DMCC
DUBAI MULTI COMMODITIES CENTRE
Government of Dubai

IN-DEPTH ANALYSIS

THE IMPOSITION OF GOLD IMPORT DUTIES IN INDIA AND ITS IMPACT ON GOLD TRADE FLOWS WITH DUBAI

GOLD INDUSTRY REPORT

Report prepared by:

DMCC Commodity Services

Executive Summary

Commodities such as gold and other precious metals have become an asset class with a proven history of retaining their value and being able to hedge against inflation. In addition, culture plays a major role in global consumption patterns and this is more prevalent in markets such as India where buying gold is a social tradition. This deep affiliation for gold is seen to be the leading cause of the record high Current Account Deficit (CAD) in India. With the use of primary and secondary data from industry participants, articles and trade, as well as economic data from government institutions, this report takes an in-depth look at four areas:

India's relationship with gold: Rising gold prices in recent years have not deterred the acquisition of gold in India, where demand is driven by multiple factors including cultural underpinnings, the ease of purchasing gold in rural India and the simplicity of converting gold into cash. With a minimal production of gold, India's substantial consumption of 864 tonnes in 2012 is largely met by imports, making up approximately 15% of the country's total goods and services imported. [1]

India's Current Account Deficit: The overall growth rate of the Indian economy has slowed down to 6.5% in 2011-12 in comparison to 8.4% achieved in 2009-10. This is coupled with a growing CAD that is at an all time high of 6.7% of the country's GDP. Such a high CAD is considered unsustainable given the slow growth rate of the economy and a population (1.2 billion) growing at approximately 2% per year. [2] The country's strong affiliation with gold is considered to be a major contributor to the country's CAD as it is the second most imported commodity after petroleum.

Long term analysis and measures to curb the CAD: The government and the Reserve Bank of India have adopted a number of measures to combat the CAD. Key to the gold industry; the core focus of this report is the 2% increase of the import duty on gold taking it up to 10%. In the current environment of declining gold prices, it is believed that the impact of this duty hike will not be felt very strongly at a consumer level. Economic indicators and market analysts are pointing towards India retaining its position as the world's largest importer and consumer of gold, to what policy makers feel is detrimental to the nation's welfare. Traders also highlight that while the supply of gold through organised channels can be restricted, the import hike may require increased attention to gold inflows through unauthorised channels.

Impact on Dubai: India is Dubai's top trading partner across all commodities with gold being the second highest commodity by value traded by the two parties. With such a strong relationship and a deep-rooted cultural linkage to gold, a change in any trade policy in either Dubai or India is expected to have a short to mid-term impact on the trade volumes. Last year the growth of gold trade between the two parties tapered off and with an additional duty hike the trade may be further impacted.

This report is limited by the availability of recent data; however all findings and analyses point towards the conclusion that the increase in the import duty will have minimal impact in the reduction of the CAD. In the span of 20 months, the Reserve Bank of India has raised the import duty four times (currently set at 10%) and has still not achieved the desired outcome of curbing the CAD. In addition, India's duty raises threaten to have a detrimental effect on India's economy by encouraging the growth of the informal sector and decreasing competitiveness of its gold and jewellery traders.

India and the consumption of gold

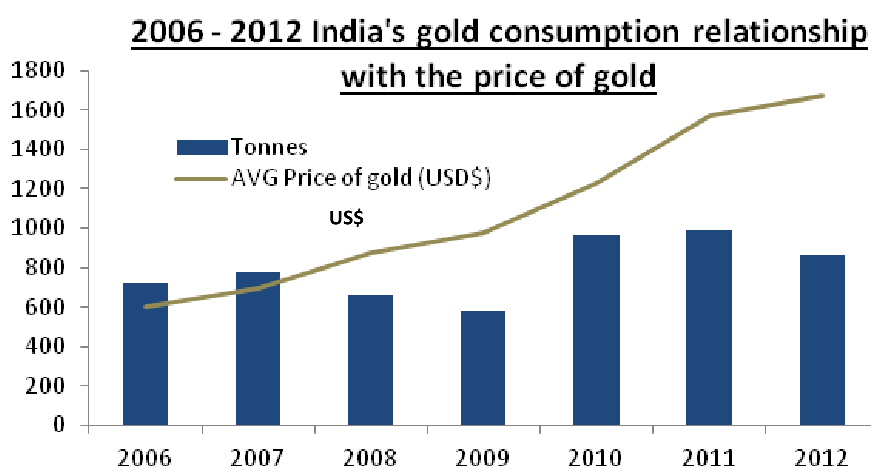
Indians see gold as a symbol of purity, prosperity and good fortune. As such, the purchase of gold is associated with auspicious occasions such as weddings and religious festivals e.g. Dhanteras, Akshaya Tritiya and Diwali. It is believed the quantity of gold jewellery Indians purchase on Akshaya Tritiya exceeds the amount bought on any other day of the year. [3]

Gold is the only item that permeates every strata and class of the Indian society; equally sought after by a wealthy urban businessman or a humble farmer in a village. In fact, 65-70% of gold purchases in India happen in rural areas, where 70% of the population lives and where agriculture is the main activity. In such areas, due to low literacy levels and the inability to access investment products like mutual funds, gold remains the top investment option. According to Vijay Sarda, a Mumbai-based bullion dealer and director of the Bombay Bullion Association, the main reason for such high rural demand for gold is non-taxation of agricultural income. If agricultural income were taxed, disposable income would be substantially reduced resulting in lower gold demand. [4] [5]

As noted by Pushpak Bullions Pvt. Ltd, one of the largest bullion dealers in India, the Indian community used to only buy gold for traditional or cultural family events, but in the last 10 years it has become a part of investment strategies as a whole. Mutual funds and other investors try to build up their investment portfolios now by having a larger percentage in gold. Initially gold's share was 2%-3%, but now it has risen to 25% since gold has provided strong returns over the last 5-7 years. [6] In addition, gold has played the role of safe haven as the value of global equity markets has fallen in comparison to the pre-2008 financial crisis and the value of the Rupee has devalued further by almost 25% in 2012 -2013.

India's gold trade

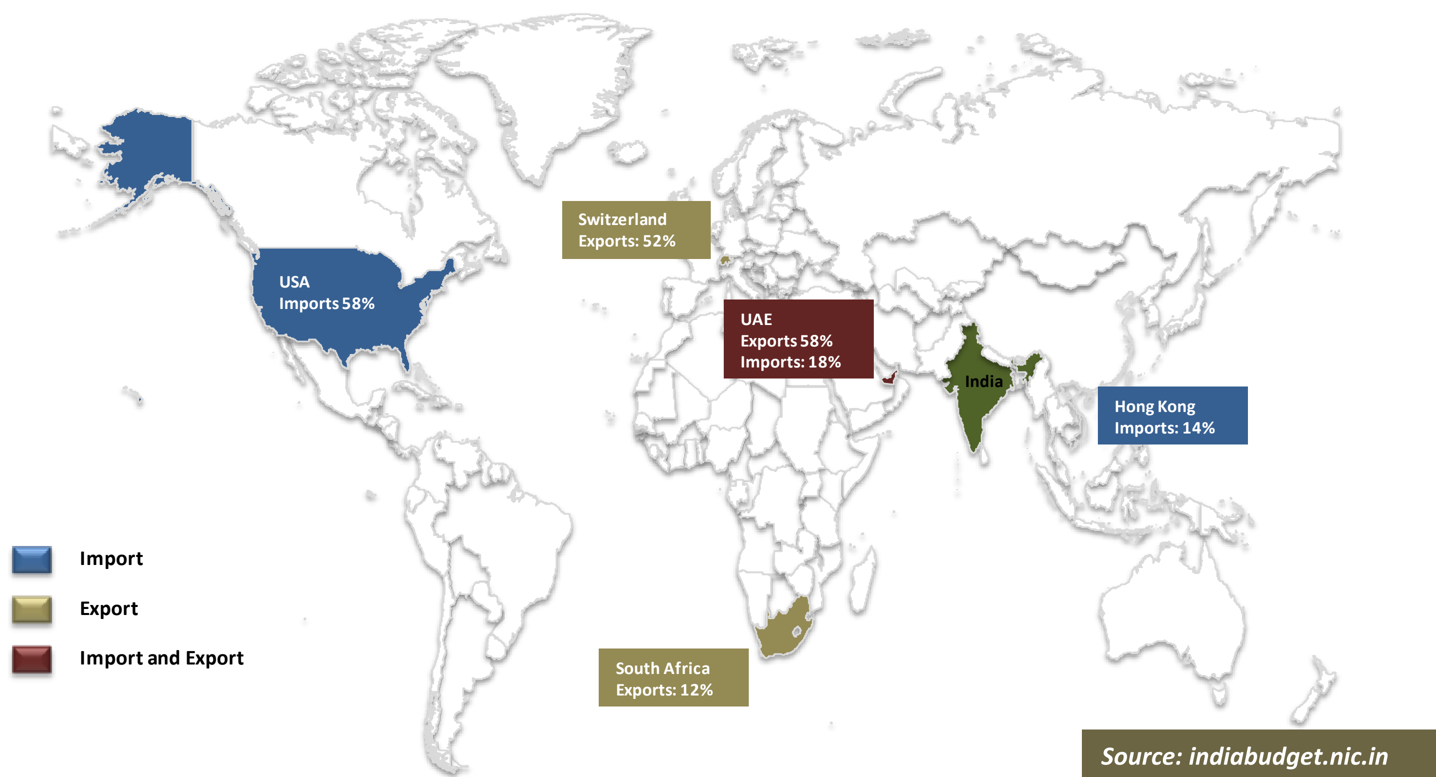
The cultural relevance of gold has led to a steady rise in its consumption and as a result, India has become the top consuming nation over the last 10 years. According to statistics provided by the World Gold Council (WGC), consumption in India has increased from 721.9 tonnes in 2006 to a total of 864.2 tonnes in 2012, the equivalent of 27% of the total gold consumed globally. As illustrated on the right, India's gold consumption is not strongly related to the price of gold. Over the last 7 years India has experienced an average growth in consumption of 2.6% in spite of increasing gold prices.



Source: World Gold Council [1]

Domestic production of gold is estimated at only 2.8 tonnes in 2011-12 and can meet around 0.3% of the demand, as per the 2011-12 Annual Report of the Indian Ministry of Mines; India depends significantly on imports to meet the domestic demand for this precious metal. In 2011, the major source countries for import of raw gold by volume for India were Switzerland (52%), and the UAE (17.6%) [7] as illustrated on the next page.

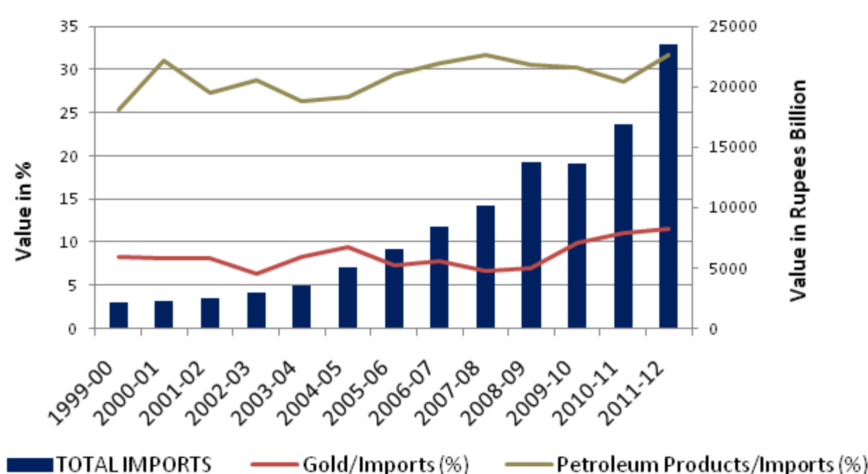
India’s top trading partners in 2012



In 2012 India’s main export destination of gold jewellery by volume included the UAE (57.9%), Hong Kong (14.1%), and the USA (12%) – see above – whereby export is driven by India’s status as a manufacturing hub.

Furthermore, gold is the second most imported commodity in India, and together with petroleum, accounts for 45% of the country’s total imports (value). Gold made up 11% of the total import (value) in 2011. Petroleum has been categorised as an essential commodity as it is used to power 90% of the country’s infrastructure. The use of gold is not nearly as important to the Indian economy and thus subject to greater scrutiny.

Percentage of gold & petroleum products against total imports



Source: www.rbi.org.in, http://indiabudget.nic.in/ and Foretell business solutions [7] [8]

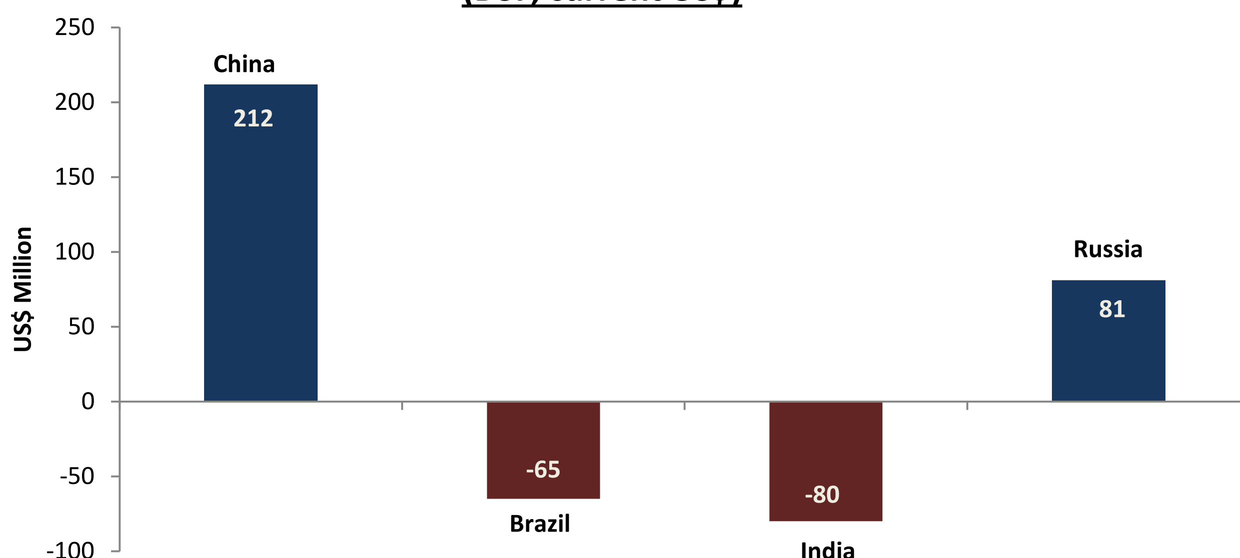
The Current Account Deficit Problem

India's total imports of goods, services and transfers are greater than its total export of the same services and products; leading to a Current Account Deficit (CAD) or negative balance of trade. In developing countries a CAD is acceptable in the short term because there are certain services, labour force and products that need to

be imported in order to enhance the socio-economic growth of the country. However, in the long term, a CAD can lead to inflation, currency devaluation, low interest rates and slow economic growth.

According to the CIA world fact book, in 2012 India's trade deficit was estimated at US$ 80 billion, representing a 33% increase from 2011. The second half of 2012 was particularly challenging as imports rose significantly faster than exports. In Q3 2012 India's CAD increased by US$ 22.3 billion (5.4% of GDP); an additional US$ 32.6 billion was added in the fourth quarter of the year. Almost 70% of India's deficit was created in the second half of 2012 generating great concern about the emerging pattern. [9]

In comparison to the other 'BRIC' countries, namely Brazil, Russia and China, India's current account balance performed the worst in 2012.



Source: cia.gov: The CIA FACTBOOK [10]

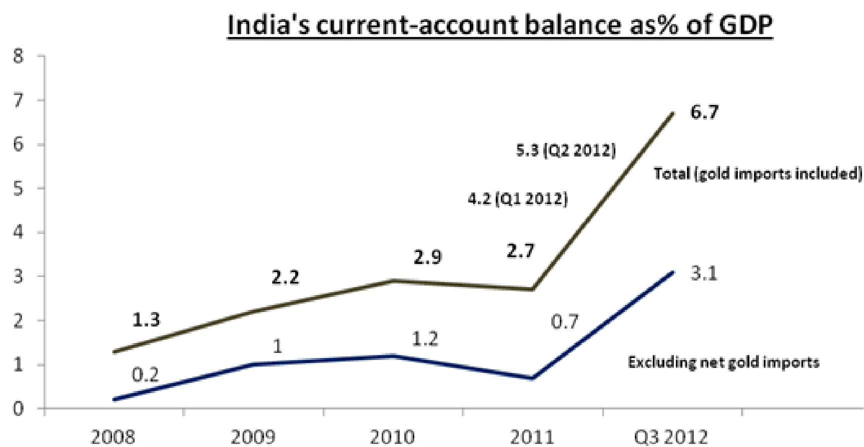
To reduce this deficit the country needs to bridge the gap with capital inflows which are currently hard to find as India's biggest trading partners – North America, Europe and Asia – are still recovering from the aftermath of the 2008 financial crisis. The Indian government believes they are comfortable with a CAD of 2.5%, which is why the Finance Minister P. Chidambaram has said that the soaring deficit is "worrying". [11]

The economics department at Citi Group forecasts India's current account deficit to remain unchanged in 2013. However in the next two years they see the rate falling to 4.7% in 2014 and to 3.5% in 2015. This forecast is set against a GDP that is growing at 4.5% to 5.5% a year.

Gold's impact on India's deficit

In India 30% of the trade deficit in 2011-12 has been attributed to the rise in gold imports. The RBI in its draft report of the Working Group to study 'Issues Related to Gold Imports and Gold Loans by Non Banking Financial Company's in India' has stated that if gold imports in India had grown by 24% (the average growth in world gold demand during the past three years) instead of 39% in 2011-12, the CAD would have been lower by approximately US$ 6 billion and the CAD-GDP ratio would have been 3.9% instead of 4.2%. The featured graph – next page – shows the CAD to GDP relationship with and without gold.

There has been a gradual increase of India's current account deficit on a yearly basis since 2004-05. The last two years were particularly bad for the economy as the CAD has gone up significantly due to the increase in the gold imports, the economic slowdown of the nation and increase in the demand of overseas market products to that of locally produced goods. Gold has come under scrutiny because of the continuous rise in imports. Furthermore, according to the Finance Ministry, there is enough gold inside the country which, if it were mobilised domestically, could provide for the country's jewellery segment.



Source: economist.com, www.rbi.org.in, Foretell business solutions [8]

According to the World Gold Council, today there are 165,000 metric tonnes of stocks in existence above ground. Indian households hold 18,000 tonnes of gold (9.6% of the world's total gold stock), as revealed by global research firm Macquarie. This amounts to US$ 950 billion, which in turn is around 50% of the country's GDP in dollar terms and is almost double the gold reserves maintained by the US Federal Reserve. [12] The Indian government in comparison owns a negligible 360 metric tonnes of gold (forming about 6% of the current value of its total foreign exchange reserves).

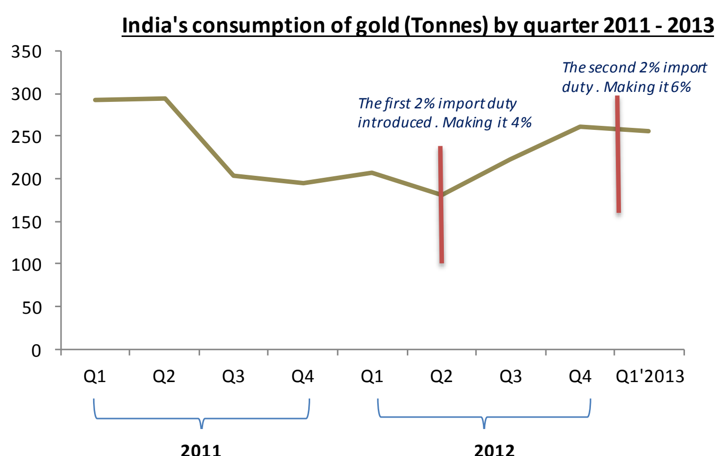
India accounts for over a quarter of the global gold consumed (3,163 tonnes in 2012), and spends about 12% of its import bill on the metal. In addition it is projected that India's continued rapid growth will have a significant impact on income and savings and is set to increase gold purchasing by almost 3% per annum over the next decade. [13] According to Venugopal Reddy, a former governor of the India's central bank, the Reserve Bank of India, gold has created an incurable 'drain on savings', threatening to hinder economic progress.

Mitigating steps taken by the government to curb the import of gold

Measures taken in 2012

Since his re-appointment in 2012, Chidambaram Palaniappan, India's Minister of Finance, has made it his mandate to tackle the country's CAD. Soon after his return to office, a bill was passed to increase the import duty on standard gold and platinum from 2% to 4% and non-standard gold from 5% to 10%.

Despite these measures the quantity of gold consumed in the country grew by 44% from 181 tonnes in Q2 2012, prior to the duty increase, to 262 tonnes in Q4 2012 when the import duty was higher. [1] For the full year 2012, India's total gold consumption (864 tonnes) fell by 7% compared to 2011; with the lowest volumes in Q1 2012 prior to any duty changes. [1] It is important to note that gold consumption globally also fell by 9% as a result of the slow growth of the global economy and the rising gold price.



Source: World Gold Council [1] and Reserve Bank of India [8]

Surprisingly, the increase in duty had no visible effect on the quantity consumed. Gold trade began to increase in India after the duty

introduction. RBI increasing the import duty on gold to 4% had little measurable effects on reducing the outflow of foreign exchange on account of import of gold.

Measures taken in 2013

At the start of 2013, the Finance Ministry once again increased the import duty on gold and platinum, from 4% to 6%. According to data from WGC, consumption of gold in Q1 2013 has dropped by 24% in comparison to Q4 2012 suggesting that the hike of the import duty is finally correlating to a reduction in the quantity of gold being consumed in India.

On the 15 April 2013, gold prices fell 9.3% to US$ 1,361, the biggest two-day drop in more than 33 years. This drop was the result of, but not exclusively, the economic instability in Europe, revival of the equity markets in North America and the Federal Reserve signalling the end of Quantitative Easing[1]. The price fall lead to a buying frenzy driven by India, Dubai, Japan and other leading gold consuming countries. In a report released on May 29 2013, WGC has forecasted India's gold imports will be 300 to 400 tonnes, which is almost half of what was consumed in 2012. In order to control the demand, on June 5 2013, the RBI increased the import duty further to 8%. [14] The latest import hike of 2% taking the total duty to 10% was introduced on August 14, 2013.

	Jan. 2012	Mar. 2012	Jan. 2013	Jun. 2013	Aug. 2013
Dore	0%	2%	4%	6%	8%
Bars	2%	4%	6%	8%	10%
Tola bars/ Others	5%	10%	10%	10%	10%

Increase in duty of Dore bars: In June the government increased the import duty of standard gold to 8%, it also increased the import duty on gold Dore bars from 4% to 6%. "*It was a duty arbitrage they have plugged*," said Shekhar Bhandari, Executive Vice-President of Treasury at Kotak Mahindra Bank. "*Otherwise, people wouldn't import through normal channels, but import Dore bars*." However, Harmesh Arora, Director, Bombay Bullion Association, said, "*There won't be much impact. Dore imports would increase day by day*". The small percentage increase would not deter refiners as they are still trying to tap small miners in Ghana, Kenya and other African countries for Dore bars.[2] [15] This has now been increased to 8%.

Introduction of Precious Metals in the Prevention of Money Laundering Act (PMLA): In December 2012, the government has also amended the Prevention of Money Laundering Act (PMLA) to include Precious Metals under its purview. Market sources say that due to the inclusion of gold into PMLA, dealers cannot sell gold without proper proof of the identity of buyers. They have to follow strict Know Your Customer (KYC) guidelines to sell gold. If dealers fail to follow the guidelines, they will have to pay hefty penalties and/or may face imprisonment of between three to seven years. [16]

Gold bars import on consignment: The RBI has introduced a new import law for approved banks and financial institutions to import gold bars on a consignment basis in order to moderate the demand for gold for domestic use. The law states that it is only the RBI assigned bullion banks that are permitted to import gold bars on consignment loan. An initial deposit will have to be paid to the bullion bank prior the gold being imported into the country. Payment at the current gold price is to be made back to the bullion bank once the

[1] *Dominic Schnider, an analyst at UBS Wealth Management, highlights, "people recognize that an environment where you have no inflation is a powerful driver to get out of gold"*

[2] *Annual imports of Dore, an alloy of gold and silver used by refineries to produce pure gold, stand at about 100 tonnes. Most of the Dore imports are bought by state-run MMTC (MMTC.NS), PAMP and Rajesh Exports (REXP.NS)*

gold is sold by the local client. If the gold is not sold in 30 days, it will be returned to the institution that brought it in. This rule by the government is intended to cool down demand for gold for domestic use, as only the genuine needs of gold jewellery exporters would be exempt.

Other propositions

At the same time a proposal was made to unfreeze or release a part of the gold held physically by mutual funds under Gold ETFs and enable them to deposit the gold with banks under the Gold Deposit Scheme.[3]

The advantage would be that part of the gold lying in stock would be brought into circulation and will partially meet the requirements of the gem and jewellery trade. It is hoped that, consequently, this would lead to greater moderation in the quantity of gold that is imported into the country.

Apart from Gold ETFs, the changes proposed to the Gold Deposit Scheme will make it attractive for individuals to deposit their unused gold with the banks under the Scheme. The minimum quantity of gold that may be deposited will be reduced and the minimum tenure of deposit will be reduced to six months (from the present stipulation of three years). Banks have been advised to notify clients of the changes in the Gold Deposit Scheme.

The government has also proposed to initiate gold linked products such as: [8]

Gold Linked Accounts: Non-interest bearing accounts, giving users the exposure to gold markets – where the gold would be purchased and hedged abroad.

Gold Pension Plans: Targeted at senior citizens and allowing reverse mortgage of properties; banks would open an annuity plan with the insurance companies for a specific period.

Gold Accumulation Plans (SIPs): Where small quantities could be bought at regular intervals.

Inflation linked bonds: In June 2013, for the first time in 15 years the government reintroduced and sold inflation-linked bonds to provide investors with an alternative to gold as a buffer against inflation.

Analysis and impact of the increase in import duties

At the recent Dubai Precious Metals Conference (DPMC) 2013, it was highlighted by Pankaj Parekh, GJEPC, that since the import tax increase at the start of the year, gold consumption has been forecasted to drop to 200 tonnes by the end of the April 2013.

However, market sentiment is that the impact of customs duty on import will be temporary and not yield the desired results. This is driven in part by the fact that since January 2013 the average price of gold has been declining, which has helped offset the increase in import tax and adjusting the imports for gold.

Overall, gold is nearly 30% down from its all-time trading highs of more than US$ 1,900 per ounce in September 2011. The average gold price for April 2013 was US$ 1,486 - 7% less than the previous month. In comparison to the same period last year, the average price was 10% less.

The Indian Government Planning Commission Deputy Chairman Montek Singh Ahluwalia said the declining prices will, "Certainly make our macroeconomic balancing exercise easier... Now people will not rush into gold

[3] Gold deposit scheme, allows investors to earn interest on the gold lying idle with them. The scheme is open to resident Indian individuals, Hindu undivided families, trusts and companies. The deposit is typically offered for 3-7 years. The interest earned on the deposit is exempt from income tax and the value of the gold offered is exempt from wealth tax.

as an investment asset. They will look for other more productive assets. I think that would be good for the economy." [17]

In contrast, HSBC recently reported that because of the high price sensitivity of demand this latest price drop may actually increase Indians' demand for gold leading to higher imports and eventually end up with little or no impact on the CAD. Lower inflation and wage growth would matter more in bridging CAD. [18]

Market forecasts

According to a Bloomberg report, Somasundaram P R, Managing Director of WGC India, said, "While the current account deficit is a serious issue, increasing the duty and trying to stop gold demand will not yield results." [19]

In spite of the import duty increase by the Indian government, WGC has predicted imports will increase this year as there are 20% more celebratory gold buying occasions in comparison to 2012.

In 2013, WGC expects India's gold demand to increase to a minimum of 865 tonnes and to a maximum of 965 tonnes. Last year, it was 864.2 tonnes while recycled gold stood at 117 tonnes.

According to an article in Business Standard, a leading business daily publication in India, jewellers saw good demand in March 2013 and they expect this trend to continue through summer. Demand would re-emerge in August through to the end of the year. "We are seeing good sales this year, compared to last year. In value terms, I expect sales to be up 20-25%," said Mehul Choksi, Managing Director of Gitanjali Gems.

Parallel market

The illegal parallel market is of huge concern to global market participants and collectively they have been working together to bring it to an end. "It may be that at least a quarter of the gold coming into India is coming through unofficial channels," Global Head of Thomson Reuters GFMS, Philip Klapwijk quoted to Business Day's Allan Secombe.

One of the key dangers highlighted from the current duty structure is the re-emergence of smuggling through the border countries like Bangladesh and Nepal. The Directorate of Revenue Intelligence (DRI) recently informed the government about organised cartels becoming active again in gold smuggling because of the price differential. "Emergence of tola bars on the smuggling scene only confirms this," said a customs official.

On April 9, 2013 the DRI caught 35.85 kg of tola bars being smuggled into the country from Bangladesh. "The trend does not augur well... Tola bars are unnumbered and therefore, tracking them is very difficult," said a DRI official confirming the haul. [20]

Aparna Ramalingam, a senior correspondent from Times of India has highlighted, "Air customs officials speculate that more gold will be smuggled from abroad through airports as import duty is now at its steepest. There has been an increase in smuggling of gold through Chennai from Sri Lanka, Singapore, Malaysia and other Southeast Asian countries over the past three years". To help control and/or possibly eradicate smuggling, the Customs officials have to be on their best performance to be able to pinpoint and identify any irregular trades. Jewellers say smugglers, couriers and middlemen can make as much as Rs 1,800 (US$ 34) for every 10g of gold imported (6% of US$ 556). [21]

Prithviraj Kothari, Managing Director, RiddiSiddhi Bullions, said, "It [increase in import duty] will have a big impact on the bullion sector. The increase comes to approximately Rs 60,000 per kg of gold (US$ 1,112). There will be a difference of 7% between international and domestic prices of the yellow metal. This may lead to rise in malicious activities to import gold and jewellery. In turn, it will lead to an increase in unemployment among skilled artisans - around two million people depend on this sector for their livelihood." [21]

"The fallout of every duty increase is the rise of the parallel imports (economy) as it becomes more and more profitable to the parties concerned. This will result in the rise in corruption and also all work done in the past few years to bring transparency in the jewellery industry being undone. A direct result is also the anti-social elements become more and more powerful. Also any increase in the duty is not going to change the demand for the yellow metal in the long run, it may be a temporary lull but than the price adjusts itself and the demand resumes." said Chandu Siroya, Owner, SIROYA JEWELLERS LLC

Decrease in Trade

The 10% import duty is an increase in cost for the entire gold value chain in India which will be passed on to the end customer. It also gets added to manufacturing costs for the export market reducing the competitiveness of Indian manufactured jewellery in the global market. The end impact could be a reduction of the export of jewellery out of India, challenging India's status as a manufacturing hub and having a further compounded negative impact on the CAD.

Change in selling and consumption patterns

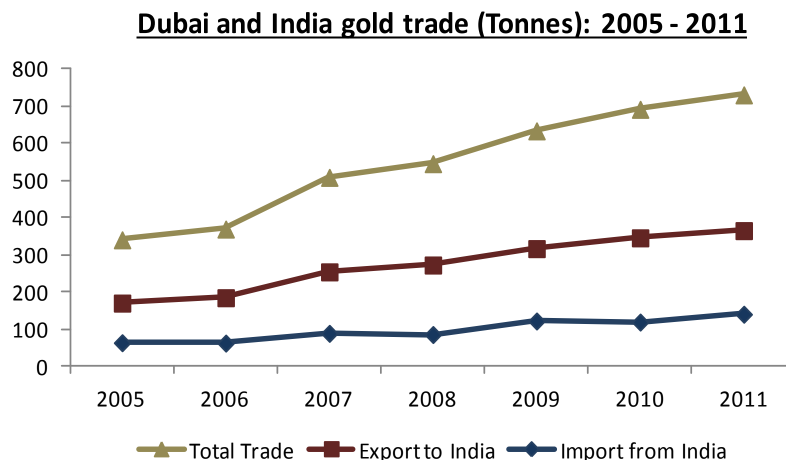
Last year, the fall in consumer demand for gold in the investment segment in India was sharper than in the jewellery sector. While the jewellery sector recorded a fall of 6.83% (565.9 tonnes), demand in the investment segment fell 16.3%. Jewellers have started gradually phasing out sales of coins and bars, owing to the low margins for investment products. They have, instead, intensified their focus on ornaments, which have much higher margins. [22]

What does this mean for Dubai?

Over the last decade India has remained Dubai's most significant trade partner. In 2011 India accounted for 19% of Dubai's trade (commodities + finished products) at a value of US$ 47 billion. The top traded commodities in the Emirate were diamonds, gold, rice, silver, steel and sugar. These six commodities made up 83% of the trade. On its own, gold accounts for 38% of the total trade.

Dubai has a strong gold trading relationship with India. In 2011 India imported 25% of its gold consumption from Dubai. The total trade volume of gold was 365 tonnes with a 7 year CAGR of 12%. Exports to India represented 225 tonnes, while Dubai gold imports from India stood at 140 tonnes. [23]

The increase in import duty in India has the potential to change the trade dynamics with Dubai, which has a strong gold market and state-of-the-art infrastructure that supports the trade of gold. Indian traders could prefer to import,



Source: Dubai Customs [23]

store and trade their gold in the Emirate in order to avoid the import tax cost. The most likely trade model would be that of gold being sourced from producing countries and brought to Dubai, stored and/or refined in Dubai and then exported to India only when needed, maintaining reserves and excess stock outside of India.

Recommendations discussed by market leaders

The Indian Minister of State for Finance, Namo Narain Meena, has said that measures such as raising customs duty are expected to lead to moderation in gold imports which is adding further pressure on the current account deficit today. He highlighted that the aim of this policy is not to eradicate the trade of gold but to curb the import of gold. Market analysts challenge this notion and believe the market will adjust itself to the current situation and return back to square one. In addition the duty hikes would create an avenue for smuggling and illegal trade, which can cause a major setback on the ongoing effort by gold regulators to clean the gold trade value chain i.e. responsible sourcing.

Many market participants believe that investors are diversifying from the Stock Exchange to the Bullion Market in order to earn speculative gains. To obtain the desired result, instead of increasing the import duty, some believe that VAT should be increased from 1% to 5% on the sale of bullion, coins, primary gold, Exchange Trade Funds (ETFs), etc. If the buying and selling price has a difference of 5-6 % rather than an increment of price by 6-7 % over a given period, speculators would yield no gain (being an unregistered dealer would make him lose the entire amount of VAT paid). Under such circumstances, speculators are likely to shy away, reducing the requirement of importing gold. [24]

Whilst the supply of gold through organised channels can be constricted, as per market leaders there needs to be vigilance regarding gold inflows through unauthorised channels. They believe that ultimately, the best way to reduce gold imports in a sustainable manner is to offer the public financial investment opportunities that generate attractive returns. This means bringing down inflation as well as expanding the range of investments that can be easily accessed.

Furthermore, it has been highlighted that alternative measures to increase the country’s export of other commodities and services may need to be considered in order to combat the CAD and create a current account balance in trade or a surplus. Other measures taken by the government to tackle the high rate of gold imports have not yet yielded the desired result.

Conclusion

India’s strong cultural affiliation with gold has turned out to be detrimental to the Indian economy in the current scenario. With a compounded growth of the country’s current account deficit, the government has adopted and proposed a number of measures to curb the excessive demand and consumption of the precious metal. Over the last 12 months, one measure that has caused a serious stir is the 10% import duty (increased from 4%) imposed by the Indian government in August 2013 as a means of increasing the cost of imports.

However, market analysts till June still forecasted India’s gold imports to increase to 1,200 tonnes by the end of 2013. As the global economy and equity markets begin to pick up, the price forecast of gold by major banks and trade institutions have been revised to US$ 1,500 per ounce by the end of 2013, from a high of US$ 3,000 per ounce by the end of 2013. This fall in price would only spur demand and play a key role in the purchase of gold.

This is not the first time the Indian government has increased import duty, nor is it the first time the government has adopted various measures to reduce the import of gold. However, all the steps taken thus far have yielded no long-term positive result. For every policy, the Indian society recovers from the initial shock, readjusts and continues to import gold as done previously. According to market leaders, these new policies and laws have the potential to lead to illegal trade and open more channels of irresponsible sourcing which is a troubling concern for India and its trade partners. The true effect of the recent increase in import duty is yet

to be known, but the end of year import weight of gold will give a clearer picture on whether the import duty increase had a major impact.

In the last week of July, the RBI passed a law making it mandatory for gold importing agencies to allocate 20% of gold imported for re-exports as jewellery. The gold imported can be in any form or purity, including unrefined gold. Importers are to store 20% of their gold imports in a custom bonded warehouse and will only be allowed to import more gold when 75% of that 20% has been exported.

Many believe that the Indian government needs to consider other avenues to reduce gold consumption that is intrinsic to its society. In order to combat the CAD, the government could look at other goods and services that are imported and channel their energy to reduce import in those segments. For example, the import of petroleum (the largest contributor to the CAD) could be reduced by focusing on alternative source of energy such as bio-fuels and solar energy to be able to power the country's infrastructure. Such an alternative would provide a win-win solution for the government and its citizens as it creates jobs, reduces Co2 emissions, and contributes to the reduction of the CAD.

Furthermore, it has been highlighted that financial products need to be made available at the grassroots level to offer a viable alternative to investment in gold to even the smallest investor. If other avenues are ignored and the main focus continues to be gold, the government might only scratch the surface in the CAD reduction and not see any tangible long-term results.

Definitions

Tola bars

These are unnumbered gold bars, as opposed to the numbered and standard bars. Once melted tola bars are difficult to trace but standard bars leave a trace of utilisation. Smuggled standard bars can be traced. The government started imposing higher import duty on tola bars since 2003. The move slowly killed the manufacturing of tola bars globally because the 10% duty differential made them unviable in India through the official route.

Current Account Deficit

The state of the current account of a country is one of the economic indicators of a country. There are a number of indicators that determine a current account deficit, some of which are a high level of borrowing and the inability to pay back the principal and interest rates. Another form of current account deficit is when there is an increase in saving investment in comparison to the amount that is saved. And the last indicator of CAD, which applies to the situation India is encountering, is the negative balance in trade (trade deficit). The balance of trade is expressed as the difference between the value of exports of goods and services and the value of imports of goods and services. A deficit then means that the country is importing more goods and services than it is exporting.[4] Turkey, U.S and South Africa currently have current account deficits. The US has the highest current account deficit at US$ 475 billion in 2012 (combined balances on trade in goods and services, income, and net unilateral current transfers). [25]

Concerns arising from the Current Account Deficit [26]

Concerns arising from CAD are manifold since it can lead to the following:

Devaluation of the currency: More people tend to sell local currency to buy any other foreign currency that they require to support their imports. The demand-supply gap between the foreign currency in demand and the local currency leads to devaluation.

Inflation: As a result of the decrease in the amount of money in circulation because of the increase in imports the government will be forced to increase the money in supply which leads to an increase in price and inflation.

Low interest rates and slow growth of the economy: Inflation puts pressure to decrease interest rates and the exchange rates of a currency. As a result most foreigners tend to take money abroad, or keep it away from the depleting economy.

Low Capital inflows: As a result of the above points, investors become weary about the economic situation and countries tend to experience a decrease in Foreign Direct investment (FDI) into their country.

[4] The current account also includes net income (such as interest and dividends) and transfers from abroad (such as foreign aid), which are usually a small fraction of the total.

Appendix

Gold timeline in India [27]

In the last 51 years the Indian government has passed several laws to curb the demand of gold but at all times has failed to achieve its objective. The laws passed lead to unofficial channels and markets, smuggling and the creation of a black market and the death of the official gold market. Some of them are:

Prior to the Sino Indian war (war between India and China), India was the largest gold market in the world. However after the war in 1962, due to loss of reserves, in the same year the government passed the Gold Control Act, which prohibited the citizens of India from holding pure gold bars and coins. At that time only licensed dealers were allowed to deal in pure gold bars and coins. This forced all bullion that was privately held to be turned into jewellery; at the same time opening channels for smuggling of bullion bars.

In November 1962, an initiative to eradicate the gold that was hoarded in the country was set up and was lead by the government and RBI in partnership with the commercial banks. The initiative was a scheme where the commercial banks pay interest on bonds issued in return for gold bullion bars, coins or jewellery. For example, Fifteen year Gold Bonds had a 6.5% annual interest payment. However the initiative was not able to build momentum as it could only mobilise 16.7 tonnes of gold. A second attempt to garner gold was made through the 7% Gold Bond 1980 Scheme but it could mobilise only a further 6.1 tonnes.

The third attempt was the National Defence Gold Bonds in 1980, which could only get 13.7 tonnes, while the Gold Bond Scheme 1993 garnered 41 tonnes of gold. The last Gold Deposit Scheme, launched in 1997[5], could mobilise only 7 additional tonnes of gold within two years of its launch.

In the 1999-2000 budget, the Indian government announced a revised initiative to the agreement they had with the commercial banks to tackle the gold held privately. The commercial banks could take gold deposits of bars, coins or jewellery against payment of interest. The interest set was based on the discretion of the banks and the deposit periods ranged from 3-7 years. In addition, the interest and any capital gains on the gold were exempt from tax, and the banks could lend the gold to local fabricators or sell it onto the main Indian Gold Market or to local banks. The State Bank of India was the first to accept deposits, but to date the amount of gold collected under this scheme is just 10 tonnes. Again, the scheme didn't work.

The reasons pointed out for the failure of some of the schemes carried out by the government are:

Since 1992, the government has made it mandatory for the depositor of gold to show the origin of the gold. This becomes an issue as most of the gold owned is from centuries back and some of it may have been illegally imported.

Secondly, the fabrication value of the gold jewellery is lost because the bank converts the jewellery into plain bars before accepting it as a deposit.

And finally, many depositors don't believe they get any significant value for their gold if it's stored in the bank.

In addition, with the price of gold rising at a faster rate than the rupee, the rate of interest needed to convince private Indian gold owners to part with their bullion would have to rise substantially. [27]

[5] *From 1980 to 1997, the schemes were based on a 7% interest rate*

Duty Structure in India [28] [29]

Year	S.No.	Description of goods	Rate
JANUARY 2012	1	Gold bars, other than tola bars, bearing manufacturer's or refiner's engraved serial number and weight expressed in metric units, and gold coins having gold content not below 99.5%.	2%
	2	Gold in any form (other than those specified against S. No.1 in this column) including liquid gold and tola bars.	5%
MARCH 2012	1	Gold ores and concentrates for use in the manufacture of gold	2%
	2	Gold dore bar, having gold content not exceeding 95%	2%
	3	(i) Gold bars, other than tola bars, bearing manufacturer's or refiner's engraved serial number and weight expressed in metric units, and gold coins having gold content not below 99.5%, imported by the eligible passenger (ii) Gold in any form other than (i), including tola bars and ornaments, but excluding ornaments studded with stones or pearls	4% 10%
	4	Gold bars, other than tola bars, bearing manufacturer's or refiner's engraved serial number and weight expressed in metric units, and gold coins having gold content not below 99.5%,other than imports of such goods through post, courier or baggage.	4%
JANUARY 2013	1	Gold ores and concentrates for use in the manufacture of gold	4%
	2	Gold dore bar, having gold content not exceeding 95%	4%
	3	Gold bars, other than tola bars, bearing manufacturer's or refiner's engraved serial number and weight expressed in metric units, and gold coins having gold content not below 99.5%, imported by the eligible passenger	6%
	4	Gold bars, other than tola bars, bearing manufacturer's or refiner's engraved serial number and weight expressed in metric units, and gold coins having gold content not below 99.5%,other than imports of such goods through post, courier or baggage.	6%
JUNE 2013	1	Gold ore and concentrates for use in the manufacture of gold	6%
	2	Gold dore bar, having gold content not exceeding 95%	6%
	3	Gold bars, other than tola bars, bearing manufacturer's or refiner's engraved serial number and weight expressed in metric units, and gold coins having gold content not below 99.5%, imported by the eligible passenger	8%
	4	Gold bars, other than tola bars, bearing manufacturer's or refiner's engraved serial number and weight expressed in metric units, and gold coins having gold content not below 99.5%,other than imports of such goods through post, courier or baggage.	8%
AUGUST 2013	1	Gold ore and concentrates for use in the manufacture of gold	8%
	2	Gold dore bar, having gold content not exceeding 95%	8%
	3	Gold bars, other than tola bars, bearing manufacturer's or refiner's engraved serial number and weight expressed in metric units, and gold coins having gold content not below 99.5%, imported by the eligible passenger	10%
	4	Gold bars, other than tola bars, bearing manufacture's or refiner's engraved serial number and weight expressed in metric units, and gold coins having gold content not below 99.5%,other than imports of such goods through post, courier or baggage.	10%

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