by non-resident Indians outside the legal supply of foreign exchange as in the case of FCNR deposits, remittances, etc.

To the extent hawala premiums attract these foreign currencies, their inflow into the country through legal channels will decline.

It is generally recognised that overinvoicing of imports and under-invoicing of exports have given rise to large capital flight. At least a part of this leakage provides a source of supply of foreign exchange in hawala market. Therefore, the magnitude of annual capital flight is likely to influence the supply of fund for smuggling gold. In the absence of any estimate of this variable, the volume of external trade as percentage of GDP can be considered a proxy variable. Current account deficit (CAD) as percentage of GDP may also serve the same purpose.

For these considerations, the relationship between the smuggled gold on one hand, and domestic and international price differentials or hawala premium, foreign exchange inflows through NRI deposits and remittances, CAD or volume of trade as percentage of GDP on the other, have been examined estimating regression equations in double-log form for the period 1980-81 to 1990-91. The estimated equations are presented in Table 10.

Among the variables, 'volume of trade' did not yield statistically significant result and was therefore dropped. All the other variables yielded positive and significant coefficients. The only caveat here is that contrary to expectation, the 'foreign exchange inflow through FCNR deposits and private transfers' showed a positive sign and was significant. We may therefore surmise that foreign exchange inflow through official channels and through the hawala market probably complement each other and do not substitute each other.

A clear message emerging from this analysis is that supply of gold follows the demand for gold, indicating thereby the need for reducing the demand for gold as well as for converting gold itself into a financial asset. However, this cannot be achieved in the near term, since it involves a change in the asset preference of the households and more importantly minimisation of the black-income generation in the economy. In a situation as it is, the excess demand for gold has to be explicitly recognised while at the same

time appropriate measures affecting both the factors mentioned above should be taken. The explicit recognition of excess demand underscores the necessity of evolving a more transparent policy in regard to supply of gold. As will be argued later, if an effective mechanism is devised for mobilising gold from the household sector and putting them to economic use, it would facilitate a policy of this type.

## SECTION IV

### Gold Mobilisation

In recent months, a number of strategies for mobilisation of gold within the country have been mooted by a number of writers.<sup>1</sup> The Budget for 1992-93 contained, as indicated earlier, two elements, viz., allowing NRIs and Indians returning from abroad after a minimum period of stay of six months to bring gold subject to certain conditions, and proposing the introduction of a gold bond scheme.

Any strategy for gold mobilisation should sharply distinguish the fact of mobilization of the *existing stocks* of gold *in the short run* from the *flows* of gold either through NRIs or others into the country which, *by definition*, would become a part of gold accretion in future. It is the former aspect that is particularly pertinent to *mobilisation* strategy. The latter aspect, which becomes a part of the former ex-post has critical role to play in the overall policy towards gold. For one thing, to the extent gold smuggling, estimated at 170 tonnes a year worth US \$ 2 billion, is substituted by transparent and legal inflows of gold, hawala transactions can be eliminated, and foreign exchange resources involved in gold smuggling diverted to official channels such as officially recognised gold imports and foreign exchange remittances into the country. For the other, it should be possible to

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1. An important contribution in this regard is by Atul Sarma. See "Why Not A Gold Bank As Alternative To IMF Loan?", *Hindustan Times*, New Delhi, August 7, 1991.

mobilise the gold thus imported as a continual add-on to the gold mobilized from the existing stock; to that extent, it would continually enhance the stock of gold which can be used for external adjustment. Indeed if the gold that is imported legally gets effectively mobilised by appropriately designed gold mobilisation schemes, the present scheme of gold import can be further relaxed.<sup>2</sup> The point is that a large enough import of gold to have the effect of narrowing price differentials can be conceived only in a situation where gold imported could be mobilised for external adjustment.

A strategy for gold mobilization should be closely knit with the ways adopted of utilizing the mobilised gold. This indeed would be the logical outcome of pursuing the framework enunciated at the very outset of this study. The main point to recognise here is that the gold mobilised should be used for releasing external constraints and not for correcting fiscal imbalances as was done in the past. As will be argued in the following section, the use of gold for external adjustment has been interpreted in terms of providing flexibility in optimal management of official foreign currency reserves. This means that the holding of reserves in the form of foreign currency assets should be minimised with the increasing accretion of gold reserve. Such a specific use of gold clearly rules out the possibility of commercialising gold in the international market as argued by some.

One of the important schemes to mobilise a part of the existing gold stock is to offer a gold bond against the surrender of gold in physical terms, by households. Temples and a number of trusts are also known to have large stocks of gold. Rural households in particular are known to invest considerable amount of savings in gold. Mobilisation of gold from these sources without offending the socio-religious sentiments would be a major challenge of any strategy.

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2. Whether the desired effects are realised will crucially depend upon the effectiveness in curbing smuggling.

The credibility of gold bond scheme, as indeed of any other mobilisation scheme, would depend on a number of factors - the trust and credibility of the institution that would handle gold, the safety of the gold that is parted with against the issue of bond, the liquidity and negotiability of the bond issued against the receipt of gold, the *effective* rate of return that could act as an inducement to part with gold for *temporary* periods for gold bond, and a general amnesty, even if it is for a *short period of 3-6 months* from the date of introduction of the scheme, guaranteeing that no examination would be made of the manner in which gold was acquired. Since gold will be returned after maturity, rate of return offered is in real terms.

As noted earlier, gold is held by different categories of households for a variety of motives. This makes it extremely difficult to design one particular scheme to mobilise gold from households effectively. Keeping this in view, we refrain from suggesting any comprehensive scheme. However, purely for purposes of illustration, Annexure III broadly indicates certain possible schemes. Any scheme after its introduction will need continual review and changes incorporating the insight and understanding of household behaviour towards gold and other economic realities.

The strategy of mobilisation clearly touches upon the critical role of the policy of gold towards adjustment. To facilitate its effective deployment, a Gold Management Corporation (GMC) guided by a Gold Policy Board (GPB) for consideration of both mobilisation of the existing stock and the uses to which gold is put to may have to be set up. Details of the institutional apparatus are given in Section VI. For the present, what is important to note is that the GPB is a policy-making body attached to the GMC which implements and executes the policies laid down by the GPB. Thus, it is the GPB which works out the scheme that takes into account the concerns of those who part with gold for *temporary* periods.

## SECTION V

### The Economics of Use of Gold

The success of any strategy for mobilisation of gold rests essentially on the credibility that is brought to bear on the manner in which gold is used. It is for this reason that the economics of use of gold assumes a critical role in the overall gold policy of the country.

The apparent questions in the economics of use of mobilised gold are : what should be the rate of return that would induce households to part with their gold and the one which can be considered operationally and/or economically feasible and who should bear such costs?

Pure commercial considerations would suggest that the institutional mechanism for mobilising and using the mobilised gold - the Gold Management Corporation (GMC) about which details are given subsequently - should make profits or at least break even within a short- to medium-term period. Such commercial considerations would suggest that if the GMC should give a rate of return - an incentive rate at that, in order to induce households to part their gold temporarily with GMC - the use of gold itself should fetch a yield that is higher than the incentive rate for mobilisation. Alternatively, the GMC should give to households that rate of return which is *feasible*, depending on the income it gains from its different uses, in which event the rate of return that households get need not necessarily be an 'incentive rate'.

Purely for illustrative purposes, Annexure IV indicates the possible options for gold use as also the feasible rates of return. As the annexure shows, each of the options of lease, repurchase and collateral gives rates of return which would not be more than 2.5 per cent per annum.

But economic logic that follows from our analytical framework as

well as from the fundamental objective of gold policy, viz., to make use of gold solely for releasing external constraints, would suggest that in the present Indian context, commercial considerations have no relevance and should give way to what may be called economic approach. The GPB which guides GMC - details of which are given later - would be the deciding authority of the avenues of use of the mobilised gold. However, to ensure that the GPB does not deviate from the parameters that follow from our analytical framework, it should be made abundantly clear that gold mobilisation would be done for two purposes: first, to facilitate the financing of export-linked imports. This would be in the nature of self-financing, in the sense that the exporters will be provided advances to release their foreign exchange constraint with the stipulation that it should be repaid with interest at commercial rates in foreign exchange. Secondly, to build up gold reserves, with a view to shoring up confidence of the external financiers, improving credit-worthiness, providing an environment of uninhibited capital inflows and more importantly facilitating optimal management of foreign currency reserves, i.e., minimising currency balances in the investment portfolio. The last is extremely important because foreign currency holding is always costly in terms of interest payment liabilities or opportunities foregone.

Such inflows would be much less costly than the incentive rate of return presently being paid in foreign currency terms on FCNR deposits.<sup>1</sup> In addition, to the extent such inflows facilitate RBI minimising foreign currency holding, interest payment liability of RBI in foreign exchange goes down explicitly or implicitly. Moreover, they also provide RBI with some degree of flexibility in the management of their own gold reserve. The foreign currency inflows would clearly reflect the confidence of external financing units since their funds are matched by the accretion in gold reserves.

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1. At present, the rate of interest on FCNR three year US \$ deposits is 8.2 per cent per annum in dollar terms. In the last two years the rate varied in the range of 7.5 per cent to 10 per cent per annum.

As gold would not go out of the GMC/RBI account, the confidence of the economic units - be they households, temples or trusts - that the gold parked by them temporarily with the GMC is secure, will be maintained.

A precautionary step may have to be taken to boost the confidence of resident units in the gold policy. The RBI, as agent of the GMC, may show separately, the gold reserves accumulated through the means of mobilisation in their books of account, even though such gold reserves could be deemed to be part of total foreign assets (foreign currencies plus gold) of the Reserve Bank for purposes of foreign exchange balance. Yet another factor to boost confidence of resident units could be an announcement by GMC and its agent RBI to the effect that the mobilised gold will not be sold either in the international or the domestic markets to make commercial gains or even to utilise the sale proceeds for balance of payment purposes.

The use of gold for external adjustment through professional reserve management is of particular importance while addressing the question of convertibility of the Indian rupee. When convertibility is only "partial", as at present, increase in gold stocks for building up confidence and enabling foreign exchange inflows would send signals to the markets that the authorities could eventually move toward "full" convertibility. The foreign exchange reserves built on the basis of the mounting stocks of mobilised gold would also enable the authorities to use reserves for intervention purposes whenever the exchange rates are out of alignment. Once full convertibility is established, it is not as if gold's role is relegated to background. In fact, its role becomes much more critical, especially in the initial phases of full convertibility when there would be a need for large foreign exchange reserve back-up to undertake not merely external adjustment but also a more comprehensive structural adjustment. Gold accretion would give the necessary confidence as well as the *real* economic strength in support of full convertibility.

Apart from providing finances for export-linked imports, the GMC would help finance the general import needs through its agent, viz., the RBI. To the extent that such imports increase domestic production, there would be rise in growth and employment. A part of the increase in production could well be a 'surplus' that could be exported. The 'economic' return underlying such a transmission channel triggered by the increased availability of foreign exchange for supporting necessary imports cannot be measured in quantitative terms - at least in the short-run. The GPB, while fixing the incentive rate of return for mobilising gold, would have to clearly follow the economic logic of the use of gold, rather than go by pure commercial considerations.

## SECTION VI

### Institutional Mechanism

As noted earlier, the gold mobilisation and its economic use are characterised by a high degree of complexity. Effective mobilisation of gold from the households requires a clear understanding of household behaviour with regard to gold which shifts with their perception of changing economic realities. Similarly, the manner in which gold is to be used for releasing external constraints will have to be adjusted depending as much on changes in global situation as on changes in domestic economic performance.

The policies relating to all aspects of gold, in particular those concerning mobilisation of gold, importation of gold and the use of gold, as well as the implementation of the conceived policies would warrant continual review, and therefore, be most effectively addressed by establishing a distinct institutional mechanism for the purpose. The mechanism would promote the use of gold for external adjustment. For creating the requisite confidence and for credibility, the institutional structure shall be the Gold Management Corporation (GMC), which would be guided by the policies laid down by a 'Gold Policy Board' (GPB). GMC would

be an autonomous institution, fully guaranteed by the Reserve Bank of India (RBI).

### **Gold Policy Board**

The GPB will be responsible for evolving and for laying down policy guidelines and strategies for implementation of schemes, in particular regarding both mobilisation of gold and use of gold solely for releasing external constraints. The GPB would not merely be playing an advisory role; it will be a policy-making body. Governor, RBI shall constitute the Board, and shall appoint the Chairman of the Board. The Board shall consist of six members, one each drawn from Reserve Bank of India, other share-holding financial institutions, Government of India (Ministry of Commerce), and academic/research institutions, and an eminent woman social worker; and the Head of GMC shall be the ex-officio Member-Secretary of the Board. The Board shall have a life of five years. The Board shall meet at least once a month. The Board shall give policy directives to GMC which in its turn shall give account of its activities and future plans.

### **Gold Management Corporation (GMC)**

The GMC shall serve as the central pool for management of gold resources. The GMC, being an autonomous body corporate guaranteed by the RBI, shall have initial paid-up capital to the extent of 49 per cent provided by the RBI. The remaining capital shall be contributed by the Exim Bank, ICICI, and Indian public sector banks.

The management of the Corporation shall rest with professionals appointed by the RBI. The GMC will execute all policies laid down by the GPB. The GMC would work out operational details of the policies and put them into effect. The Head of GMC would be the ex-officio Member-Secretary of the GPB.

**The GMC shall have the following objectives :**

- (i) to execute appropriate schemes for mobilising gold for different target groups;
- (ii) to facilitate the use of gold for releasing external constraints for export-oriented industries as also for increasing the country's reserves, thereby improving credit-worthiness;
- (iii) to review matters relating to import of gold and to take corrective measures whenever needed; and
- (iv) to design and disseminate educational and promotional measures to influence asset preferences of economic units.

### **GMC-RBI relationship**

The GMC shall maintain gold accounts with RBI and RBI shall be the agent of GMC for storing, investment and redeeming of gold. The actual handling of gold – collection, transport, refining, etc., may be left to authorised agencies, public sector banks and the India Government Mint. The agencies may be allowed to open 'depots' at convenient locations for the purpose.

RBI shall keep a separate gold reserve account on behalf of the GMC. This reserve account shall be kept separate from the official reserve holdings and the income arising out of operations of this gold reserve account shall accrue to the GMC. The RBI shall not levy any agency charges on GMC since the gains arising out of the expanded gold reserve for the country as a whole, being maintained at the RBI, are very substantial and should be considered as economic returns on the entire operation and therefore, any shortfall in meeting the liabilities on account of gold mobilisation by GMC has to be borne by the RBI.

RBI has been kept as the focal point for management of gold reserves of GMC keeping in view its experience in reserve

management as also the required confidence to be built up in the minds of the public about the safety of the gold as also saving in transaction costs of handling gold. It is for this reason that the GMC should never have the option of selling gold in the external market or enter into any kind of swap arrangements. Gold stock will essentially be used to improve the overall credit-worthiness and to raise resources at lower costs. The gold reserve account of GMC is to be kept distinct and separate from the official reserve holdings for the reason that the use of GMC's reserves shall be guided purely by external adjustment and other priorities set by the Gold Policy Board.

## SECTION VII

### Concluding Observations

The approach to gold mobilisation and its use as discussed in the preceding sections consist of :

- (i) Gold is a real good that has an access to international market. Thrice in the past, gold mobilisation schemes were introduced, but, none of them explicitly considered this property of gold. They were merely used to ease the fiscal imbalance. In contrast, gold mobilisation considered here and the mechanism proposed is entirely based on the need for exploiting this property of gold.
- (ii) The country has come to possess, even if through illegal channels, an enormous amount of gold running into billions of dollars in value – roughly, \$ 87 billion. The country has chronically faced external imbalances. It is high time that this enormous stock of gold is imaginatively used for releasing external constraints.
- (iii) Several motives inherent in the Indian psyche and the social system combined with ineffective tax-administra-

tion have led to the excess demand for gold and consequent high price differentials between domestic and international markets. This objective condition together with inept gold policies in the past have led to a large scale import of gold through unofficial channels. The result has been the loss or diversion of foreign exchange that could have been legitimately expected by the country.

- (iv) While the long-term objective of gold policy is to eliminate the incentive for gold smuggling acting on both demand and supply sides, the short-term objective is to mobilise gold from households by offering appropriate incentives and to use the mobilised gold for external adjustment.
- (v) Keeping this objective in view, the requirements of effective gold mobilisation have been highlighted. Considering the complex interactions of both demand and supply forces, an institutional mechanism called 'Gold Management Corporation' has been suggested. The GMC guided by the 'Gold Policy Board' should be developed into a mechanism that can evolve and continuously evaluate the required schemes for gold mobilisation as also its utilisation for releasing external constraints.
- (vi) In view of the crucial importance of the credibility of an institution of this type as also for considerations of economic efficiency a close and mutually supportive relationship between the GMC and RBI has been visualised and suggested.
- (vii) The direction in which the management of the mobilised gold can contribute to easing external imbalances has been indicated. This essentially constitutes an optimal management of investment portfolio of RBI that will lead to moving from more expensive to less expensive asset holdings. The basic thrust of the use of mobilised gold has been on the build-up of gold reserve through gold

mobilisation which should provide the basis for maintaining and raising credit-worthiness in the external markets. The possibility of commercialisation of gold has been totally disregarded in this approach.

- (viii) The feasibility of providing incentive rate of return to induce the households to park their gold with the GMC has been shown both in terms of financial and economic considerations.

The policy towards gold import should essentially be based on the effectiveness of gold mobilisation and utilisation. If the response to gold mobilisation scheme ensures the funneling of imported gold into the gold reserve, thus providing flexibility in RBI reserve management, a considerably liberal import policy can be thought of. In the long-run, however, the strategy should be to induce the households to treat gold on par with any other financial asset.

**Table 1 : Stock of Gold in India**  
**(Quantity in tonnes)**

1831-1931 Net Imports	3700 <sup>1</sup>
1931-1940 Net Exports	1400
Stock at end of 1940	2300
1941-1950 Net Imports	311
1950-1957 Unauthorised Imports	653
Total Stock at the end of 1957 <sup>2</sup>	3264
1958-1963 Net Illegal Imports	520
1964-1967 Net Illegal Imports	720
1968-1973 Net Illegal Imports	750
1974-1978 Net Illegal Imports	210
1979 Net Illegal Imports	11
1980 Net Illegal Imports	09
1981-1990 Net Illegal Imports	1550
Total Stock at the end of 1990	7034
1991 Provisional Imports (Illegal)	180
 Total Gold held with People in India	 7214
 Stock with Reserve Bank of India	 351
 Grand Total	 7565

1. Official Trade Statistics

2. This comes to 105 million ozs.-See RBI Bulletin, April, 1958.

Source : Bombay Bullion Association.

**Table 2 : Indigeneous Production of Gold from 1901 to 1987  
(Units in kgs.)**

Year	BGML	HGML	HCL	TOTAL#
1901-1910	1,70,000			1,70,000
1911-1920	1,25,480			1,25,480
1921-30	1,16,980			1,16,980
1931-40	1,16,980			1,16,980
1947	5,342			5,342
1960-61	4,349			4,349
1970-71	2,178			2,178
1975-76	1,748			1,748
1980-81	1,563	783	61	2,407
1981-82	1,421	781	75	2,277
1982-83	1,370	754	117	2,241
1983-84	1,186	821	71	2,078
1984-85	1,106	865	80	2,051
1985-86	916	837	122	1,875
1986-87	792	916	102	1,810
1987-88	896	1000	NA	1,896
1988-89	1032	1154	NA	2,186
1989-90	868	968	NA	1,836
1990-91	871	1061	NA	1,932

# Data from 1987-88 onwards do not include production of HCL.

N.A. : Not available.

**Table 3 : Supply from Fabricated Old Gold Scrap  
(in tonnes)**

Year	Scrap Gold
1981	35.0
1982	47.5
1983	50.8
1984	50.0
1985	50.0
1986	57.5
1987	60.0
1988	52.0
1989	49.0
1990	60.0

Source : Gold Fields Mineral Services Ltd., 'Gold 1991'.

**Table 4 : Gold Imported by SBI and HHEC  
(Quantity in kg.)**

Year	SBI	HHEC	Total
1981-82	—	1932	1932
1982-83	—	3022	3022
1983-84	—	4180	4180
1984-85	416	4073	4489
1985-86	1112	4286	5398
1986-87	1235	2813	4048
1987-88	1615	1595	3210
1988-89	4585	1709	6294
1989-90	6459	1851	8310
1990-91	5501	973	6474

Source : India Government Mint, Bombay.

**Table 5 : Gold Smuggling into India**  
**(Quantity in tonnes)**

<b>Year</b>	<b>Quantity</b>
1968	140.1
1969	108.3
1970	217.0
1971	179.0
1972	107.3
1973	63.6
1974	15.7
1975	26.2
1976	33.8
1977	39.5
1978	44.0
1979	10.0
1980	-9.0
1981	25.4
1982	60.0
1983	53.0
1984	94.5
1985	123.4
1986	88.4
1987	99.2
1988	135.0
1989	172.5
1990	170.0
1991	150.0

Source : Consolidated Gold Fields Ltd. and Gold Fields Mineral Services Ltd.

**Table 6 : Annual Average of Price of Gold in Bombay & London Markets and its Spread – 1980 to 1992**

Month/Year	Bombay		London		Spread between Bombay and London Markets	
	Rs. per 10 gms.	\$ per troy oz.	\$ per 10 gms.	Equivalent Rs. per 10 gms.	Absolute	Percent- age
<b>1980</b>						
January	1418.60	667.64	214.65	1707.86	-289.26	-16.9
February	1362.26	665.89	214.09	1701.37	-339.11	-19.9
March	1348.48	558.29	179.49	1463.82	-115.34	-7.9
April	1379.33	516.71	166.13	1336.24	43.09	3.2
May	1345.08	514.27	165.34	1303.20	41.88	3.2
June	1333.35	600.79	193.16	1516.91	-183.56	-12.1
July	1395.23	645.75	207.61	1613.15	-217.92	-13.5
August	1442.04	626.36	201.38	1566.27	-124.23	-7.9
September	1509.36	673.94	216.68	1678.70	-169.34	-10.1
October	1564.28	662.27	212.92	1643.39	-79.11	-4.8
November	1629.00	623.88	200.58	1563.01	65.99	4.2
December	1693.35	596.72	191.85	1519.09	174.26	11.5
	1451.70	612.71		1551.08	-99.39	-6.4
<b>1981</b>						
January	1680.88	557.81	179.34	1430.72	250.16	17.5
February	1655.46	500.80	161.01	1325.14	330.32	24.9
March	1641.91	499.69	160.65	1320.27	321.64	24.4
April	1685.65	496.63	159.67	1323.19	362.46	27.4
May	1715.13	480.32	154.43	1303.52	411.61	31.6
June	1649.92	460.50	148.05	1280.45	369.47	28.9
July	1666.64	409.28	131.59	1173.49	493.15	42.0
August	1721.83	410.24	131.90	1191.99	529.84	44.5
September	1752.04	443.77	142.68	1302.32	449.72	34.5
October	1773.87	437.68	140.72	1287.78	486.09	37.7
November	1773.58	413.40	132.91	1214.61	558.97	46.0
December	1737.08	410.12	131.86	1207.92	529.16	43.8
	1704.50	460.02		1280.12	424.38	33.2

Month/Year	Bombay		London		Spread between Bombay and London Markets	
	Rs. per 10 gms.	\$ per troy oz.	\$ per 10 gms.	Equivalent Rs. per 10 gms.	Absolute	Percent- age
<b>1982</b>						
January	1740.70	384.53	123.63	1133.27	607.43	53.6
February	1743.09	374.46	120.39	1111.80	631.29	56.8
March	1670.52	330.41	106.23	988.89	681.63	68.9
April	1723.86	350.34	112.64	1056.98	666.88	63.1
May	1724.17	334.50	107.54	1001.76	722.41	72.1
June	1650.80	314.96	101.26	959.67	691.13	72.0
July	1643.08	337.90	108.64	1038.29	604.79	58.2
August	1669.72	363.41	116.84	1119.64	550.08	49.1
September	1702.40	437.36	140.61	1358.14	344.26	25.3
October	1721.46	422.79	135.93	1318.39	403.07	30.6
November	1758.13	415.11	133.46	1305.90	452.23	34.6
December	1753.38	444.78	143.00	1391.31	362.07	26.0
	1708.44	375.88		1148.67	559.77	48.7
<b>1983</b>						
January	1778.26	481.84	154.92	1525.41	252.85	16.6
February	1770.30	493.44	158.64	1575.64	194.66	12.4
March	1774.96	420.71	135.26	1353.43	421.53	31.1
April	1831.36	433.17	139.27	1393.36	438.00	31.4
May	1875.60	437.39	140.62	1409.76	465.84	33.0
June	1791.54	413.15	132.83	1342.89	448.65	33.4
July	1788.00	422.65	135.89	1375.74	412.26	30.0
August	1812.29	416.22	133.82	1365.37	446.92	32.7
September	1832.50	412.25	132.54	1354.60	477.90	35.3
October	1860.92	394.39	126.80	1300.32	560.60	43.1
November	1876.60	380.98	122.49	1272.65	603.95	47.5
December	1860.96	388.06	124.76	1311.74	549.22	41.9
	1821.11	424.52		1381.74	439.37	31.8

Month/Year	Bombay		London		Spread between Bombay and London Markets	
	Rs. per 10 gms.	\$ per troy oz.	\$ per 10 gms.	Equivalent Rs. per 10 gms.	Absolute	Percent- age
<b>1984</b>						
January	1879.57	370.75	119.20	1282.31	597.26	46.6
February	1929.20	386.04	124.11	1331.76	597.44	44.9
March	1963.07	394.74	126.91	1364.19	598.88	43.9
April	1995.90	381.37	122.61	1329.42	666.48	50.1
May	1973.05	376.96	121.20	1335.83	637.22	47.7
June	1918.08	378.54	121.70	1350.22	567.86	42.1
July	1948.80	347.60	111.76	1270.18	678.62	53.4
August	1952.14	347.68	111.78	1292.88	659.26	51.0
September	1973.96	340.95	109.62	1301.04	672.92	51.7
October	1985.00	340.22	109.38	1318.36	666.64	50.6
November	1995.45	341.21	109.70	1326.29	669.16	50.5
December	1976.88	319.62	102.76	1264.82	712.06	56.3
	1957.59	360.47		1313.94	643.65	49.0
<b>1985</b>						
January	1968.13	302.88	97.38	1230.11	738.02	60.0
February	2022.33	299.83	96.40	1250.18	772.15	61.8
March	2097.27	303.20	97.48	1256.06	841.21	67.0
April	2172.73	324.88	104.45	1305.10	867.63	66.5
May	2169.80	316.40	101.72	1272.39	897.41	70.5
June	2055.65	316.30	101.69	1266.88	788.77	62.3
July	2113.15	317.20	101.98	1229.64	883.51	71.9
August	2122.20	330.13	106.14	1271.78	850.42	66.9
September	2142.50	323.76	104.09	1265.74	876.76	69.3
October	2136.46	326.09	104.84	1263.04	873.42	69.2
November	2152.23	325.55	104.67	1264.24	887.99	70.2
December	2114.05	321.99	103.52	1259.42	854.63	67.9
	2105.54	317.35		1261.22	844.33	66.9

Month/Year	Bombay		London		Spread between Bombay and London Markets	
	Rs. per 10 gms.	\$ per troy oz.	\$ per 10 gms.	Equivalent Rs. per 10 gms.	Absolute	Per- centage
<b>1986</b>						
January	2095.19	345.56	111.10	1364.67	730.52	53.5
February	2103.26	339.05	109.01	1348.26	755.00	56.0
March	2128.43	346.09	111.27	1365.92	762.51	55.8
April	2203.17	340.96	109.62	1357.76	845.41	62.3
May	2195.46	342.33	110.06	1376.17	819.29	59.5
June	2127.00	342.80	110.21	1386.96	740.04	53.4
July	2109.00	348.55	112.06	1402.99	706.01	50.3
August	2179.62	376.29	120.98	1521.21	658.41	43.3
September	2245.45	418.15	134.44	1706.19	539.26	31.6
October	2352.88	423.86	136.27	1752.62	600.26	34.2
November	2385.45	396.98	127.63	1669.73	715.72	42.9
December	2399.64	391.60	125.90	1655.49	744.15	45.0
	2210.38	367.69		1492.33	718.05	48.1
<b>1987</b>						
January	2466.17	408.52	131.34	1711.71	754.86	44.1
February	2611.57	401.05	128.94	1683.23	928.34	55.2
March	2606.42	408.85	131.45	1700.23	906.19	53.3
April	2701.14	439.67	141.36	1808.59	892.55	49.4
May	2804.10	461.65	148.42	1885.20	918.90	48.7
June	2744.31	449.28	144.45	1855.39	888.92	47.9
July	2792.68	450.33	144.78	1886.49	906.19	48.0
August	2930.48	460.95	148.20	1937.80	992.68	51.2
September	3019.38	460.15	147.94	1924.92	1094.46	56.9
October	3170.83	465.76	149.75	1955.04	1215.79	62.2
November	3471.35	468.10	150.50	1952.44	1518.91	77.8
December	3371.12	487.04	156.59	2027.43	1343.69	66.3
	2890.80	446.78		1860.71	1030.09	55.4

Month/Year	Bombay		London		Spread between Bombay and London Markets	
	Rs. per 10 gms.	\$ per troy oz.	\$ per 10 gms.	Equivalent Rs. per 10 gms.	Absolute	Percent- age
<b>1988</b>						
January	3453.10	477.76	153.60	2010.17	1442.93	71.8
February	3321.54	441.93	142.08	1855.75	1465.79	79.0
March	3209.09	443.49	142.59	1851.25	1357.84	73.3
April	3178.71	451.56	145.18	1915.18	1263.53	66.0
May	3149.48	451.32	145.10	1933.42	1216.06	62.9
June	3177.12	451.66	145.21	2006.58	1170.54	58.3
July	3106.40	437.45	140.64	1983.94	1122.46	56.6
August	3170.48	431.06	138.59	1977.59	1192.89	60.3
September	3124.32	412.76	132.71	1923.83	1200.49	62.4
October	3158.80	406.39	130.66	1921.77	1237.03	64.4
November	3211.87	419.97	135.02	2020.64	1191.23	59.0
December	3158.33	419.25	134.79	2028.36	1129.97	55.7
	3201.60	437.05		1952.37	1249.23	64.0
<b>1989</b>						
January	3253.26	404.45	130.03	1967.77	1285.49	65.3
February	3260.63	387.97	124.74	1902.31	1358.32	71.4
March	3153.25	390.27	125.47	1943.13	1210.12	62.3
April	3203.10	384.72	123.69	1946.04	1257.06	64.6
May	3219.08	371.35	119.39	1928.27	1290.81	66.9
June	3086.04	367.73	118.23	1945.00	1141.04	58.7
July	3081.04	375.21	120.63	1981.03	1100.01	55.5
August	3158.26	365.55	117.53	1957.94	1200.32	61.3
September	3121.59	361.80	116.32	1948.72	1172.87	60.2
October	3161.57	366.80	117.93	1989.03	1172.54	59.0
November	3235.45	394.36	126.79	2146.83	1088.62	50.7
December	3290.00	409.66	131.71	2231.25	1058.75	47.5
	3185.27	381.66		1990.61	1194.66	60.0

Month/Year	Bombay		London		Spread between Bombay and London Markets	
	Rs. per 10 gms.	\$ per troy oz.	\$ per 10 gms.	Equivalent Rs. per 10 gms.	Absolute	Percent- age
<b>1990</b>						
January	3383.21	410.12	131.86	2236.45	1146.76	51.3
February	3495.71	416.54	133.92	2275.58	1220.13	53.6
March	3316.92	393.66	126.56	2169.93	1146.99	52.9
April	3416.50	374.93	120.54	2083.41	1333.09	64.0
May	3431.40	368.85	118.59	2055.34	1376.06	67.0
June	3314.35	352.66	113.38	1975.57	1338.78	67.8
July	3284.80	361.82	116.33	2044.55	1240.25	60.7
August	3414.71	394.86	126.95	2204.39	1210.32	54.9
September	3409.05	389.56	125.25	2238.52	1170.53	52.3
October	3490.76	381.33	122.60	2216.84	1273.92	57.5
November	3460.52	381.87	122.77	2219.69	1240.83	55.9
December	3453.20	378.16	121.58	2204.34	1248.86	56.7
	3405.93	383.70		2160.38	1245.54	57.7
<b>1991</b>						
January	3687.52	384.59	123.65	2266.55	1420.97	62.7
February	3534.78	363.75	116.95	2205.91	1328.87	60.2
March	3520.70	363.39	116.83	2256.06	1264.64	56.1
April	3583.35	358.05	115.12	2294.56	1288.79	56.2
May	3750.77	357.13	114.82	2262.66	1488.11	65.8
June	3733.87	366.43	117.81	2477.25	1256.62	50.7
July	4065.54	368.01	118.32	3027.32	1038.22	34.3
August	4187.08	356.66	114.67	2957.29	1229.79	41.6
September	4246.48	348.46	112.03	2898.23	1348.25	46.5
October	4491.28	358.83	115.37	2987.56	1503.72	50.3
November	4713.55	360.50	115.90	2997.23	1716.32	57.3
December	4883.20	361.88	116.35	3010.74	1872.46	62.2
	4033.18	362.31		2636.78	1396.40	53.0
<b>1992</b>						
January	4930.84	354.33	113.92	2953.14	1977.70	67.0
February	4737.79	353.85	113.78	2948.29	1789.50	60.7
March	4247.79	344.64	110.80	3178.62	1069.17	33.6

Source : Reserve Bank of India.

**Table 7 : Fabrication of Gold Including Scrap Use  
(in tonnes)**

Countries	1986	1987	1988	1989	1990
India	146.8	159.9	187.9	222.3	241.6
Japan	342.5	175.3	173.6	199.3	193.2
Indonesia	28.0	29.1	48.0	72.5	79.2
U.S.A.	246.9	259.5	228.8	230.2	215.9
U.K.	30.4	37.9	38.9	41.0	42.0
France	25.7	26.5	28.3	31.7	38.0
Canada	60.6	55.8	48.6	46.7	41.5
Kuwait	16.3	16.3	19.4	18.2	16.5
Saudia Arabia & Yemen	47.5	49.0	62.0	70.0	70.0
Arabian Gulf States	10.8	8.7	14.9	21.6	20.3
Taiwan	24.8	49.8	87.9	107.2	96.6
Hongkong	21.00	28.0	75.0	65.9	52.0

Source : Gold Fields Mineral Services, 'Gold 1991'.

**Table 8 : Gold Used for Industrial Purposes\***

Year	Electronics	Other	Total	(in tonnes)
1981	0.2	0.5	0.7	
1982	0.2	0.6	0.8	
1983	0.2	0.6	0.8	
1984	0.1	0.6	0.7	
1985	0.2	0.7	0.9	
1986	0.2	0.7	0.9	
1987	0.1	0.6	0.7	
1988	0.1	0.8	0.9	
1989	0.1	0.7	0.8	
1990	0.2	1.8	2.0	

\* Including the use of scrap

Source : Gold Fields Mineral Services, 'Gold 1991'.

**Table 9 : Results of Regression (Demand)**

**Dependent variable : Smuggled gold**

Constant	Independent Variables					$\bar{R}^2$	DW	F
	Gold Price (Bombay)	Service Sector Income	Fertiliser Consumption	Increase in Whole- sale Price Index				
1. 6.2670 (0.4490)	2.9824 (2.0324)	-3.1169 (-1.1936)	1.1787 (0.5471)	-0.6310 (-2.1967)		0.8580	2.3155	16.1078
2. 4.6481 (0.3592)	3.3580 (2.7293)	-2.2481 (-1.1431)	-	-0.6801 (-2.6271)		0.8722	2.0096	23.7552
3. -9.7446 (-3.2080)	2.0100 (5.6162)	-	-	-0.6305 (-2.4245)		0.8673	1.9021	33.6875
4. -16.3811 (-3.1499)	-	-	2.4159 (4.5422)	-0.5527 (-1.7339)		0.8168	2.2161	23.2888
5. -25.9912 (-3.0065)	-	2.8959 (3.8383)	-	-0.6650 (-1.9119)		0.7692	1.9116	17.6658

**Table 10 – Results of Regression (Supply)**

**Dependent Variable : Smuggled gold**

	Independent Variables				$\bar{R}^2$	DW	F
	Constant	Hawala Premium	Foreign Exchange flow through FCNR deposits and private transfers	Current Account Deficit as percent-age of GDP			
1.	0.2945 (0.1223)	4.1209 (2.9479)	0.3224 (1.0542)	0.4807 (2.7732)	0.9063	2.5708	33.2555
2.	2.8146 (9.6696)	4.2884 (3.0665)	-	0.6030 (4.6465)	0.9050	2.6920	48.6511
3.	- 4.4201 (- 1.9127)	5.8075 (3.4049)	0.8896 (2.8876)	-	0.8280	1.6518	25.0706

## ANNEXURE I

### A Historical Account of Official Policies Relating to Gold<sup>1</sup>

The official gold policy in India has had a chequered history. In the early years of this century when the country enjoyed trade surplus, there was free inflow of gold into the country. After independence, restrictions were sought to be placed on both imports and domestic gold use mainly due to the scarcity of foreign exchange resources. It is only very recently that there has been some rethinking regarding importation of gold in official circles. Some historical developments in the policy towards gold are given in brief in this annexure.

Prior to the First World War, there were practically no restrictions on the movements of gold. During the war, the Gold Import Ordinance, 1917, was promulgated, which empowered the Government to acquire gold imported into India. During the inter-war period, free movement of gold took place. With the outbreak of the Second World War, imports and exports of gold without the permission of the Reserve Bank of India were prohibited. In 1942-43, as an anti-inflationary device, the Government of India followed a short-run policy of importing and selling gold in the market, through the Reserve Bank of India so that excess liquidity in the economy could be mopped up.

In the post-war period, the stringent regulations on trade in gold were relaxed, only to be reimposed early in March 1947. Bullion imports and exports were banned under the Foreign Exchange Regulation Act, 1947.

The domestic production of gold has always been very small. Mysore has been the main gold-producing centre in India. Control over gold production was assumed by the Mysore Government in November 1956 by the nationalisation of gold mines in the State, in terms of the Kolar Gold Mining Undertakings (Acquisition) Act, 1956.

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1. For a detailed review of gold policy upto 1978 one may see S.L.N. Simha (e.d.), *Aspects of Gold Policy*, Institute for Financial Management and Research, 1979.

With the availability of gold being limited, and as foreign exchange reserves were not adequate, the official gold stocks of the Reserve Bank of India had to be revalued in 1956. The proportional reserve system was replaced by a minimum reserve system for purposes of note issue. The revaluation took place at Rs.62.80 per tola (Rs.53.38 per 10 gms.) from Rs.21.24 per tola earlier. It was further revised to Rs.84.39 per 10 gms on February 1, 1969 consequent to the devaluation of the rupee by 36.5 per cent in June, 1966. Since October 1990, value of gold reserves with RBI are being revalued every month at rates nearer to international prices. From June 1958, the Government decided to retain the entire domestic production as part of its unofficial reserves in an attempt to wean people away from gold. Formerly, this was being sold in the Bullion market. In 1962, the Reserve Bank also advised the commercial banks to consider recalling loans made against the security of gold. Forward trading in gold was banned in November 1962. A bill was passed in the Lok Sabha with provisions to deal severely with gold smugglers.

### **Policy on Gold Bond**

The first time the Government of India recognised the need for mobilising gold from public and strengthening gold reserves was in the wake of the Chinese aggression. India was direly in need of funds to provide arms and support services for the army. For this purpose, a 15-year Gold Bond at 6-1/2 per cent simple interest was issued on November 3, 1962 for public subscription. The bonds were issued in exchange of gold, gold coin and gold ornaments and the principal was calculated at the rate of Rs.53.58 per 10 gms. for gold of fineness 0.995. Interest was payable half-yearly, subject to income tax but the bond was free of wealth tax during the validity period of the bond. No questions were asked about the source or manner of acquisition of gold. Subscriptions to these bonds totalled 16.3 tonnes. The issue of Gold Bonds was accompanied by exhortations to the public to refrain from buying gold and to surrender their holdings to Government.

A second attempt to garner gold from public was made in March 1965, when a new series of 7 per cent Gold Bonds, 1980 was issued. Opportunity was given to holders of unaccounted money to convert them into these bonds. Subscriptions to these bonds totalled 6.1 tonnes.

A third series of gold bonds, designated as National Defence Gold Bonds, 1980 at 6-1/2 per cent was issued in October 1965. Unlike the earlier two issues, which were repayable in Rupees (the value of gold being calculated at international prices), these bonds were redeemable in gold of standard purity at maturity. Subscriptions to these bonds totalled 13.7 tonnes.

It may be mentioned that the above series of bonds were issued as an instrument of correcting fiscal imbalances. Gold as a real resource had never been conceived.

### **Gold control**

In a bid to remove, or at least curb the high proclivity to acquire gold, the Government of India promulgated Gold Control Rules in January 1963, at the initiative of the then Union Finance Minister. Other important objectives of the Rules were:

- (i) extending the control over gold as an anti-smuggling measure, so that gold would no longer be vendible with ease and the prevention of smuggling and detection of smuggled gold will be facilitated.
- (ii) bringing down the domestic price of gold and rendering the processes connected with smuggling unprofitable.

The immediate cause prompting the Gold Control Rules, 1963 was the need to mobilise funds to finance increased defence requirement following the Chinese aggression and the financial resources needed for the Third Plan.

'In terms of the Gold Control that was instituted -

- (i) manufacturing of gold ornaments of more than 14 carat purity was banned;
- (ii) fresh acquisitions of non-ornamental gold by private individuals was banned. The existing individual gold holdings in private possession were untouched, but they had to be declared to the Government if they exceeded 50 grams;
- (iii) restrictions were put on manufacture and acquisition of articles of gold;
- (iv) gold trade was to be regulated by a system of licensing; and
- (v) a dealer could buy gold only from another dealer and on production of permit issued under the Rules.

Control over the internal trade and distribution of gold by the government was sought to be fully achieved by the passing of the Gold Control Bill by the Lok Sabha in December 1964. However, it was rendered practically ineffective because of certain accompanying relaxations in rules. In fact, even in 1963, goldsmiths were allowed to remake ornaments in the same purity. Secondly, in November 1966, gold control was modified lifting the ban on manufacture of ornaments of more than 14 carat purity. This was an important dilution of the Rules. The amendments in 1966 also placed ceilings on individual holdings and extended controls over refineries and dealers. Holdings of gold ornaments and articles over 2000 gms. by an adult individual, 800 gms. by a minor or over 4000 gms. by a family were to be declared.

In September 1968, the Gold (Control) Act, 1968 was passed, establishing the scheme of gold control on a permanent statutory basis.

Except for some minor modifications, incorporated in the Act in 1969, 1972, 1973 and 1988, the structure and objectives of the Act did not undergo any change. However, due essentially to the dilution of Gold Control Rules in 1966, the objectives were not achieved in any substantial way, though during the span of four years – from 1963 to 1966 – there were signs of slackening of demand for gold ornaments.

### **Gold auctions**

In the 1978-79 budget, the Government envisaged sale of gold from the stocks held by the Government with a view to (a) reducing the differential between domestic and foreign gold prices which has been a contributory factor to smuggling, and (b) reducing the budgetary deficit of Rs.1,050 crore in a non-inflationary manner.

Accordingly, Reserve Bank was chosen as the Government's agent in the sales operation. Gold was sold through a series of bi-monthly auctions, on the basis of sealed bids received from licensed gold dealers and certified goldsmiths in amounts between 1000 - 5000 gms. and in multiples of 100 gms., accompanied by payment for 10 per cent of the value of the bid.

Allotments were made to bidders, whose bids exceeded a secret reserve price', out of the quantity earmarked for sale by RBI. Allotments were made at 12 out of the 14 auctions held and nearly 13 tonnes of gold were sold, garnering about Rs.87 crore.

The gold auction policy however did not reduce the differential due to cartelisation of dealers, widening of absolute margins, limited stocks for sale and the high reserve prices which defeated the original purpose of reducing the domestic price. As a result, the auction policy had to be given up.

### **Repeal of the gold control**

Due to the almost complete ineffectiveness of the Gold Control

Act, 1968 to achieve its objectives, Government and Reserve Bank of India received numerous representations from various gold and jewellery merchants' associations and concerned individuals of the country, asking for a repeal of the Act so as to remove the impediments which the Act posed to the gold business in India. In view of these developments, the Government scrapped the Gold (Control) Act, in 1990. This was done through the Union Budget for 1990-91.

The Union budget for 1992-93 has announced a scheme for permitting non-resident Indians (NRIs) and returning Indians with a minimum stay of 6 months abroad to bring into the country gold upto 5 kgs. subject to payment of import duty in foreign exchange equivalent to 15 per cent (modified subsequently to 10 per cent) of the value of gold. The budget also announced that a gold bond scheme would be introduced from May 1992.

### **Role of mints**

There are four mints in our country - Bombay, Calcutta, Hyderabad and Noida. Of these, Bombay Mint and Alipore Mint at Calcutta are the sole repositories of gold. Prior to 1987, Bombay Mint used to buy gold from Bharat Gold Mines Ltd. (BGML), Hindustan Gold Mines Ltd. (HGML) and Hindustan Copper Ltd. (HCL), refine it and make it into 12.5 kg., 500 gm., 100 gm., 50 gm., and 10 g. bars and store it in vaults till ordered by the Government for sale to RBI. The value of gold sold to RBI would be credited to Government account. The price at which gold was bought from the mining companies was at the rate of Rs.84.40 per 10 gm upto 1987 and at LME rate thereafter for 995.3 fineness. The difference between the unit cost of extraction and the sale price was subsidised by the Ministry of Steel and Mines to the mining companies directly. Certain quantity of gold received from mines are also cast into 400 oz. bars and kept with RBI vaults in safe custody.

After 1987, BGML, HGML and HCL were allowed to sell gold in

the open market; HGML through SBI and the other two through their agents.

Currently though the mining companies are selling in the open market, newly-mined gold is still sent to Bombay Mint for refining to the 995.3 fineness and bar making, for which the Mint receives some processing charges.

Apart from the newly-mined gold, the other sources from which gold is received in the Mint for refining into 995.3 fineness and bar-making are:

- (a) Confiscated contraband gold,
  - (b) Lost and found gold,
  - (c) From merchants for assaying,
  - (d) From colleges, schools, government for making medals,
  - (e) From Temples of Tirumala, Guruvayoor, Sabarimala for making 'dollars', and
  - (f) Gold of 999.9 fineness imported by SBI, HHEC.
- (a) and (b) Confiscated contraband and lost and found gold

Confiscated gold in considerable amount was placed at about 5.6 tonnes in 1988-89, 7.8 tonnes in 1989-90 and 6.6 tonnes in 1990-91. After confiscation, the collectorate is supposed to give the gold to the Mint for assaying, refining, bar-making and storing for sale, later to RBI. Though Customs authorities are expected to pass on the confiscated gold on which there is no dispute, sometimes some disputed gold is also given to Mint, which has to be returned in case the verdict goes against the Government.

Between October 1990 and April 1992, the entire seized gold was being sent to SBI from Mint for sale to gold jewellery exporters.

## **ANNEXURE II**

### **Unauthorised Import of Gold (Gold Smuggling) and the resultant loss of Foreign Exchange**

Domestic production and recycling of gold taken together have generally fallen far short of the domestic demand. Since import of gold has been under ban continuously since 1939 (but for a short break in post-World War II period upto March 1947) to conserve foreign exchange for importing more crucial inputs, the short fall in demand could not be met by legal imports. However, the excess demand for gold has pushed up the price of gold in Indian markets to levels much above those ruling in the international markets. This has prompted a large scale inflow of gold into India through prohibited channels, despite attendant risks, mostly from Hong Kong, Beirut and Dubai where gold is available at much lower free market prices. However, the gold thus smuggled has to be paid for either in hard currencies, generally the US dollar, or commodities. There is thus a drain on foreign exchange, actual or potential, through illegal channels. Payment can be done in other ways too, as may be seen from the various options open to the smugglers as given below:

- (a) through unrecorded export of commodities (or reverse smuggling), e.g., edible oils, sugar etc. from India to neighbouring countries or silver earlier;
- (b) building illegal foreign currency balances abroad through under-invoicing of exports and over-invoicing of imports;
- (c) by funnelling the remittances made by Indians residing and earning abroad into illegal channels through purchase of foreign exchange in the free market abroad; or
- (d) through hawala transactions;

- (e) by attracting away into illegal channels the foreign exchange brought by tourists; and
- (f) by unauthorised export of Indian currency.

The price of smuggled gold paid in foreign exchange will lie somewhere between the US dollar price of gold in the international (London) market and the equivalent domestic price in the Indian market. However, for convenience, the loss of foreign exchange could be reckoned roughly on the basis of the average London price and the estimated inflow of smuggled gold into India on an annual basis. The relevant figures thus obtained are presented in Statement II.1.

The loss in foreign exchange has generally shown a steadily rising trend due to gold smuggling. The total value of the 1,181 tonnes of smuggled gold during 1981-91, measured in US dollar terms, works out to \$ 14,624.9 million (Rupee equivalent of 21,614.4 crore). For 1990 alone, the value of smuggled gold amounted to about US \$ 2,200 million.

**Statement-II.1 Loss in Foreign Exchange due to Gold Smuggling**

Year	Quantum of Smuggling			Annual Average gold price In \$/ Troy oz	Total value of smuggled gold	
	In tonnes	In 10 gms.	In troy oz.		In Rs/10 gms	In \$ million
					London	Bombay
1981	25.4	2540000.0	816627.8	460.02	1280.12	1704.50
1982	60.0	6000000.0	1929042.0	375.88	1148.68	1708.44
1983	53.0	5300000.0	1703987.1	424.52	1381.74	1821.11
1984	94.5	9450000.0	3038241.2	360.47	1313.94	1957.59
1985	123.4	12340000.0	3967396.4	317.35	1261.22	2105.54
1986	88.4	8840000.0	2842121.9	367.69	1492.33	2210.38
1987	99.2	9920000.0	3189349.4	446.78	1860.71	2890.80
1988	135.0	13500000.0	4340344.5	437.05	1952.37	3201.60
1989	172.5	17250000.0	5545995.8	381.66	1990.61	3185.19
1990	179.6	17960000.0	5774265.7	383.70	2160.38	3405.93
1991	150.0	15000000.0	4822605.0	362.31	2636.78	4033.18
					1747.3	3955.2
						6049.8

## **ANNEXURE III**

### **Schemes for Gold Mobilisation**

The GMC guided by the Gold Policy Board would design, evaluate and modify schemes depending on the understanding of the household behaviour and the economic realities. Even so salient features of some of the gold mobilisation schemes which have been frequently referred to have been listed below, again for purposes of illustration.

#### **(a) Gold bonds with an intitial amnesty**

The leit-motif of this aspect of mobilisation is to induce domestic holders of gold to part with their gold for temporary or longer periods, and make such gold available for removal of constraints in external adjustment. In the process, gold could get transferred into a quasi-financial asset.

#### **Salient features**

- i) Each subscription may be of minimum amount of 5 gms. and tenders may be accepted in multiples of 1 gm. In the case of stone-studded jewellery, stones would be removed and returned to the holder. The assaying facilities will be worked out with the help of Mint and approved valuers.
- ii) The subscriber will be given a 'Gold Bond' demominated in fine gms. of gold. The bond would clearly state that the return of gold is guaranteed by the RBI.
- iii) The term of bond could vary from 3 years to 10 years.
- iv) On maturity, the quantity of gold equivalent to the weight of the deposited gold will be returned to the holder.

- v) During the currency of the deposit, the holder will be paid a return on the deposit, based on the prevailing international price at inter-bank exchange rate. Interest would be paid annually in rupees by means of warrants.
- vi) The return on and the balance in the account will be exempt from income tax, wealth tax and gift tax. The source of gold will not be questioned and there will be general amnesty for depositors which could be availed of within a *specified period of not more than 6 months*.
- vii) The holder can use the bond as security for obtaining finance thereon. The GMC could arrange to get for the original certificate-holder a loan from commercial bank.
- viii) The bond will be negotiable.
- ix) Nomination facility could be made, if desired.
- x) secrecy of accounts and transactions with the GMC would be ensured.

This is a facility that is in the nature of safekeeping (or a safe custody), and is secure, given the RBI guarantee. The rate of return along with a very limited lock-in period and a general amnesty should work as added incentives to part with gold for a bond which is freely negotiable. Although gold will not be returned in the same form in which it was tendered in case of jewellery, the holder would nonetheless have the advantage of exercising options in converting gold received on maturity of gold bond in any manner he likes.

### **Other issues**

A few issues arise in the operation of the scheme.

As not all holders have gold in bar or biscuit form, they may l

permitted to tender gold in jewellery form as well. The GMC may establish centres at the offices of the RBI. There may also be gold windows opened in several centres as part of commercial bank offices. At these centres, the tender will be assayed and exchanged into standard nuggets conforming to specifications prescribed for the purpose of depositing in exchange for gold bond. For this purpose, the Mint and approved valuers may be coopted. The nuggets obtained in exchange for the tender may be deposited by the holder into her account at any of the centres of the GMC. The gold collected at the various centres may be held in the vaults of the RBI offices/GMC.

It is hazardous to guess as to how much of gold could be mobilised against issue of gold bonds. If one were to assume that only income tax assessees with income over Rs.2 lakhs per annum would be the potential investors, then there would be a serious underestimation. An exercise done on this assumption shows that only about 7 tonnes could be mobilised through gold bonds without amnesty. If the scheme is combined with an amnesty, for say 3 to 6 months, and if unaccounted gold wealth is considered amenable to mobilisation, then about 50-100 tonnes could be expected to come in through this scheme. (Please see Annexure III.A). This is based on the following analysis.

According to the study on 'Aspects of Black Economy in India' by the National Institute of Public Finance and Policy (NIPFP) (1985), tax-evaded non-corporate non-agricultural income was about 3.7 to 5.8 per cent of GDP at current prices in 1975-76 and 4.2 to 8.6 per cent in 1980-81. In absolute terms, it amounted to Rs.5,000 crore to Rs.10,000 crore in 1980-81. It may be surmised that this proportion and amount must have got further enlarged over the last decade. Though a substantial part of such income— about half to two thirds— is believed to have been spent on conspicuous consumption of goods and services, a good portion of this accumulated income had no doubt been converted into 'black wealth.' The NIPFP questionnaire survey has observed that 'gold, silver and other precious metals' is one of the significant forms in

which black wealth is held. In other words, a good portion of demand for gold, smuggled or otherwise, could be attributed to black-wealth holders.

### (b) Gold scrip scheme

Under this scheme, the public is encouraged to deposit their gold by allowing them limited import of gold from abroad.

#### Salient features :

1. Gold may be deposited with the GMC, over a floor amount of 150 gms. and in multiples of 10 gms. with no maximum limit for a minimum period of 5 years.
2. On depositing 150 gms., the depositor becomes entitled to import 20 per cent of such deposits (30 gms. of gold) from foreign markets through a gold scrip issued in his name.
3. The depositor is allowed to sell the gold scrip or import gold in India freely.
4. The deposit shall not carry any interest and is redeemable in gold after 5 years.
5. The period of currency of the gold scrip should be limited to a maximum of one year.

#### Rationale

This scheme which will be complementary to the one that envisages import of gold through NRIs, will arrest smuggling and ease the supply of gold in the short-run.

As in the case of Gold Bond Scheme, gold scrip scheme may not facilitate large amount of mobilisation of gold, going by the assumption of the number of Wealth Tax assesseees and assesseees of annual income of over Rs.2 lakhs (see Annexure III.A). With amnesty scheme, this scheme too could help mobilise about 50 tonnes.

**(c) Gold imports through visiting NRIs**

Unlimited imports would imply considerable diversion of foreign exchange resources, whether for purposes of fully meeting the demand for gold or for bringing about a convergence of international and domestic prices; it would be useful to allow limited imports through NRIs. Moreover, this would be a transparent way of containing the problem of gold smuggling and bringing about a/an reduction/elimination of the differential between the official exchange rate and the hawala rate. NRIs could profit from such a policy to the extent that such imports would facilitate satisfaction of their own demand for gold or that there exists a domestic premium on gold. Government too could improve its receipts by levying a modest customs duty payable in foreign exchange resources. The following could be the salient features of such a scheme:

**Salient features :**

- (1) NRIs residing abroad for 1 year or more may be allowed to bring in gold;
- (2) Ceiling for bringing gold may be fixed at 100 oz. per adult per trip. This ceiling was arrived at by assuming that an NRI's capacity to bring in gold is roughly equivalent to average FCNR deposit per account holder. Any unduly large ceiling would entail diversion of foreign exchange as also might cause NRIs being made vehicles to smuggle gold into the country;
- (3) Customs duty may be levied on the basis of domestic gold premium (valued at prevailing price in the London market and Bombay market on the day prior to the one of landing). The duty may be realised in foreign exchange at the port of entry;
- (4) The base for levy of customs duty on imported gold could be the 'excess of Bombay price over London price in \$ terms on the marketing day prior to the day of the arrival

at port of entry'. The duty could be structured progressive to gold premium. The duty rates that may be considered are:

Slabs	Base: Difference in Bombay price over London price of gold in per cent	Rate of duty calculated on the positive difference in US \$ terms
I	Upto 10 per cent	nil
II	11 to 20 per cent	10 per cent
III	21 to 30 per cent	20 per cent
IV	Above 30 per cent	30 per cent

Thus, if the London market price is \$ 350 per oz. and Bombay price is \$ 550 per oz. the base will fall under IV slab ( $550-350 / 350 = 0.57$ ) since the domestic gold premium works out to 57 per cent. In this case, the levy at 30 per cent would fetch a duty of  $\$ 200 \times 0.3 = \$ 60$  which at the Bombay price works out to about 10.9 per cent and at London price to about 17 per cent.

The above system will have the convenience of removing uncertainty on the part of importers about the movements in gold premium. Incentive to import gold will continuously be maintained and will not be thwarted by narrowing of domestic premium upto a level of 10 per cent.

On some assumptions, one could expect to mobilise gold worth 750 tonnes over a ten-year period. As shown in Annexure III.B, the inflows in the first 3 years could be 550 tonnes. Customs collection could, on this basis, be about 75 tonnes worth of gold (Annexure III.B).

#### (d) Mobilising gold from cultivator households

A good part of domestic demand for gold comes from the rural sector in particular from the farming community. Several factors have contributed to this phenomenon: (i) the distribution of land holdings continue to remain highly skewed despite land ceiling legislations; (ii) the highly skewed impact of green revolution/

New Agricultural Technology, creating a new class of wealthy farmers in rural areas; and (iii) the traditional preference for investment of surplus in gold by affluent farmers for various reasons : (a) social prestige, (b) acquisition as part of 'Stree-dhana' property, (c) for liquidity and safety and for easy availment of credit from money lenders to meet cash deficits and as a hedge against inflation.

That the rural asset distribution has become highly skewed is evident from an analysis of the distribution of cultivator households according to asset groups based on the All India Debt and Investment Surveys 1971-72 and 1981-82. The relevant data are presented in Table 1. Assuming that increase in asset values was proportionate to increase in general price level (Wholesale Price Index), the asset groups for 1981-82 were approximately adjusted for inflation during the decade (at about 77 per cent overall) and a comparable picture (at 1970-71 prices) is presented in the Table. It is clear that the asset group of 'above Rs.50,000' had swelled from about 5 per cent to about 10 per cent during the above period. Secondly, the asset group of 'above Rs.3 lakh' (Rs.5 lakhs at 1980-81 prices) had become a significant entity with about 3.2 lakh households in 1981-82.

**Table 1 : Distribution of Cultivator Households according to Asset Group**

Asset Group (Rs.) (1971 base)+	No. of households ('000)			
	1971	Percentage to total	1981	Percentage to total
Upto 10,000	33,347	59.8	33,617	47.0
10,000 - 30,000	15,957	28.6	20,659	28.9
30,000 - 50,000	3,584	6.4	9,996	14.0
50,000 - 3 lakh	2,881	5.2	6,960	9.7
Above 3 lakh			320	0.4

+ Asset Group for 1981 adjusted for inflation at 77 per cent during the 10-year period 1971-72 to 1980-81 to make the distribution comparable with base = 1971.

Note : Compiled from All India Debt and Investment Surveys 1971-72 and 1981-82, RBI.

If the above data are juxtaposed with the information that rural bank deposits and investments in financial assets had not increased to any significant extent, one could hazard a relatively safe guess that a substantial portion of this added surplus had been diverted to building up of gold holdings. This is supported by the supplementary evidence that non-institutional sources formed a significant part of cash borrowings of cultivator households. With a better performance of agriculture during the 1980s, the asset distribution of households should have become further skewed since 1981-82, with the result that the diversion of potential rural savings into gold assets would have been higher than was the case in the 'seventies.

### **Scheme for mobilising gold from rural areas**

For rural households to be a target group for the mobilisation of gold, some innovative efforts might be required, to satisfy preferences/needs of rural cultivator households. Since early and quick availment of credit is an essential feature of gold holdings and farmers have cyclical cash deficit periods which get further accentuated during periods of drought/floods, etc., it might be desirable to link gold mobilisation schemes in rural areas with short/medium-term bank lending to farmers.

One may in this context, consider the following factors as desirable elements of a scheme for mobilising gold from rural farming community :

- (i) Farmers may be permitted to deposit gold in 5 gms. and multiples thereof in the form of coins, jewellery or biscuits;
- (ii) The nationalised bank branches may act as agents for the Gold Management Corporation (GMC) for the above purpose to collect such gold and for accounting;
- (iii) Gold deposit certificates with a maturity of 3 to 5 years may be issued to farmers;

- (iv) A definite return comparable to Gold Bond Scheme could be allowed on such deposits;
- (v) Gold deposits should be made redeemable in primary gold at maturity of an equivalent weight and fineness;
- (vi) Such deposits shall be exempt from Wealth Tax and the return on such deposits shall be exempted from Income Tax;
- (vii) Farmers can be allowed loan facilities on the strength/security of such gold deposit certificates at a rate lower than the normal rates of interest applicable to respective purposes and loan size by one percentage point. (The effective interest on such loans will obviously be less by the return offered on such deposits).

### **Features of loan facilities**

Gold as security no doubt offers an adequate safeguard to bankers from running into credit risk of any sort. Therefore, loan disbursement facilities backed by gold certificates should necessarily be made very simple, quick and nearly costless to farmers. While 'need-based lending' should basically be the principle, loan assessments and documentation procedures should be made extremely simple. As a matter of fact, based on an estimate of cultivation expenses, a cash-credit sort of account would even be a feasible proposition for such loan facilities. This would result in considerable saving on interest cost to farmers and also inculcate better discipline regarding their cash management.

### **Refinance facilities**

GMC could provide refinance facilities for such loans on the surrender of gold initially collected by banks. A small margin can be allowed to banks by keeping refinance rate at around 1.0 per cent lower than the ultimate lending rate. On repayment of

refinance, redeemable gold should be returned to banks to enable them to redeem gold to depositors in time.

### **Response**

If we consider roughly the cultivator households in asset group above Rs.50,000 (at 1970-71 prices) as the target group, there are about 72.8 lakh households under this category. About 28 per cent of their cash borrowing requirements are met through non-institutional agencies like money-lenders, landlords and relatives/friends for asset group, '50,000 to 8 lakh' and about 9 per cent for asset group 'above Rs.3 lakh'. The average cash borrowings per household outstanding as of June 1982 was Rs.9,747 for '50,000 to Rs.3 lakh' asset group and Rs.47,622 for the asset group of 'Rs.3 lakh and above'. On this basis, the total cash dues attributable to non-institutional sources would work out to Rs.2,059 crore as follows :

Asset Group (Rs.)	No. of households in '000	Average cost	Total outstand- ing for the group (Rs. crore)	Attribu- table to non-insti- tutional sources
50,000 - 3 lakh	6,960	9,747	6,783.91	1,926.63
Above 3 lakh	320	47,622	1,523.9	132.58
	<u>7,280</u>		<u>8,307.81</u>	<u>2,059.21</u>

(Compiled from All India Rural Debt and Investment Survey, 1981-82)

If we assume that about 25 per cent of loans from non-institutional sources are secured by pledging of gold and the margin on such

advances at about 50 per cent, then rough calculations show that about Rs.1,000 crore worth of gold would be associated with such loans at 1981-82 prices (Rs.1.72 crore per tonne). This would amount to around 500 tonnes of gold in weight. Thus, even on a very conservative basis, there is good scope for mobilising gold from the rural sector.

### ANNEXURE III.A

#### **Estimated Mobilisation of Gold under different schemes : Issuance of gold bond and gold scrips**

Issuance of gold bond and gold scrips target the same population and result in depositing of gold against bond/gold scrips. It is assumed that all Income Tax assessees in the categories of individuals and HUFs with net incomes above Rs. two lakh form the potential group; and at least 50 per cent of them in income ranges between Rs.2 to 5 lakh and 25 per cent of them in income ranges above Rs.5 lakh will effectively participate in one of these schemes. The contribution to these schemes is estimated on the basis of contribution per assessee assumed as follows :

Range of Net Income (Rs. lakh)	No. of IT Assessees* '000			Contri- bution per unit gms.	Total (% Effec- tive) (tonnes)
	Indivi- duals	HUFs	Total		
2 to 5	4,690	351	5,041	20	10.08
Above 5	452	36	488	25	3.05
					13.13 or 13 tonnes

\* For 1988-89

(Compiled from All India Income Tax Statistics, Directorate of Income Tax)

It may be assumed that the total potential of 13 tonnes as estimated above will be equally distributed between gold bond and gold scrips @ 6.5 tonnes each.

### **Bond Scheme combined with Amnesty**

The total number of wealth tax assessees in the categories of individuals and HUFs at 1989-90 was about 72,000 with a total net wealth assessed at Rs.3,264 crore. As per the study on aspects relating to black economy in India (NIPFP, 1985), the estimated tax-evaded non-agricultural non-corporate income as percentage of assessed income was 87.4 per cent in 1975-76 and 140 per cent in 1981-82. It may be assumed that this ratio has further gone up to 200 per cent over the last decade. Assuming that the unassessed wealth to assessed wealth is roughly in the same proportion as unassessed income to assessed income, the total unassessed wealth can be reckoned at Rs.6,528 crore. There is no definite statistics available on the distribution pattern of unassessed wealth. An indirect evidence available from NIPFP Report is that 'gold and other precious metals' is a significant form in which black wealth is held. In that sense, about 40 to 60 per cent of unassessed wealth can be reckoned as held in gold. This would give us an estimate of Rs.2,600 crore to Rs.3,900 crore of wealth in gold at 1989-90 prices, i.e., about Rs.3,500/- per 10 gms. On this basis, the total gold hoarding in black wealth can be reckoned at 74 tonnes to 112 tonnes respectively at 40 per cent and 60 per cent assumptions. For practical purposes it could be taken to be around 100 tonnes.

If we assume that about half of the hoarded gold will come into open through amnesty scheme, then about 50 tonnes could be mobilised through Gold Bonds.

### **ANNEXURE III.B**

#### **Estimated Mobilisation of Gold under different Schemes : Imports by NRIs and levying of customs duty**

The potential NRI visitors into India can be roughly gauged by the number of FCNR/NRER Account holders. The available statistics throw up the following figures :

1. No. of FCNR/NRER Accounts as on June, 1987.

FCNR :	98,389
NRER :	<u>9,40,885</u>
	(A) <u>10,39,274</u>

2. No. of Accounts opened between July, 1985 and June, 1988.

FCNR \$	1,02,900
Pound	<u>16,014</u>
	<u>1,18,914</u>
NRER	3,12,000
Total (B)	<u>4,30,914</u>

On the basis of the above information, assuming that the new accounts opened are evenly spread over the three years period under item (2) above and that there had been no substantial change in the number of accounts after June, 1988 (any addition could be assumed to have been offset by the Gulf crisis), the total potential NRI visitors/number of FCNR/NRER account holders could be reckoned at 12,00,000 as follows:

$$\begin{aligned}
 (A) + 1/3 \text{ of } (B) &= 10,39,274 + 1/3 (4,30,914) \\
 &= 10,39,274 + 1,43,494 \\
 &= 11,82,768 \text{ or } 12,00,000
 \end{aligned}$$

The actual tourist arrivals into India during 1990-91 had been 12,40,082 out of which 50 per cent may be assumed to be NRI tourists, i.e., 6,20,000. On the assumption that NRI adults constituted two-thirds of NRI tourists, the potential NRI tourists bringing in gold could be roughly reckoned at 4,31,360. Considering the total potential of NRI tourists, this is consistent with the assumption that NRIs undertake visits into India roughly once in three years.

Though the total potential NRIs are about 12,00,000 all of them may not bring in gold upto the maximum limit. A rough approxi-

mation can be made on the basis of NRI deposits per account. Based on the current statistics, it works out to about Rs.1,70,000 per account. At current international prices, gold equivalent of this amount would be about 20 oz. On the assumption that there could be a net addition of gold/foreign exchange stock roughly equivalent to this amount, the total import of gold will work out to 750 tonnes over a ten-year period under the assumption that the inflow of gold could be substantial in the beginning and would taper off in the later years.

The following could be an approximate picture of gold inflow through NRI tourists and mobilisation through customs collections at an average of 10 per cent in terms of gold/foreign exchange.

Year	Gold inflow (tonnes)	Customs collection at 10% (tonnes)
1	300	30
2	150	15
3	100	10
4	50	5
5	50	5
6	25	2.5
7	25	2.5
8	20	2
9	20	2
10	10	1
Total	<u>750</u>	<u>75</u>

## **ANNEXURE IV**

### **Options for Gold use and their Economics**

There are a number of alternative ways of using gold as a real good in the international market. While we do not visualise any of the options to be exercised by the GMC, we have discussed *purely for illustrative purposes*, the following possibilities just to indicate their possible use in the international market. There are mainly four options, viz., (a) gold term deposits on lease basis; (b) gold repurchase agreement; (c) borrowing against gold pledged as collateral and (d) outright sale. The elements underlying each of these options are outlined here to provide an idea of their relative costs and benefits.

#### **(a) Gold term deposits on lease basis**

Gold can be deposited with active members of the bullion market in London, New York, Zurich and other centres, on a lease basis, for a fixed time-period for an income. The lease income may be specified to be payable in gold or in specified foreign currency. A quantity of 32,000 oz. of gold leased for six months at a rate of 1.5 per cent per annum would fetch an income of 240 oz. in terms of gold or \$ 84,000/- where an ounce of gold is agreed to be priced at \$ 350.

#### **(b) Gold repurchase agreement**

Gold reserves could be utilised to raise funds abroad at sub-LIBOR rate through a gold repurchase agreement. The modus operandi in this regard usually goes by the following pattern. Gold is sold for dollars at the current spot price. Concurrently, a formal trade deal is entered into with the purchaser of gold for a period of 1 month to a year at a price that is related to the interest rate of gold expected to be prevalent on the maturity date. This formal deal enables exercising option of repurchasing gold, if necessary, within the specified period of the formal trade agreement. Since the

interest rates for gold are generally lower than those for the US dollar, it would reduce the costs of borrowing US dollar from the international markets. For instance, borrowing US dollar one million at 6 per cent per annum from an international commercial bank would imply interest cost of \$ 60,000/-. If, on the other hand, by selling 2,857 oz. of gold at \$ 350 per oz. spot, to receive US \$ 2 million, a formal deal is struck at \$ 365.75 per oz., the total outlay to be incurred in a year for repurchase would be only \$ 45,000/-. The differential between the straight forward borrowing from the international commercial bank and gold repurchase in this case would be US \$ 15,000/- or 1.5 per cent.

#### **(c) Gold as collateral for borrowing**

Gold could be pledged as collateral security for foreign exchange funding to the extent, say of 75 per cent of the value of pledged gold. In this case, gold valuation is often done at a price, determined at the time of the sanction of the loan. Since the transaction is a secured one, the interest rates chargeable on borrowing would often be lower than the market rates.

#### **(d) Outright sale**

Gold could be sold outright in order to acquire foreign exchange resources which could be utilised for easing foreign exchange constraint in the external sector as also for building up secondary reserves. While this can be considered for the gold that is confiscated or acquired through customs revenue, this cannot be a feasible option for gold mobilised from households through issuance of securities.

The choice of an option or an optimal combination of these options will depend upon the macro-economic objectives arising out of the adjustment-with-growth strategy. It would be possible to arrive at tentatively the direct or notional financial cost benefit of these options on the basis of certain assumptions.

## **Economics of individual options**

The economics of options has been worked out based on financial values, taking generally 'one tonne' of gold as the unit. The following important assumptions have been made in respect of all the four options.

### **Assumptions:**

(i) Price of 1 tonne :	@\$350/oz.= \$11.25 mn.
(ii) Interest rate for \$ investment :	6 per cent per annum (at 1 per cent above LIBOR which in the recent period is ruling at around 5 per cent).
(iii) Income from lease :	1 per cent.
(iv) Maturity period :	3 years (considered a reasonable waiting period at least initially)
(v) Profit margin allowed	10 per cent of absolute money return

Interest accrual (where applicable) is computed in terms of gold.

### **(a) Lease**

Income on 1 tonne	\$0.3375 mn.
Profit retained	\$ 0.03375 mn.
Available for investor for 3 years per oz.	\$ 303750/32150 i.e. \$ 9.447
Annual return	0.889 per cent or 0.9 per cent.

### (b) Swap/Gold repurchase agreement

Assuming a gold price of \$ 350 at the end of 3 years, the annual return will be the same as in d: Sale option, i.e., about 5.7 per cent. A decrease in the acceptable return will provide a corresponding cushion for price increase. The extent to which such cushion will be available is shown below :

	Return Acceptable (p.a.)	1%	2%	3%
(i) Net income (\$ per oz)	49.65	49.65	49.65	
(ii) Acceptable return (\$ per oz)	10.61	21.42	26.91	
(iii) Surplus available (per oz)	39.04	28.23	22.74	
(iv) Maximum price increase in \$/oz over present price for which cushion is available.	39.04	28.23	22.74	
(v) Percent increase over present price that can be tolerated	11.15	8.07	6.5	

(Calculations are for a three-year period)

The above calculation shows that a return of about 3 per cent or less is feasible since we may have to allow a safe margin for international gold price increases to an extent of about 6 per cent per annum on the basis of recent trends.

### (c) Gold as collateral for borrowing

Forex loan on 80 per cent of 1 tonne	\$ 9.00 mn
Interest payable (LIBOR - 0.5 per cent)	\$ 0.945 mn
Interest otherwise payable (LIBOR + 0.5% percent)	\$ 1.215 mn
Notional saving on collateralised borrowing (for 3 years)	\$ 2,70,000
Profit retained	\$ 27,000
Benefit available for 3 years per oz.	\$ 43,000/32,150=
	\$ 7.55
Annual return	2.5 per cent

The benefit here is purely notional.

4) Sale

Proceeds of sale of 1 tonne	11.25 mn
Return at 6 per cent for 3 years (compounded)	\$ 2.15 mn
Profit margin retained	\$ 0.22 mn
Surplus for 3 years per oz.	\$ 1.93 mn/32150, i.e. \$ 60.03
Annual return	5.72 per cent (60.03/350)
	$\frac{5.72}{3} \times 100$

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