Gold and India: A New Perspective

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India has aninsatiable appetite for gold, anda large proportion of Indians have a sentimental and traditional affiliation with the noble metal. India has been one of the largest consumers of gold in the world. Demand for this metal comes uniformly from across the spectrum of population, for various reasons. While gold is generally utilized for adornment purposes,itmay beperceived simply as a symbol of high status by somebutis considered as a reliable economic investment by many others.In the traditional history of India, gold has been associated with religious and cultural values for a period extending a few thousand years.

The domestic sources of gold are insignificant in India. To meet the enormous demand, the country depends heavily on imports. Gold imports into India have been mounting over the years, from USD 4 billion in 2000-01 to USD 54 billion in 2012-13. The huge demand of gold importswas identified as the most significant factor in the widening current account deficit (CAD) whichrecorded a historic high of 4.8 per cent in 2012-2013. The measures implemented to restrict imports such as increase in customs duty, prohibition of gold import in the form of coins and medallions, and a provision that 20 per cent of every lot of gold import be exclusively made available for exportshelped to restrict gold imports to USD 29 billion in 2013-14 or 664 tonnes compared with 1,037 tonnes in 2012-13. These volumes of gold imports in 2014 were significantly higher than 471 tonnes in 2001. The persistence in demand and difficulty in imports encouraged domestic supply of recycled goldto increase from 59 tonnes in 2011 to 101 tonnes in 2013.

The surge in demand for gold in the recent years, in addition to traditional reasons,could be a result of uncertainty, measured by high interest rates and high inflation.The high demand for gold is widespread with nearly seventy per cent of gold purchases made by the rural population mainly for investment purposesand as a hedge against inflation. According to Professor Jeffrey Franks, holding gold is the only way the peasant can protect himself against inflation and the vicissitudes of politics. People in the rural regions may find gold as the most suitable investment option for numerous reasons such as ease of purchase in cash, purchasesin small denominations, and without any documentation.

To address the issue of high dependence on gold during periods of uncertainty, there is a need to develop alternative financial instruments, especially for the rural populace. This would also aid in deviating the demand for gold, towards other productive instruments.The network of business correspondents of banks as well as significantly larger network of post offices and fair price shops could also be explored for distributional network of new and modern financial instruments. Inflation-indexed small saving instruments could be one such instrument. The extant national savings certificates could have an inflation-indexed option or even anintroduction of inflation indexed special bearer bonds in the market. No documentationrequirement for a stipulated amount of up to, say, Rs 20,000could also be considered by the government to make such instruments popular.

The measures taken by the government in the past few months, to clamp down on the gold imports have succeeded in bringing the CAD down. However, serious concerns about by-products of such restrictions exist. As per World Gold Council, a sharp reduction in official import of gold caused gold demand getting fulfilled through unofficial channels, estimated at around 150-200 tonnesin 2013.In addition any risks of revival of 'hawala' traders and larger smuggling of gold would need to be strictly restrained. These developments have direct revenue implications for the government in terms of lower customs duty collection.

Gold may be considered as an investment which does not add much value to the productive capacity of the economy. According to Warren Buffett, "(Gold) gets dug out of the ground in Africa, or someplace. Then we melt it down, dig another hole, bury it again and pay people to stand around guarding it. It has no utility. Anyone watching from Mars would be scratching their head."Although gold may be perceived as anineffective investment by some, possibilities to make this segment flourish could be explored. India is one of the largest markets for gold jeweler and the concept of branded jeweler is gradually picking up pace in the country. Efforts should be made to make gems and jewelermarket competitive at the international level. Quality aspects should be accentuated andappropriate steps must be taken for hallmarkingofjeweler,and authentication of purity of gold. Also, the idea of hand-made jeweler with intricate patterns could be marketed as a unique selling point. Such initiativesmay give a boost to exports and add to economic growth.

To conclude, gold is unique and a very liquid asset. Illustratively, gold has universal acceptability and recognition as a financial instrument across the world. In future, demand for gold is expected to increase with higher economic growth and increasing income levels in India. Also, in view of the young population, demand for gold is expected to increase along withthe number of marriages in the next few decades. The issue of consistently high demand for gold in India needs to be addressed by two distinct strategies. First, a range of financial instruments need to be offered, especially in rural areas through a network of post offices, fair price shops and business correspondents. Second, to avoid spill-over of domestic demand into imports, there is a need to devise schemes to unearth gold sitting idle in vaults of households across the country and ensure higher volumes of recycled gold in the domestic market. Amongst others measures, this would need liberal availability of certified assaying machines in different cities and villages for households to confidently convert their idle gold in more modern financial instruments ranging from cash, bank deposits, stock market instruments and mutual funds. Financial inclusion through increased banking and insurance penetration, and higher financial literacy could be a useful development in this endeavor. Finally, the government can initiate measures to reduce inflation and anchorinflation expectations to support household savings in financial instruments rather than gold.

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