Gold in the Indian Economic System*

Y.V.Reddy

I am delighted to be with you this morning and I thank the organisers for the opportunity given to me to address this conference At the outset, let me extend warm welcome to you and a special welcome to participants from foreign countries. I hope you will enjoy the pleasant weather and warm hospitality as much as you would enjoy the stimulating deliberations here. Much of the retail market for gold in our country is in jewellery shops and I trust that you will visit them. Please see for yourself where the gold is put to maximum use in India – by attending one of the wedding ceremonies or receptions here.

2. In the larger context of economic reform, we are examining a number of policies and surely gold cannot escape serious attention. For my part, I intend to present both a review of the policies and the emerging issues relating to gold, with special reference to the role of the Reserve Bank of India.

3. I will start with a brief account of India's position in the global gold economy and of the features of India's gold economy. I would then present a review of the policy as well as the ongoing debates. As a central banker, I would share with you the present position on reserves management, on the use of gold as a financial instrument of development and on gold markets in general. This presentation should lead one to flag the issues that are, and in any case, ought to be engaging our attention. At the same time, I trust that we will benefit immensely from your rich international experiences and considered views in addressing these issues.

India and Global Gold Economy

4. Our position in the global gold economy in terms of broad magnitudes can be highlighted with a few facts.

First, the total gold stock in India is estimated at 9,016 tonnes as against the world stocks of 1,28,800 tonnes in 1994 giving a share of 7.0 per cent to India. This should be viewed against our share in land area at 2.4 per cent, in population at 16.4 per cent and in GDP at 1.2 per cent.

Second, mining and production of gold in India is negligible, now placed around 2 tonnes as against a total world production of about 2,272 tonnes in 1995.

Third, during 1990-95, our share in global gold demand is placed at about 402 tonnes (16.4 per cent) a year, including imports into India. This should be viewed against our share of 0.6 per cent in world trade. On the other hand, India exported about 23 tonnes in 1995 accounting for a negligible part of world trade – though there was a brief period of illegal exports in the early 'seventies and substantial legal exports in the pre-independence era.

Fourth, it is pertinent to note that world gold trading is concentrated in the U.K., Switzerland, Dubai, Hongkong, etc. and India does not figure among them.

Fifth, facilities for refining, assaying, making them into standard bars in India, as compared to the rest of the world, are insignificant, both qualitatively and quantitatively.

Sixth, of the total gold reserves estimated to be on the books of Central Banks (subject to some Banks not declaring them) of 28,225.4 tonnes, the holdings of Reserve Bank of India are only a modest 397.5 tonnes. Government of India has in its possession some amount of gold mainly out of confiscation of smuggled gold remaining after transferring it to the Reserve Bank of India from time to time. Generally speaking RBI is neither a speaking purchaser nor a seller of gold reserves, unlike many other countries including some developing economies, especially in Asia. A part of gold was used by RBI (in parallel with gold with Government) for raising foreign currency resources during the balance of payments crisis in the early 'nineties. These overseas gold holdings are being used as part of reserve management to yield a return.

Seventh, use of gold as a financial product is virtually non-existent in India except to a limited extent of issuing ‘Gold Bonds’ by Government of India from time to time coupled with occasional tax amnesty. Commercial banks, however, accept gold as security, but no advances are permitted for purchase of gold by their customers for non productive use.

Features of India’s Gold Economy

5. India has been known to possess large stocks of gold and studies show that they are mostly accumulations from centuries of trading rather than result of production of her mines. What is of contemporary interest, however, relate to the demand, supply and price-movements and their link with policy. Some broad generalizations on these aspects would be appropriate to review the policy and identify the issues.

First, on the demand side, while there are no authentic estimates, the available indications are that about 80 per cent is for jewellery fabrication (mainly of over 22 carat purity) for domestic demand, 15 per cent is for investor-demand (which is relatively elastic to gold-prices, real estate prices, financial markets, tax-policies, etc.) and barely 5 per cent is for industrial uses. The demand for gold jewellery is rooted in the societal preference for a variety of reasons viz. Religious, ritualistic a preferred form of wealth for women and as a hedge against inflation. It will be difficult to prioritize them but it may be reasonable to conclude that it is a combined effect, and to treat any major part as exclusively a store of value or hedging instrument would be unrealistic. Nor would it be realistic to assume that it is only the affluent who create demand for gold. There is reason to believe that a part of investment demand for gold assets is out of black money. The annual consumption of gold which was estimated at 65 tonnes in 1982 has increased to 505 tonnes in 1995. Although it is likely that with prosperity and enlightenment, there may be deceleration in demand, particularly in urban areas, it would be made good by growing demand on account of prosperity in rural areas. In the near future, therefore, the annual demand will continue to be high at around 400 to 500 tonnes.

Second, as the domestic production of gold is very limited, around 2 tonnes per year, and supply from fabricated old gold scraps estimated at around 62 tonnes per year being not adequate, the rising demand has to be sourced from outside the country. In the face of a virtual ban on official import of gold for domestic consumption till 1990, the rising demand was met by illegal imports. During the period 1968 - 1995, smuggled gold into India varied in the wide range of 10 – 217 tonnes per year with the sole exception of 1980 when 9 metric tonnes were reported to have been smuggled out of the country to take advantage of the soaring gold prices in the international market. However, the situation changed drastically during the ’nineties since the proportion of smuggled gold in our total supplies has gone down substantially. While currently there are some efforts to promote gold mining domestically, especially involving private sector, there are no indications that domestic supply would increase in any perceptible manner.

Third, the strong domestic demand for gold and the restrictive policy stance are reflected in the higher price of gold in the domestic market compared to that in the international market at the available exchange rate. During the 19-year period from 1977-78 to 1995-96, the average spread between Mumbai and London market prices (Mumbai price less London price in rupee terms) of gold has been positive except for a brief period during 1980-81 when the international gold price zoomed briefly, following the oil crisis, the persistent weakening of the US dollar resulting in flight of dollar resources into gold and accelerating world-wide inflationary trends. The average spread was as high as 41.3 per cent during 1977-79 which rose to 46.6 per cent during 1981-85 and further to 56.6 per cent during 1986-91. In the post-liberalisation period, with changes in the exchange rate regime and some relaxations on the import regime of gold, the average spread between domestic and international prices has come down from 53.1 per cent in 1991 to 20.6 per cent in 1993, 20.1 per cent in 1994, 19.9 per cent in 1995 and further to 17.5 per cent in 1996 (up to October). In the absence of open import, the domestic gold prices relative to international prices appear to have been governed by two factors: (i) the spread between the official and market exchange rate of the rupee and (ii) the customs duty, transportation cost, storage cost, risk premia, etc.

Fourth, the value of gold imports through official channels increased from $ 1.25 billion in 1992 to $ 3.4 billion in 1995 while that of smuggled gold was in the range of $ 1.2 to $ 1.7 billion. Viewed from any angle, gold import has emerged, in terms of importance in our foreign trade, only second to that of oil.

Fifth, as the policy-debates would show, the management of demand and supply of gold has important policy implications for fiscal policy and exchange rate management, and in the recent times, use of gold as a financial instrument, especially mobilisation of domestic gold has attracted attention.

REVIEW OF POLICY

6. The evolution of the gold control policy since independence was centred around five main objectives viz. (a) to wean people away from gold, (b) to regulate supply of gold, (c) to reduce smuggling, (d) to reduce the demand for gold and (e) to reduce the domestic price of gold. It would be interesting to briefly recall the policy measures since our independence.

(a) Bullion imports and exports were banned under the Foreign Exchange Regulation Act, 1947. Control over gold production was assumed by the Mysore Government in November 1956. The official gold stocks of the RBI were revalued in the same year. The proportional reserve system was replaced by the minimum reserve system, for purposes of note issue.

(b) In a major effort to mobilise the vast gold reserves in the country, an issue of 15-year Gold Bonds at 6.5 per cent was made in November 1962. The bonds were issued in exchange for gold, gold coin, and gold ornaments. Subscriptions to these bonds totaled 16.30 tonnes. The issue of gold bonds was accompanied by exhortations to the public to refrain from buying gold and to surrender their holdings to the Government. The RBI advised commercial banks to consider recalling loans made against the security of gold. Forward trading in gold was banned in November 1962.

(c) The diversion of savings into the bullion market was sought to be controlled by the promulgation of the Gold Control Rules in January 1963. The Rules prohibited manufacturing of gold ornaments of more than 14 carat purity. Individual gold holdings had to be declared. In July 1963, refineries were prohibited from manufacturing gold of more than 14 carat purity. Control over internal trade and distribution of gold by the Government was fully established in 1964.

(d) A second attempt to garner gold 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. The quantity raised was 6.1 tonnes.

(e) A third series of gold bonds designated as National Defence Gold Bonds, 1980 at 6.5 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. The quantity raised was 13.7 tonnes.

(f) Strict gold control remained in force till November 1966, when the rules were amended, lifting the ban on the manufacture of ornaments of more than 14 carat purity. The amendments also placed ceilings on individual holdings and extended control over refineries and dealers. In September 1968, the Gold (Control) Act 1968, was passed establishing the scheme of gold control on a permanent statutory footing. Except for some minor modifications incorporated in the Act in 1969, 1972 and 1973, the structure of the Act did not undergo any change.

(g) The Voluntary Disclosure of Income and Wealth (Amendment) Ordinance, 1975 granted immunity from confiscation, penalty and prosecution under the Gold Control Act, 1968, to all disclosures of wealth and income in the form of gold within the stipulated period.

(h) There was a major shift in policy by the Central Government as reflected in the 1978-79 budget which strongly disapproved of smuggling operations, considered to be a consequence of the differential between the domestic and international gold prices. The Government that year undertook gold auctions, which was construed as an anti-inflationary measure of raising resources to bridge the budget deficit which then was around Rs.1,050 crore. It was also felt that sale of gold from stocks held by the Government would curb smuggling to some extent. The Reserve Bank of India was chosen as the Government's agent in the sales operation. However, these auctions came in for criticism as it was concluded that this was not a practical proposition to either check smuggling or contain domestic prices. The Government thus discontinued the official auctions in October 1978.

(i) Liberalisation brought with it major changes in the regulations governing the purchase and ownership of gold. Prior to 1991, gold was allowed to be held only in the form of jewellery. This has been repealed and holding of gold bars and coins has since been permitted. Under the NRI baggage rules, an NRI is entitled to bring in 5 Kgs. of gold every six months by paying a nominal duty of Rs.220 per 10 gms. Import of plain gold is now allowed on Special Import Licences for sale to the domestic market. The Special Import License Scheme also allows a category of exporters to repatriate their overseas earnings by importing goods which had previously been banned including gold bullion. The scheme was subsequently relaxed, allowing imports of gold jewellery and coins in addition to bullion.

(j) Incidentally, the Maharashtra government's new tax of two per cent on the value of gold processed was revoked. Further, a civic tax in Mumbai (an entry tax into the municipal limits) City, the main gold hub, has been reduced from 2 per cent to just half per cent as recently as 1st April 1996.

Policy Debates

7. A number of issues relating to gold policy are reviewed by the Reserve Bank of India from time to time. In 1978, in the context of gold auctions, there were consultations by the Reserve Bank of India and the issues posed related to measures to reduce the demand for gold, the stance on import of gold and related matters. It is interesting to recall the principal suggestions considered at that time to get a flavour of our mind-set at that time.

(i) To reduce the demand for gold suggestions made were

(a) Fixation of quantitative ceiling on holdings per family/per individual; (b) Reduction of the gold content of jewellery to say 14 cts. purity; (c) Creation of alternative assets with attractive yields and the introduction of gold bond scheme/gold securities; (d) Imposition of a tax on the jewellery component of wealth at a higher rate; and (e) Administrative measures including very strong and quickly effective penal measures for tax evasion where such evasion exceeds a specified penal limit.

(ii) As regards import of gold, five options were considered (a) Import of gold as a feasible socio-economic policy measure; (b) Import of gold on a limited scale to meet specific purposes; (c) Import of gold as a last resort; (d) Import of gold as a necessary evil; and (e) No import of gold.

(iii) On the level of gold prices and related issue of gold auctions by Government also, there were interesting observations. One view was that to a majority of the people, gold prices do not matter at all. The national economy is, however, affected because they generate black incomes. they provide a means for holding black wealth and thus increase the propensity to go in for illegal operations and they invite smuggled imports and unaccounted use of resources for payment abroad. If the price of gold goes on rising, gold provides not only a safe means of holding illegal gains, but also makes such holdings highly profitable. Another view was that gold should not be regarded as a basic consumption of the poor. Therefore, there is no point in reducing the price of gold. A more neutral view was that the Government need not pursue an active gold policy. The price of gold should not be a matter of concern to the Government since it does not enter the cost of living of the industrial and agricultural workers of the country. About the system of auctions as a step to reduce smuggling or bringing about a reduction in price, there were universal apprehensions.

8. In 1978, a Committee to review the gold policy of the Government was appointed under the Chairmanship of Dr.I.G.Patel, Governor, Reserve Bank of India. The Committee's terms of reference were to review the Government's gold policy in all its aspects and to make suitable recommendations to Government. The Committee in its report suggested the reintroduction of 18 or 14 carat gold jewellery by stages; but the process should be so regulated as not to have any adverse effects on small goldsmiths and artisans. It also recommended that the banking system should devise an effective scheme to provide financial assistance to goldsmiths at concessional rates of interest. They also desired that limit on the individual holding of jewellery be restricted to 2 kgs and the family holding to 4 kgs.

In view of the strain in the balance of payments at that time, the report did not find enough justification to suggest import of gold nor did they favour resuming gold auctions, though it was in favour of the Reserve Bank of India accumulating gold to add to official reserves rather than let it be exported. The question of issuing gold bonds was examined but not favoured since this would in effect amount to indexing the value of the savings of those who want gold as a hedge against inflation as compared to the savers who are willing to hold other financial assets. A higher sales tax on jewellery was preferred on the count that it might act as a better disincentive to wealth tax.

A Working Group to Review Gold Policy in its aspects was appointed by the Government in 1986 under the Chairmanship of Dr.C.Rangarajan following the Finance Minister's assurance to the Parliament, on a `second look' at the Gold Control Act. Some of the specific aspects that the Group studied related to import of gold, separate treatment for import of gold by NRIs, bringing gold into the country as part of personal baggage, and non-utility of the Gold Control Act as an anti-smuggling measure. The Committee felt that import of gold against free foreign exchange could not be permitted but saw merit in a scheme to attract NRI funds on a non-repatriation basis through 7-year deposits denominated in foreign currency. In the view of the Committee, the proposal to allow all returning Indians to bring primary gold as a part of the baggage allowance would lead to a very large substitution of normal foreign exchange flows apart from unmanageable problems of enforcement. The Committee was also in favour of enhancing the ceiling on the value of gold jewellery imported under the transfer of residence rules and the Customs Baggage Rules. Finally, the Committee recommended drastic modification of the Gold Control Act.

As would be evident, substantial elements of these recommendations were acted upon by the Government.

9. In recognition of the importance of gold in the changed circumstances, the Reserve Bank came out with a discussion paper in 1992, underscoring its bearing on external debt. Considering the complex interactions of both demand and supply forces, an institutional mechanism called 'Gold Management Corporation' (GMC) was suggested. The GMC guided by the 'Gold Policy Board' was to be developed into a mechanism that can evolve and continuously evaluate the required schemes for gold mobilisation as also its utilisation in the event of external constraints. The policy towards gold import was to be essentially 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 to the RBI in its reserve management, a considerably liberal import policy could be thought of. In the long-run, however, the strategy recommended was to induce the households to treat gold on par with any other financial asset. In 1992, a proposal was actively considered to set up a Gold Bank with the objectives of mobilising domestic non-official gold holdings, channelise them into a centralised pool over a period of time and to deploy them in a productive manner in the interest of growth and development of the country. However, this proposal was not accepted, and instead the Gold Bond Scheme 1993 was launched, which garnered 41 tonnes of gold.

10. Almost concurrently, a Committee within the RBI has made a comprehensive set of recommendations for an integrated national gold policy. The highlights of the recommendations made in the report are : (a) There is a need for an integrated national policy on gold, covering trading, import, jewellery export, investment, refining, etc., even though guidelines exist for a few sub-sectors. (b) Import policy for gold and silver should be further liberalised to put an end to smuggling and hawala activities. Select Bullion Associations in the country or some canalising agency like the State Bank of India or MMTC may be allowed to import gold and silver subject to some annual ceiling that could be prescribed. (c) It is desirable to regulate the bullion market and introduce uniform trading practices all over the country in view of the high turnover in the bullion trade and the country's potential to become an international centre for bullion trading. (d) Certain deficiencies are seen in the

trading practices in the Mumbai market which could be prevalent in other centres as well. Standardisation of market practices would lead to transparency in dealings, investor protection and market efficiency and could be prescribed for wholesale trade in bullion. (e) It is desirable to introduce forward trading in gold as a price hedging mechanism after further liberalisation in the gold import policy of the Government. (f) Institutional arrangements need to be made for regulation and standardisation of bullion trade practices and for co-ordination with other agencies. (g) A separate statutory body called the ‘Gold Management Board’ should be set up with statutory powers to oversee wholesale bullion operations and provide focus to the trade. (h) The Board should examine and take steps to upgrade the standard and quality of the refineries in the country. Hallmarking of gold jewellery should be introduced in the country at the earliest as a measure of consumer protection. (I) The granting of permission for the participation of commercial banks in bullion trading may be deferred till the import of gold is more freely allowed. (j) The implementation of any future schemes for mobilization of gold from the public should be entrusted to agencies like mutual funds, which have greater flexibility in their operations. The mobilized gold could be offered to jewellers for meeting their inventory needs in order to make the scheme viable. (k) Gold-price-linked instruments may be made available in the market as an investment avenue to wean the public away from physical gold.

11. It may not be appropriate to conclude from the studies in the Reserve Bank of India that there is a consensus on gold policy in India. Major criticisms of liberalisation of gold policy have been on five grounds. These are:

First, we have been the largest consumer of gold in the world. The total quantities of gold imported, legally and otherwise, have risen sharply after liberalisation, particularly in the recent past. This has been a ‘drain on savings’.

Second, the liberalised policy of allowing official imports through NRI-route and SIL-route has not had the desired impact on smuggling. In fact, it made little difference to the quantities of gold imported illegally.

Third, the so-called NRI imports are actually funded by “hawala” market, and professional NRI couriers are used for importing gold through this route. Hence, the objective of reducing hawala market has been defeated. Also, much of the movement of this gold is not easily traceable within India since some of it is not traded in legal channel.

Fourth, recent increases in gold smuggling are attributable to increased narcotics trade and any change in policy-tightening or loosening would be of no use.

Fifth, the real issue in so far as hawala market financing is concerned relates to the inefficiency and high cost of banking services in handling NRI remittances from the Gulf region and not in export under-invoicing and import over-invoicing in as much as the gold smuggling activity is Gulf-centred and not in other major markets.

12. However, there are others who advocate further reforms and come up with their own arguments and proposals. Briefly, they are:

First, to the extent hawala margins have come down, and the spurt in gold demand reflects increased genuine demand for gold jewellery, there is a need to further liberalise gold imports and improve market efficiency. Clearly, the larger imports (official as well as illegal) have not adversely impacted either the balance of payments, or the exchange rate and have, in fact, provided revenues to governments as well as incentives to exporters. Further, liberalisation would in fact reduced transaction costs and the role of unsocial elements. It will open up prospects for more aggressive export trade and help the economy. There could be fiscal gains also through import and export taxes.

Second, it is better that the Central Bank and/or public sector institutions take some sort of monopoly over imports as in the case of many other countries. In other words, liberalisation should go hand in hand with a transparent regulatory mechanism.

Third, while launching a programme for encouraging the public to use gold as a financial asset, the Reserve Bank of India and the Government of India should use their own gold stocks more dynamically and earn income.

Fourth, efforts to mobilise domestic gold or permit their use as a financial asset in the banking sector require institutional development.

Fifth, though the current proposals to liberalise forward trading exclude gold, it would be necessary to permit forward trading soon.

Ma**nagement of Gold Reserves**

13. The stance of central banks like the Federal Reserve, the Bundesbank, the Banque de France and the Swiss National Bank, which together account for the largest quantum of official gold is not to be active in the gold market. However, a good number of central banks are now active, in varying degrees. One could distinguish three categories of central banks in this regard:

First, the central banks of producing countries many of whom act as the sole marketing agent for the production of their countries. These central banks are involved in the spot. Forward as well as the swap market in gold. Their activities are aimed at selling their product at the best possible price.

The second category comprises those central banks of non-mining countries which have moderate to large gold holding. They seek to add value to or defray cost by employing a part or whole of their holding in the spot, forward or swap and lease markets.

The third group, comprising central banks of both mining and non-mining countries which use both the cash and derivative markets for actively enhancing return on their gold holding.

The position of the Reserve Bank of India with regard to its activities in the gold market places it in the second category of central banks mentioned. The Reserve Bank of India has a modest holding of about 13 million ounces or about 397.5 tonnes. It still has the largest holdings in the developing world in 1995 as per International Financial statistics, 1996. Traditionally, we have been holding gold as an idle asset. The dormant reserves were, however, activated in the critical periods of the foreign exchange crisis in 1991. This provided a clear signal to the world that we were taking serious action. This also showed to the nation that gold held in the Central Bank provides a bedrock of the foreign exchange reserves of the country. Currently, a part i.e, about 15 per cent of the gold holding of the

Bank is located offshore, which is now being deployed in short-term interest-bearing deposits in terms of the provisions of the Reserve Bank of India Act.

Upgrading the gold stock to LGDB standard as also locating them at an offshore centre involve cost but it can also be argued that from the perspective of acquiring flexibility to be able to raise resources against gold, the scheme could be cost effective. It is possible to take a view that taking gold to an offshore location does not compromise, in any manner , the ownership and possession over the stock.

In this regard, the recommendation of the Rangarajan Committee on Balance of Payments in 1993 appears very relevant. The Committee had expressed that it would be advantageous to locate about one-fourth of the gold holding of the Reserve Bank of India at an offshore centre so that the same could be utilised in times of need.

Gold as a Financial Product

14. With the reform of the financial sector and development of the financial markets in terms of width, depth and liquidity in our country, it is possible that demand for physical gold as a form of insurance-cum-investment would reduce. In any case, development of gold as a financial product raises some issues.

First, the availability of financial instruments in the non-government financial sector, could help in mobilising idle gold with households. However, it may not be appropriate to treat all gold jewellery as an idle asset since it is also used as a consumer durable.

Secondly, the ban on forward trading may have to be lifted so that the hoarding demand would come down and help in bringing the idle gold into the market/official pool.

Thirdly, if the import of gold is to be liberalised, it would be necessary to evolve a framework for regulating the import, trading and market making in gold and gold related products.

Fourthly, the issue of development of financial market in gold is linked to the issue of capital account convertibility.

A brief look at the legal position reveals that in terms of Section 6 of the Banking Regulations Act, 1949, banks can buy, sell and deal in bullion and specie and the prohibition on trading in Section 8 does not apply to bullion and specie. However, in view of the gold control in force till 1990 and the provisions of FERA 1947 which impose certain capital controls, active development of financial market in gold and involvement of banks in developing and marketing financial products denominated in gold will have to await other actions in the liberalisation process.

Gold Markets

15. The Reserve Bank of India has not been an active participant in the gold market. The authorities of different countries, have on the other hand, played significant roles in furthering the development of gold markets. Here one could see three patterns:

(a) Producer nations like South Africa, Australia and Brazil have shown keen interest in the development of spot and forward market in their respective countries mainly with the intention of providing financial products to the producers. Also, since a liquid forward market in gold (for enabling the producers to sell their product forward) presupposes the existence of a leasing market, these authorities have promoted this market also.

(b) Financial centers like the U.K., the USA, Switzerland, Hong Kong and Singapore have actively promoted gold related products to be traded at these Centers. While in the UK and the USA, the market is designed to be used by residents and non-residents alike the focus in Singapore is on providing service to off-shore entities in Singapore and non-residents. There are direct benefits to the countries concerned in the form of value-addition in the products, employment etc.

(c) In Turkey, the gold market has recently been liberalised. Turkey has quite a few parallels with India in respect of gold i.e. no significant domestic output; and large private sector holding. In Turkey, the private sector holding is estimated at 5,000 tones, while in India the same is placed at 7,500-10,000 tonnes. Further, like India, Turkey seems to have high income elasticity of demand for gold. In early 1995, Turkey liberalised its gold control regime by throwing open imports. The Istanbul Gold Exchange was set up in July 1995 to help bring into the economic mainstream the huge quantity of gold held by the private sector. Gold-based paper is sought to be introduced there as also the setting up of a gold refinery with international accreditation for providing refining services to the gold producing countries in Central Asia.

16. While, prima facie, the Reserve Bank of India and the Government of India could play an active role in developing gold market domestically on sound lines and linking such markets with the financial sector, it is difficult to design such a role till the general stance of gold policy in the country is more positive and more liberal.

Issues

17. To sum up, there are a number of issues that we have to address. I am sure your deliberations, especially your experiences, would be of great interest to us. For convenience, I will flag them here, especially, in the form of a set of questions.

(a) Is there a need to review our current overall policy stance to gold?

(b) If so, should the direction of change be in terms of imposing more restrictions on domestic demand? What are the instruments and their possible effectiveness in restricting such domestic use – both in terms of quality and the end use?

(c) From the supply side, is it possible to encourage domestic production and if so, what would be the relative roles of public, private and foreign investment?

(d) How should trade policy be re-oriented to the new policy? Is the existing system of imports through individuals and exporters by payment of foreign currency adequate? If not`, should there be a more liberal approach in allowing all individuals to import gold against rupee payment?

(e) Are there advantages in managing gold imports, if such imports are restricted to select banks or corporates that satisfy well defined criteria?

(f) From the angle of the external sector, what would be the impact of more liberal imports on balance of payments and exchange rate? Would such a liberalisation help increase exports of gold jewellery?

(g) Is it advantagenous to mobilise idle gold assets lying with households and bring them into the official pool to provide support for the external resources?

(h) Is it possible to build fiscal gains by adequately taxing imports of gold and would this be more effective if import is effected through institutions?

(i) What would be the role of the Reserve Bank of India in managing gold imports?

(j) Is there an advantage in allowing the use of gold by the Reserve Bank of India in a more dynamic way – both in terms of purchase and sale of gold to keep the reserves in the form of gold?

(k) Is there are advantage in permitting a more active role for banks in the gold market? If so, what should be regulatory framework to be considered by the Reserve Bank of India?

(l) How should the policy stance of gold as a commodity and financial instrument be differentiated? In such a scenario, who would be the regulator?

(m) What would be the sequencing of any change in the context of liberalisation of the economy and globalisation of the economy? Is it appropriate to initially concentrate on trade policy liberalisation and subsequently arrange for enabling forward market provisions followed by use of gold as a financial instrument?

(n) Finally, how should the policy towards gold be integrated with financial sector reform and in the final analysis, what would be its link with currency convertibility on capital account?

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