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Talking Points

HYDERABAD LITERARY FESTIVAL

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GOLD: WHITE, BLACK AND YELLOW

I am thankful to the organisers for inviting me to the Hyderabad Literary Festival. I must confess that I have not been a student of Literature. I have no literary talents.

The organisers told me that as long as I am able to share my interesting experiences with you, it would serve the purpose.

I will speak on my journey dealing with gold; several varieties of gold, and conclude with a case for a positive comprehensive Gold Policy for India.

Valuing Gold

What is the value of gold?

My first exposure to the issue of Gold came up in 1991 as Joint Secretary in Ministry of Finance. We were in deep Balance of Payments crisis. Foreign exchange reserves consist of foreign currency reserves and Gold. Our foreign currency reserves were very low.

The RBI stock of Gold was valued as per statute as Rs. 281 crores. Their market value was Rs. 7,250 crores in U.S.A. and (26 times) Rs.11,214 crores in India (40 times).

We wanted to tell the world that the value of our foreign exchange reserves was not as low as the official valuation indicated.

GOI and RBI had to revalue gold on October 15, 1990 with effect from October 17, 1990. The new method adopted a monthly average price of gold in international market.

We had to bring about an Ordinance and later to enable us to value the gold as per market value from time to time.

Lesson is: Gold and its proper valuation are relevant even for the management of a central bank, the one that issues the currency notes for us.

Leasing Gold

Have you heard of government leasing gold? We did that in 1991 to manage crisis. Not only families, the government also uses gold when desperate.

19.65 Metric Tonnes of gold from Government account was "made available" in March, 1991 to the SBI for sale with repurchase option to get a little over \$ 200 million. UBS purchased the gold and gave SBI money.

We know that smuggling gold is a crime; and government confiscates the gold if it catches you. Gold confiscated by government out of that crime became very useful for government.

Government leased that gold: To whom? A bank: public sector bank – State Bank of India.

The SBI sold the leased gold with a repurchase option at market price. That is how SBI was able to discharge its obligations in the overnight inter-bank market.

For protecting the credibility of the largest commercial bank of India, we had to use the gold of the government – paradoxically Gold confiscated from the smugglers.

Interestingly, this is where the issue of black money comes. Import of Gold was prohibited for several years / decades. Yet, huge Gold was imported through unofficial channels, mainly smuggling. Almost all the additions to stock of gold has been through imports. This generated huge black money, both in foreign exchange market and within the country.

The largest contributor to black money in India from Independence till the reform started in 1991 was holding and trade in Gold.

Lesson is simple: Bad laws are usually the major cause of black money.

Then what happened?

Government got back the gold in November-December and sold it to RBI. We got back only 18.36 MT of gold, but we leased 19.65 MT. Assorted quality of smuggled gold had to be converted into standard quality.

Gold during Wedding

We associate gold with wedding also. I handled gold issue while making arrangements for my daughter's wedding. It was RBI gold that I was dealing with.

In May 1991, I was in Hyderabad in connection with the wedding of my daughter, and I had to deal with gold in a strange manner. I was called suddenly to go to Delhi for a day to process an important matter. This related to the Gold which was part of the reserves of the Reserve Bank of India. RBI wanted to pledge Gold to get foreign exchange.

The lenders wanted the Gold to be physically transported, even though RBI was recognised as a Depository. (vanga thota – Mama -)

RBI pledged in July 1991, 46.91 tonnes of gold with Bank of Japan and Bank of England to raise U.S. \$ 405 million.

The money was raised for six months. This is not unusual among the central banks, though physical transport of Gold is not that common. Political uncertainties at that time led to this.

People would not have known about this, but for the fact that there was a tyre puncture when the Gold was being taken in the night from the Wards to the airport vaults.

Lesson: Politics trumps economics, even in matters of central banks and gold.

A Wrong Bank

In Feb. 1991, a proposal to have a National Gold Bank was made by the Governor, RBI. An Officer on Special Duty was also appointed. The bank was to mobilise gold from the public, residents and non-residents in the form of 5-7 years deposits. No questions were to be asked on sources of gold. I opposed it on the ground that the central bank should not be directly in the gold business or raising forex business and, in any case, the proposal was not commercially viable.

So, we ended up with a Gold Bond Scheme in March 1993.

Banking on Wrong Policy

Restrictive approach started in 1947 to 1962. Then there was Gold Control Rules 1963 followed by Gold Control Act 1968 which virtually prohibited gold. Only 14 carat and limit were fixed for individual holdings. Repeated in June 1990, Non-resident scheme was introduced in 1992; and a special import Licence in 1994.

However, there was no support for allowing import of gold officially, though unofficial imports through smuggling continued.

Simultaneously, as part of the reform, there was a realisation that the Gold control within the country was ineffective, and in any case, did not serve the purpose of moderating demand for and import of gold. The whole gold trade was part of the black money. For over half a century, we persisted with denial. We did not have an effective gold policy. We ignored or we were furious that people did not know what to do with their money.

As a first step, Prime Minister Manmohan Singh announced a Scheme by which a Non Resident Indian could bring Gold as part of their baggage at nominal duty. In a way, therefore, the NRIs could bring Gold officially and pay nominal duty. This opened up a small window for import of gold officially up to reaching India and, after that, it was sold naturally for earning black money.

Sitting on Nizam's Jewellery

I joined RBI in 1997. My room was on 18th Floor. But, in the basement there were precious Jewellery. They were bought by Government and stored. They were taken out to Hyderabad briefly, and brought back. When I was there, since it was too expensive to guard and insure, I sat on them, but never saw them.

Open Mouth and Gold Policy

In three months after becoming Deputy Governor, I gave a speech on gold. On November 20, 1996, I argued in favour of review of our current overall policy stance. The Tarapore Committee on CAC recommended as part of capital account liberalisation liberal import of Gold, but through banks.

The chairman attributed in open articles, the change in policy due to the speech I gave. It was bold; for the first time a policy-maker talked of liberalising import of gold.

Call for New Gold Policy (1997-2002)

Encouraged by the developments, I gave another speech on 2nd August, 1997 and called for New Gold Policy. I said, "recognise the importance of gold in the Indian economic system and enable gold to play a transparent, and positive role in the individual development, employment and export sector of the economy" and ensure orderly development of gold markets.

In RBI, I revived the role of Reserve Bank of India in gold market. The Standing Committee on Gold and other Precious Metals was revived in 1997 in RBI and activated. We in the RBI then took up the issue of Hall-marking and assaying of Gold with Ministry of Consumer Affairs. We felt that the gold market itself was getting imperfect. We wanted integrity of gold market because it has characteristics of currency.

Subsequently, I tried to encourage State Bank of India to establish a Gold Bank, similar to the one in Istanbul. However, that did not work out.

Visiting to learn

I also visited office of the World Gold Council in London during this period. It has full information about demand, supply and trade in Gold in the world. The most reliable estimates of the Gold import to India, both official and non official, are available in the Council. It was part of my learning on issues relating to Gold.

Call for Medium Term Policy

I pleaded for a medium-term policy on gold in a speech delivered on March 21, 2002. The focus now was on gold markets and links between gold and financial sector. In that speech I "estimated that in India, consumers were paying Rs.8,000 crores extra each year by virtue of questionable quality. The emphasis was on protection of consumer.

Central Banks Sell Gold

RBI became an informal party to the Washington Agreement of Central Banks on Sale of Gold in 1999. Some of the central banks started selling gold because they considered it to be non income earning and unnecessary. The Gold prices fell. There was an agreement entered into by select central bankers to put a ceiling on the total amount of Gold that would be sold by major central banks. From our side, as Deputy Governor, I clarified that we are having a passive policy towards Gold reserves. So, there was no question of selling or buying or leasing Gold by us.

There was increasing recourse to leasing gold, went up four times in 10 years.

Too much is bad too

The subject was revived after I joined as Governor in September 2003. The EXIM policy of Government of India for 2004-05 announced that Gold imports will be further liberalised so that the entities eligible to import will not be confined to banks or canalising agencies.

I protested and took up with the Government, and insisted that the agencies with imports should primarily be banks. The idea was that we would be able to track the

import of Gold and, in particular, the people to whom Gold has been sold since Know Your Customer guidelines apply to the banks. We also had a reporting system so that we could monitor the banks and the branches that were importing Gold. The idea was to track the movement and thus avoid use of Gold as a major medium for transactions in black money.

Import-Duties on Gold: Flip-Flop

Whenever there is a stress on exchange rate, we increase import duty. When we do that, official imports drop. But, smuggling goes up after a lag because of logistics involved in the shift. But smuggling meant that we were paying for unofficial imports with unofficial inputs. I explained this to government since I was dealing with exchange rate. Government's view is: you should act even if it serves no purpose if there is a problem; but the authorities feel that they have to demonstrate their concern about pressure on exchange rate and this is a visible way.

From borrower to lender / and buyer of gold

Personal satisfaction for me is that I was dealing with gold to raise resources in 1991, and obtain funds from IMF. By 2002, when I joined as ED IMF, on the board, we got clearance to be lender.

We built enough reserves to enable my successor to purchase gold from the IMF; the very same IMF which virtually made our pledging of gold and transportation of gold a condition for IMF assistance in 1991.

IMF uses Gold when in distress

The IMF was out of business by 2005 because there were no borrowers, and so no income. They set up a committee in May 2006 to examine ways in which they could raise money. On its recommendation, the IMF decided to sell some gold, invest the money received and then use the income out of the fund for day-to-day expenses.

At that stage, there was informal chat among Governors (BoE) and one of them wanted IMF to be wound up. The French Minister said it was in search of a Mystery. I

disagreed based on Godavari Valley experience. It is difficult to build institutions. One never knows when you may need them. If they do no harm, why not allow them to hang-on.

Central Banks Buy Gold

From 1999, central banks sold in limited quantities as per five year agreement which was renewed once. The confidence of central banks in international monetary system was shaken with global crisis of 2008. By 2009, central banks changed their view on gold. They decided to stop selling, but buy gold and add to Reserves. India also changed its view and bought some gold sold by IMF.

We had built considerable forex reserves during 2003-08. There was some drawal of the forex reserves, but we had enough to consider buying some gold from the IMF options. Governor Subbarao could buy Gold.

Land Mark in Gold Policy 2015-16

After retirement, I developed academic interest in the gold policy also. The landmark was in 2015-16 when Government of India announced three schemes in regard to Gold. These are: Gold Coin Scheme, Gold Monetisation Scheme and the Sovereign Bond Scheme.

Gold Coin Scheme provides an opportunity for individuals to acquire Gold Coins with assured quality. This is in right direction, first indication ever that Government is taking a positive view on gold industry domestically.

Gold Monetisation Scheme involved banks; but both from the depositors' point of view and the banks' point of view, the Scheme is not practical. I explained that this is unlikely to be successful.

The Sovereign Bond Scheme is a bond issued by the Government. I said that this was a scheme which was not in the best interest of the government, and if it succeeded, it may not be in the best interest of the country.

Recent Trends

The demand pattern for gold is changing in recent years. Rapid income growth is certainly fuelling demand for gold. However, there is a difference between rural and urban areas. In both, there is a demand for gold. However, rural Indians prefer plain gold jewellery. People in urban areas, prefer gold jewellery with precious and semi precious stones. The demand for gold coins and gold bars is more in urban areas. The youth seem to be tending towards gold coins as a means of diversifying investments.

When the reform of gold policy started in late 90s, more than 90 per cent of the retailers were unorganised. Since about 10 years, the organised industry is expanding from a low base. At the moment only 10 per cent is organised.

The expansion of non-bank financial companies started specialising in giving loans against pledging of gold.

There is a sharp rise in new capacity for refining.

Positive comprehensive policy on Gold

In the budget of 2015, the Government has taken initiative for three schemes. One of them, namely, Gold Coins is a bold step in recognition of gold as an industry. Recent initiatives on consumer protection through strengthening role of Bureau of Indian Standards are noteworthy. These measures are better than the previous ones. However, they are still ad hoc and disjointed. The White, Black and Yellow dimensions of gold supply and demand are still getting mixed up.

In November 2016, in the context of demonetisation, gold came back into news. The demand for gold from black money sources and the demand for gold for jewellery purpose could not be adequately distinguished during the process. This is the legacy of a negative attitude to gold industry which dominated our country for decades. That policy resulted in smuggling and generation of black money.

Our policy has to recognise several factors unique to gold but government should not be judgemental about gold being unproductive or a waste. It is not a 'sin' good like

Tobacco or Liquor. First, gold is an important part of our economy, and economic activity. Orderly development of markets and consumer protection are necessary. Second, Gold has characteristics of a currency. So, it can be used as a substitute. Hence, public policy has to recognise this aspect, and regulate as needed. Third, Gold is the ultimate global currency, while the U.S. Dollar is an operating currency in global economy. So, the relative preferences for safe assets influence the relative prices, between Gold and U.S. Dollar. U.S. Dollar is a safe haven asset, but gold is even more a safe haven asset. Fourth, gold as a form of savings or store of value is in competition with official currency. So, it is a commodity, but Central Bank is concerned because of its links with financial sector. Finally, the positive approach will promote industry but the import and trade within the country should also be monitored by Central bank.

In brief, we have to recognise that gold is an industry. It has a huge retail market. Millions of citizens are involved in transactions in gold. It has employment potential. The manner in which the industry develops will have an impact on the future of the financial sector. Gold has some characteristics of money and a substitute for financial asset, and hence need for policy clarity.

In brief, it is time that the government places a white paper incorporating a positive comprehensive policy on gold. That will make Gold and India glitter.

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