

## Gems, Jewels and Gold

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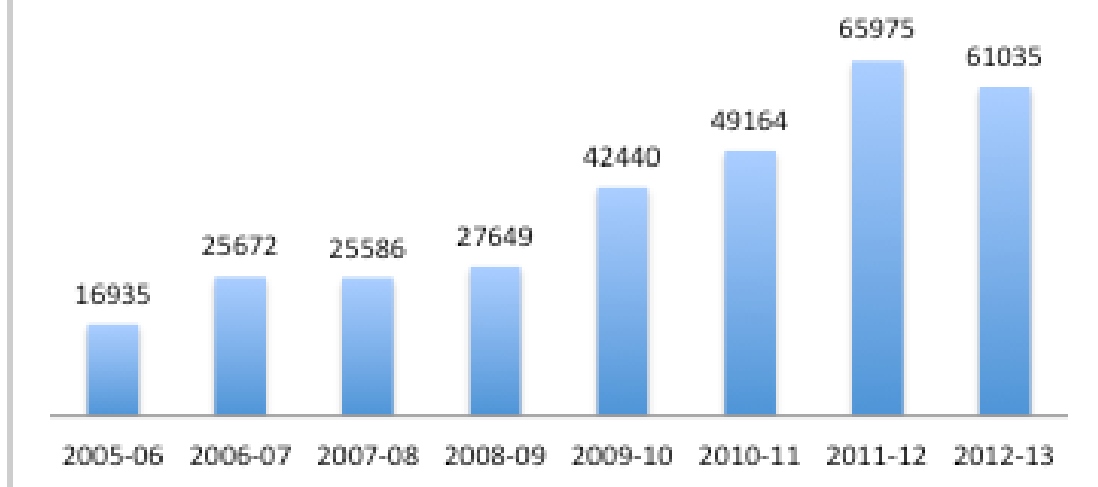
Gold, diamonds and jewellery, it appears, are in the government's perspective among India's many sacred cows. The result is a policy favouring producers and consumers of these items of luxury and stores of value. Much is done in the name of promoting exports by India's gems and jewellery industry. And little is done to curb the [insatiable domestic desire to possess gold](#) which India, for lack of known domestic reserves, is forced to import from abroad.

This, however, is only true of neoliberal India. For many years after Independence, recognising that foreign exchange was scarce and needed to purchase essential capital, intermediate and consumption goods, the government had chosen to severely restrict gold imports and limit access to the metal. This was also seen as necessary to prevent the diversion of the savings of the well to do away from productive investment into a materially unproductive asset like gold. Though the initial near total ban was subsequently relaxed, controls remained in place and were enshrined in law by the Gold Control Act of 1968. It is only recently that the jewellery industry and the desire for gold have become the favoured targets of the government's policy.

This special treatment took two forms. First, as part of a strategy that has been intensely pushed since the 1990s, the gems and jewellery industry has been built as an export platform aimed at earning foreign exchange. Inasmuch as the inputs in the form of precious metals and precious stones have to be imported for enhancing domestic production for export, they are permitted to be imported duty free under the replenishment, advance licensing and other schemes. In the event, the effective customs duty on a large chunk of gold and precious metal imports into the country has been low or nil. With import volumes and prices rising, the revenue foregone on account of the customs duty concessions has risen hugely from close to Rs. 17,000 crore in 2005-06 to a substantial Rs. 61,000 crore in 2012-13 (Chart 1).

This in itself may have been justified if the result has been a substantial gain in terms of the net foreign exchange earning from the items falling under Chapter 71 of the Harmonised System Code used in trade statistics. At first glance, when we compare the exports of gems and jewellery only with the imports of Precious and semi-precious stones, which includes the rough diamonds imported by India to cut and polish, the evidence seems to be that net exports have increased significantly, as a result of value addition in the Indian market (Chart 2). But what is missed in this comparison is the import of the gold, silver and platinum, in which much of the precious stones are embedded to produce jewellery.

**Chart 1: Revenue foregone on gold, diamonds and jewellery (Rs. Crore)**



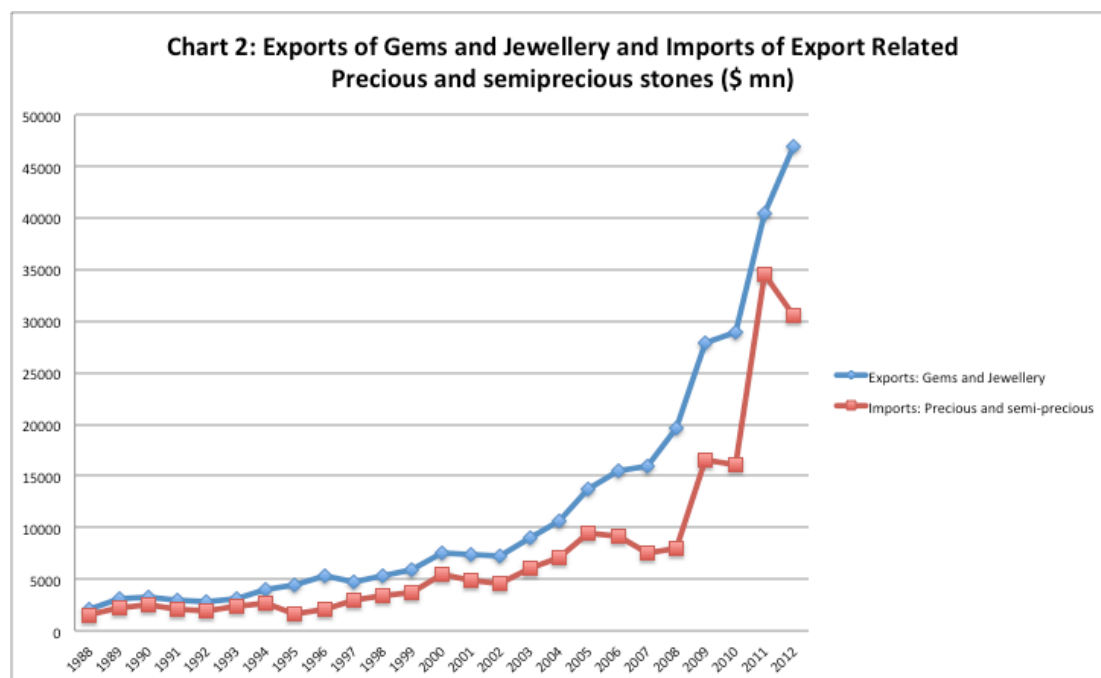
Once we recognise this, we are confronted with the problem that we cannot clearly separate from the available data the imports of raw materials entering into the production of jewellery aimed at catering to the domestic market as opposed to the imports aimed at manufacturing commodities that are subsequently exported. All that can be said is that if we include the imports of gold and silver (Chart 3), and compute the net flow of foreign exchange on account of this combination of commodities, the precious metals and stones sector is a huge drain on the country's foreign exchange earnings. This has been true especially after 2003, when India experienced a surge in gold imports. What was a surplus inflow of foreign exchange of \$2 billion plus in the mid 1990s, turned negative by the end of that decade, with the outflow rising to \$6 billion in the middle of the last decade and then surging to touch \$45 billion in 2011-12.

Though aggregate imports have risen sharply in recent years, gold imports in 2011-12 accounted for more than 11 per cent of the country's aggregate merchandise imports, and amounted to the equivalent of 30 per cent of its trade deficit. The policy of favouring gems and jewellery export has not had a positive balance of payments effect even sectorally speaking, because the Indian passion for these goods far exceeds the nation's ability to leverage skills and technology generated to cater to the domestic market to export to global markets based on imports of the required raw materials. Unless imports for domestic consumption are curbed a prime objective of the gems and jewellery export policy would remain unrealised.

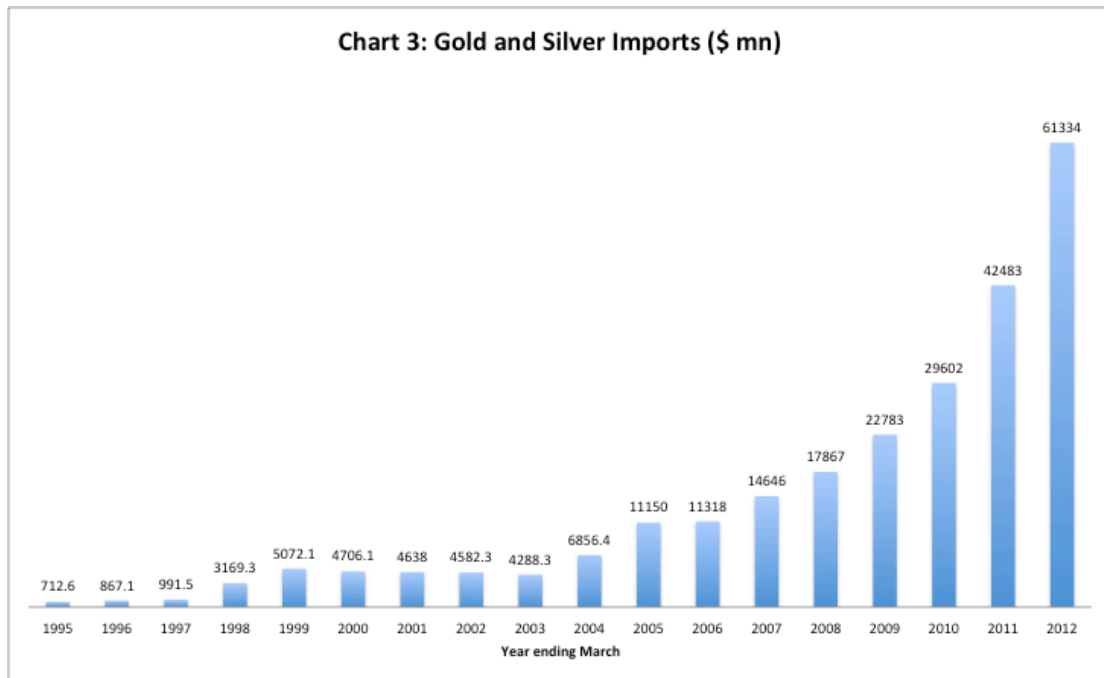
Which bring us to the second way in which the domestic gems and jewellery industry, and (in this case) its domestic customers have been favoured. As part of the overall scheme of accelerated trade liberalisation that began in the 1990s, the government chose to reduce quantitative restrictions on imports of gold. This was combined with a relatively low tariff regime. Before the 2009-10 Budget, customs duty on serially numbered gold bars (other than tola bars) and gold coins was Rs. 100 per 10 gram and on other forms of gold Rs. 250 per 10 gram. These were raised to Rs. 200 per 10 gram. and Rs. 500 per 10 gram respectively in the 2009 Budget and to Rs. 300 and Rs. 1500 subsequently.

In January 2012, the government shifted to an ad valorem duty regime, and import duty on gold was changed to 2 per cent of value from the flat duty of Rs. 300 per 10 gm while that for silver was changed to 6 per cent from earlier duty of Rs. 1,500 per kg. The Union Budget 2012-13 had further increased the basic customs duty on standard gold bars; gold coins of purity exceeding 99.5 per cent and platinum from 2 per cent to 4 per cent and on non-standard gold from 5 per cent to 10 per cent. [Recently, the duty on standard gold has been hiked further to 6 per cent.](#)

Despite these increases the level of duty remains low, leading to a continuous rise till recently in the demand for gold. There were two constituencies that the government was favouring through this low duty policy. One was the Indian ‘public’ that has an inexplicable fascination with gold. According to estimates from the World Gold Council, over the year ended September 2011, demand for gold in India was 1059 tonnes, as compared with 214 tonnes in the US and 770 tonnes in China, whereas per capita income in the three countries stood at \$1,410, \$4,940 and \$48,620 respectively. The “average” Indian could not be responsible for such “excess demand” for gold.



From the point of view of the “customer”, the passion for the metal is explained by many factors. There is the traditional obsession with the yellow metal as an adornment and an item of personal display. It has also been seen as an important investment, being a store of value that benefits from price appreciation, which is normally higher than the increase in the general price level and makes the commodity a good hedge against inflation. Gold is also characterised by a high degree of liquidity (in the sense that it can be converted easily into cash of equivalent value), since it could either be sold or pawned without much difficulty. In recent years, the [proliferation of ‘loans against gold’ schemes](#) offered by banks and non-bank financial companies has made the metal even more liquid. Thus, from a private perspective it is a highly prized possession. It is also the asset to which wealth holders shift in search of safety, when inflation is high or times uncertain.



There is reason to believe that the recent surge in imports of gold has indeed been led by the demand for the metal as an investment, though consumption driven by growing inequality also seems to have played a role. In the event, despite India's position as an important exporter of gems and jewellery, gold re-exports have been way below imports and net imports of gold have been extremely high and rising. The result has been the adverse balance of payments impact of the precious metals and stones market noted earlier.

This negative foreign exchange contribution also makes it difficult to defend the huge volume of revenue forgone on account of Chapter 71 goods. In 2011-12 they accounted for 28 per cent of the customs duty foregone and more than 13 per cent of the total revenue foregone on account of direct and indirect tax concessions. If after sacrificing that much revenue the industry cannot deliver the nation a net foreign exchange inflow, it may be far more sensible to return to regulation of gold imports and use high duties to mop up revenues from the domestic demand for gold to finance crucial welfare programmes.

\* This article was originally published in the Business Line on 18 March, 2013, titled "Curbing the insatiable desire for gold".