PAHLE INDIA FOUNDATION
FACILITATING POLICY CHANGE

Discussion Paper

Regulatory Framework For Gold

February 2018
PIF/2018/FERU/DP/13

By
Nirupama Soundararajan
Arindam Goswami

Pahle India Foundation (PIF) is an FCRA certified, not for profit policy think tank, established in June 2013 as a Section 8 company. PIF's motto is "Facilitating Policy Change." The motto guides all our activities. At PIF, we undertake research and disseminate its findings to contribute to the necessary paradigm shift in development thinking and practices in India. PIF is committed to enriching the public discourse and also to influence policy formulation that will help India successfully complete its triple transition in economic, political and social fields.

Our aim is to emerge as a credible, trustworthy and neutral bridge between economic agents like firms, farmers and professionals on the one hand and policy makers on the other and to contribute to bringing the three principle stakeholders viz government, industry and academia on the same page and pulling in the same direction - a key condition for ensuring India's success in global markets. PIF currently has an analytically strong team of dedicated researchers who are self motivated. PIF's highly qualified team specialises in analyzing India's political economy and its engagement across verticals that are relatively underworked areas that will permit PIF to create a niche for itself in the research and think tank space in the country.

Regulatory Framework For Gold

Nirupama Soundararajan
nirupama.soundararajan@pahleindia.org

Arindam Goswami
arindam.goswami@pahleindia.org

PIF/2018/FERU/DP/13

February 2018

Contents

List of Figure

List of Table

1. Introduction

India's predisposition towards gold has always been viewed as a complication rather than an opportunity. The Gold Control regime was testament to this. In subsequent years, even though the import of gold has been liberalised, the negative perception has not abated. In 2013-14 rising gold imports on account of growing rural and urban demand inflated our gold import bill and our current account deficit (CAD). This was swiftly dealt with by imposing restrictions on import and sale of gold. These had the desired impact but only in the short term. Gold imports for Q3 of 2017-18 (855 tonnes)[1] indicates renewed growth in demand for gold.

There is consensus that the demand for gold is not likely to reduce. The recent Reserve Bank of India (RBI) report on household savings pegs the average household owns an average of 11 per cent in gold. The report also states that in the coming years, the demand for gold is only likely to increase. This is not surprising. Gold is and will continue to be a trusted source of domestic savings, more so in rural India. The report attributes this choice to the lack of trust in financial institutions.

Recent demand trends suggest that urban demand for gold may be paring down. The educated younger generations are less inclined to buy heavy jewellery. Access to other financial savings products also reduce the demand for gold. Notwithstanding this, economic growth does drive up disposable income which in turn is likely to drive up the demand for gold in low and middle income groups, even if not in the higher income groups. Gold will always be viewed as a safe asset, with store of value and an effective hedge against inflation. By design or coincidence, the average Indian buys gold for the same reasons that the Reserve Bank of India (RBI) buys gold and this characteristic of the average Indian is unlikely to change dramatically in the coming years.

If one accepts the reality of a growing demand for gold, not necessarily because of an increase in per capita consumption, but because of economic growth and wealth creation, a comprehensive gold policy is essential.

2. Objectives of a Gold Policy

A new regulatory regime for gold must move beyond such short term objectives. To create a new regulatory

1 Reuters Data

regime for gold, it is important to set out the long term objectives that the policy must meet. These objectives would also act as the guiding principles for a new regulatory regime for gold. This paper has identified the following objectives as the guiding principles for a new regulatory regime for gold:

- To formulate a course of action for meeting the growing demand for gold
- To increase the value addition of gold to the economy
- For gold to contribute more to the exchequer
- For consumer protection
- To convert gold from an unproductive asset to a productive financial asset

3. The Current Regulatory Framework

Under the current regulatory regime, what is conspicuous in its absence are definitive policy objectives. The lack of clear policy objectives has also resulted in gold being treated differently by various policymakers resulting regulatory framework that appears to be an aggregation of several piecemeal regulations. These regulations and policies were meant to meet short term objectives such as curtailing imports or reducing the demand for gold. Under the current regime, gold has been viewed mainly as only a commodity and an unproductive one at that.

A new regulatory regime must be one that encapsulates all characteristics of gold. Currently, as a commodity, gold falls under the purview of the Ministry of Consumer Affairs. Financial products of gold, such as exchange traded funds (ETFs) and gold futures (that have their underlying as gold) come under the purview of Securities Exchange Board of India (SEBI). The procurement of gold comes under the purview of Ministry of Commerce, mainly the Directorate General of Foreign Trade (DGFT) and Reserve Bank of India (RBI). Ironically, the Ministry of Finance, until recently, has had little role to play in the regulation of gold. Refineries are accredited by National Accreditation Board for Testing and Calibration Laboratories (NABL) and quality of gold is regulated by Bureau of Indian Standards (BIS). Defining gold will be an essential step in assigning the responsibility of regulating gold to a single entity.

A list of agencies that currently regulate one or the other aspect of gold are:

- Ministry of Finance – Department of Economic Affairs (DEA), Department of Financial Services (DFS), Department of Revenue, Central Board of

Direct Taxes (CBDT), Central Board of Excise and Customs (CBEC)

- Reserve Bank of India (RBI)
- Securities and Exchange Board of India (SEBI)
- Ministry of Commerce and Industry – Department of Commerce, Department of Industrial Policy and Promotion (DIPP), Directorate General of Foreign Trade (DGFT),
- Ministry of Micro, Small and Medium Enterprises (MSME)
- Ministry of Skill Development and Entrepreneurship
- Ministry of Consumer Affairs and Public Distribution
- Ministry of Mines

With product innovations other regulators who may be co-opted into the system are Insurance and Regulatory Development Authority of India (IRDA), Pension Fund Regulatory and Development Authority of India (PFRDA), and Warehousing Development Regulatory Authority of India (WDRAI).

4. A New Regulatory Framework

The key to any good regulatory framework is one that strikes the precarious balance between over regulation and under regulation, and one that is adaptive and responsive to changes in the market. For such a regulatory framework, it is essential to have a framework that will lay the foundation for a gold ecosystem that will add greater value to the economy. A new regulatory framework must also facilitate India's entry into the global gold markets not as a mere follower but as an influencer. The proposed regulatory framework has been broadly divided into the following heads:

(i) Defining Gold
(ii) Business of Gold
(iii) Processes and Procedures for Gold
(iv) Infrastructure for Gold
(v) Securitisation or Financialisation of Gold
(vi) Tax Issues

5. Defining Gold

Gold takes many forms. It is a commodity, a raw material, a currency and a security. The prerequisite to creating a regulatory regime for gold is to acknowledge its multiple functions in the economy. A definition of gold must encapsulate all these aspects. A distinction between gold as a security and gold as a commodity must be made. A suggested definition is that gold that stays within the financial system is a security and when gold is transacted outside of the financial system it takes the form of a commodity.

6. The Business of Gold

India is not a global player in the gold markets because India's trade is one way. A regulatory framework for the business of gold must be one that facilitates two way trade of gold for India. The gems and jewellery industry of India is estimated to be of INR 544,000 crores in size and constitutes mainly of MSMEs. It contributes approximately to 7 per cent of the GDP[2] and providing jobs to as many as 46 lakh[3] people across the value chain. The industry is characterised by many participants, such as, jewellers (both big and small), karigars, assayers, hallmarking agencies, bullion traders, refiners, nominated agencies, jewellery manufactures, and exporters, to name some. It is highly dispersed in terms of size and location. To put this in perspective, there are as many as 5,00,000 jewellery stores of varied sizes spread across the country[4]. All of them play a vital role in the value chain[5]. The regulatory framework for the business of gold should ideally facilitate greater value addition for the sector and should also dovetail into the objectives of the Make in India campaign.

6.1 Import of Gold

Since India has no domestic mining capacity worth mentioning, most of the demand is met through imports. India imports, on an average, around 750-800 tonnes of gold every year. A sizeable proportion of the demand is also met through domestically recycled gold and through gold that enters India through illegal channels. In order to facilitate two way trade, the new regulatory framework for imports must consider four aspects.

6.1.1 Current Account versus Capital Account

The entire discussion around gold begun when India's current account deficit (CAD) escalated due to gold imports. Even in the past there have been discussions around whether gold should be part of current account or if it should be shifted to the capital account. So

---

2 IBEF Data

3 IBID

4 As per an estimation of various jewellery associations. A more accurate estimation of the industry will be possible with the help of GST data.

5 Banks and financial institutions also play an important role in the value chain. This has been dealt with in greater detail under the section of Financialisation of Gold.

long as gold was viewed as a mere commodity for consumption, keeping gold in the current account was justifiable. However, this must be examined because gold is not merely a consumption product in India, but also an investment. This debate is not new for those who believe that gold must remain in the current account because it is in line with international practices. Notwithstanding the outcome of the debate, the resolution of this will not help in transforming the India gold market. While shifting gold to the capital account, if such a move is considered prudent, will certainly help reign in our CAD, it will not necessarily help in facilitating two way trade or in increasing the value addition that this sector can provide.

6.1.2 Customs Duty

The customs duty was raised from 1 per cent to 10 per cent a couple of years ago. This was done with the intention of dampening gold imports. This met the intended purpose in the short run. However the long term impact has not been favourable. Since the cost of official gold shot up considerably, it reopened the market for illegal gold. Furthermore, it also resulted in gold coming in from countries such as South Korea and Malaysia, countries with whom India has signed free trade agreements (FTAs) with, increasing the price arbitrage in the domestic markets. Customs duty must be reduced to zero, or atleast to its former level of 1 per cent, with immediate effect in order to reduce illegal gold coming into the country. Reducing the import duty will also help resolve the unforeseen challenge of the FTA agreements.

6.1.3 Import of Gold Dore

The import of gold dorés is in line with the 'Make in India' campaign. Encouraging the import of gold dorés rather than gold will change the nature of import flows into the country. It will also help in building refining capacity, which will help contribute to economic growth and in generating employment. For this reason the import procedures for gold doré must be simplified. Gold doré must be treated as a raw material and its remittances must therefore be treated at par with other raw materials. Similarly, the tenure for settlement of doré must be made at par with bullion[6].

---

6 Specific recommendations by the Association of Refineries and Mines are provided in Appendix 1

6.1.4 Permissible Gold for Import

While it may take some time to control the quality of gold in the domestic market, it should not take long to control the quality of imported gold. Nominated agencies, by choice, tend to import London Good Delivery (or equivalent) bars. In order to formalise this, we must notify permissible quality of bullion for import.

6.2 Export of Gold

India is one of the largest exporter of gems and jewellery. However, the majority of these exports are contributed to by diamond exports. The potential for gold exports has not been realised till date. India must not only focus on increasing gold exports, but must also aspire to become a "jeweller to the world." Very few countries can boast of a variety of handcrafted jewellery that is peculiar to various regions of the country. Some example are the Kolkati, Filigree, Kundan, Jadau, Pachchikam and Meenakari works. Traditionally styled and intricately crafted jewellery can be found in abundance across India, although these have never been documented diligently. As a matter of priority, detailed documentation of local forms of handcrafted jewellery that are both exclusive and unique must be undertaken. Once this is completed, India must apply for Geographic Indications (GI) for each of these styles. This will pave the path for India to create a niche for herself in the global markets for handcrafted jewellery. India might have lost out to China and Italy for mass manufactured jewellery but India's focus must be on exquisite, unique handcrafted pieces of superior workmanship. For this, B2C exports must be made easy. Under the current regime, the duty drawback procedures make it difficult for small exporters. In order to encourage exports, export procedures must be re-examined[7].

6.3 Domestic Trade

In India gold has often been viewed with misgiving by policymakers since it tions for purchase of gold is rampant. The long term accompanied by suitable KYC norms. This is also in line with India's Digital India. In order to encourage the former, a suggestion has been to follow the Peruvian model. If a consumer uses digital payment for the purchase of gold, the consumer should be able to claim some portion of GST, say 1 per cent, as a rebate from whole filing their income tax returns. This may incentivise consumers to use more of digital payments.

---

[7] Appendix 2 details the options available for exporters under the current regime

6.4 Skill Development

Skill development is an important part of transforming India's gold markets. So far the focus of these programmes have been in providing the necessary skill sets for operating standard machine made products, in stone cutting and in the production of jewellery. Where India lags is in design, research and development. Under the new policy regime, India's skill development focus must be aligned with the policies around internal trade and exports. The skill set for handcrafted jewellery cannot be mass produced. It is a skillset that takes time and number of years to master. The jewellery sector will have to do its bit in creating these skill sets. A detailed mapping of requisite skill sets across the gold value chain is necessary. These include skills required not only in the manufacturing and crafting of jewellery, but also in the fields of assaying and refining.

6.5 Mining

Gold mining has long been ignored in India. The V. N. Vasudev Report to the Core Group on Gold and Precious Metals constituted by the Ministry of Mines set a mining target of 100 tonnes for India. The recommendations of this report must be considered for implementation[8]. To achieve the target of 100 tonnes, India must re-examine our licensing regime for mining. A single window clearance for mining licences must be considered.

7. Processes and Procedures for Gold

Processes and procedures that are in line with international experiences will help in facilitating two way trade. Processes bring about transparency and standardisation in transactions. They also build trust in the ecosystem, an important aspect that is sadly lacking in the current ecosystem. Very often the quality of gold is questioned. The quality of gold has to be controlled at the point of input or at the point of output. Repeatedly one hears of how standardisation and transparency are lacking in the gold ecosystem. This is why processes and procedures are important.

7.1 Pricing Methodology

India is a price taker as far as gold is concerned. This is despite our country being the second largest importer of gold and having one of the largest gold futures market in terms of volumes. On any given day, the price of gold is different across institutions and

---

[8] Details of the report are provided in Appendix 3

stakeholders. The world derives its daily price of gold from the London Price Fix. In India, the Indian Bullion Jewellers Association (IBJA) publishes daily prices for gold. Under the new regulatory regime, India must develop her own price fix – the India Price Fix. China has a similar price fix known as the Shanghai Price Fix or the Shanghai Gold Benchmark. This is the price arrived at by way of holding auctions twice a day, every trading day. The price pooling methodology, also known as the Walrasian Auction, is achieved through a process of trial and error. The advantages of an Indian Price Fix is that it would be available in Indian Rupees and for as low a denomination as one gram or ten grams of gold.

7.2 Good Delivery Standards

The London Good Delivery standard have long remained the international benchmark. The standards define acceptable norms of delivery of gold in terms of weight, purity and appearance. In India all commodity exchanges and custodians of gold exchange traded funds (ETFs) and other forms of digital gold have their own good delivery norms. For ease of electronic settlements and accounting between stakeholders a uniform Indian good delivery mechanism is beneficial. This will also help in controlling quality of domestically produced gold in the country, since refiners would have to meet the Indian good delivery norms. While guidelines are usually adequate for stakeholders to adopt and follow, the need for these guidelines to be notified or ratified by the government is or three reasons:

(a) It is linked to the accreditation of refineries

(b) It is a pre-requisite for a spot exchange

(c) It will boost gold exports

7.3 Responsible Sourcing Standards

Closely linked to good delivery norms are the responsible sourcing norms. Responsible sourcing of gold means conducting due diligence checks to ensure that gold that is sourced by India, internationally or domestically, do not violate any serious human rights, are not funded by conflict or terrorism, and is considered kosher. The Organisation for Economic Cooperation and Development (OECD) guidelines are the commonly accepted international benchmark. In most countries, responsible sourcing guidelines are integrated into good delivery standards, with imports, and with refinery accreditation. Increasingly, the international community is moving towards responsible sourcing of minerals, including gold. At a time when India is poised to take the big leap and play a more dominant role in the global gold market, it would be imperative to build a regulatory framework that reinforces overall integrity in the gold ecosystem[9]. The OECD is keen to work with jewellery association and with the Bureau of Indian Standards (BIS), who have been working on drafting good delivery norms for India, to draft India's Responsible Sourcing Guidelines that are in line with international best practices. Aligning our responsible sourcing guidelines with that of OECD will ensure that there is mutual recognition in international markets, thereby helping in opening up the global market to made in India gold and gold jewellery.

7.4 Accreditation of Refineries

The Association of Gold Refineries and Mints pegs its combined domestic refining capacity at 500 tonnes per annum. Internationally recognised benchmarks for refinery accreditation is that of the London Bullion Market Association (LBMA) and the Dubai Multi Commodity Centre (DMCC), to name a few. India has also laid down a process for accreditation of our refineries, but these are not compulsory[10]. Unlike international benchmarks, the Indian accreditation process does not include a financial audit. Refineries are an important part of the gold value chain and their financial health is as important as their technical expertise. For this reason, the Indian accreditation process must consider making two changes. First, it must include a financial audit, which can also pave the way for credit rating for these agencies at a future date. Second, it must consider making accreditation of refineries compulsory in order to function. A more thorough accreditation process will ensure that made in India is at par with international standards.

7.5 Hallmarking

India should aspire to have a zero tolerance policy with regard to purity of gold. For global recognition, made in India gold products must be hallmarked. The hallmarking practices in the United Kingdom have been in existence for over 700 years and are held to global best practices. Until recently, hallmarking in India, was not compulsory. With the amendment made to the BIS Act, hallmarking will be made mandatory.

Hallmarking in India can be broken down into two components. First, the marking of every article of jewellery and the second, the audit of the same.

---

9 The diamond industry in India adopted the Forevermark, which is the mark of integrity and of responsible sourcing of diamond.

10 Apart from the large organised refiners there are many "roof top" refineries. These must either be brought into the organised sector or discouraged from operating.

Under the current framework, BIS has taken on the responsibility of not only laying down the guidelines for hallmarking, but also its implementation. The BIS continues to function based on a licensing regime for jewellers. This process must be re-examined.

Under the new framework, BIS should lay down the rules for hallmarking, but the responsibility of implementation must rest with jewellers. Jewellers must register (instead of seeking a license) with BIS so that their hallmarking symbol is registered. This will also act as a means of collating market data. The stamp of hallmarking should ideally have only the mark of the jeweller, the mark of the hallmarking agency, and the purity of the item. Too many stamps is both cumbersome and visually unappealing. This is also in line with international best practices and is the process adopted in the United Kingdom. BIS must restrict itself to conducting audits to ensure that hallmarking standards are maintained. Given the number of jewellers in the country, it will be difficult to enforce mandatory hallmarking. However, registration of jewellers will ensure higher degrees of compliance. In order to ensure greater compliance, there must be no money charged for registration.

It must be noted that it will be a while before hallmarking becomes second nature to the Indian jewellery sector. However, mandatory hallmarking must be enforced for jewellery exporters. Without this, made in India products will not be successful in gaining market share in global markets.

8. Financialisation of Gold

One of the most important objectives of the new regulatory regime is to foster better integration of gold into the financial system. Gold imports and CAD may be one pertinent problem, but until such a time that gold is integrated into the financial sector, gold will be continued to be viewed as an unproductive asset. The financialisation or securitisation of gold not only demands the involvement of banks, although it is an important component. Gold must be integrated seamlessly into banking, non-banking and capital markets.

8.1 Banks and Gold

Banks should play an important part of the gold ecosystem. Currently, banks play a secondary role in the gold ecosystem, mostly because they fail to see the value in the business of gold. In India, for gold to be made a productive asset, the role of banks is crucial. Banks foster trust. Furthermore, with rural India's demand for gold rising, it is important for banks to step in to channelise these savings into the financial system.

Under the current regulatory framework, there are many restrictions on banks' participation in the gold value chain. First and foremost, banks must be allowed to source gold domestically. This means that they should be allowed to procure gold from the domestic market, mainly accredited refineries. Banks must also be allowed to hedge their risks on the domestic commodity exchanges[11]. Ironically, RBI permits banks to do both to the extent of gold that they have collected through the Gold Monetisation Scheme (GMS). It is however necessary to extend these to apply to business as usual.

Under the current policy regime, customers have no other channel to sell their gold but jewellery stores. If the gold market in India needs to be transformed, then the above ground stocks of gold will have to be channelised into the financial sector. In this, banks can play an important role. Banks had, at one point, sold gold coins in tamper proof packaging. Banks must be allowed to buy these back. This is the easiest way to bring back above stock gold into the financial system.

In the interest of expeditious decision making, it is also suggested that RBI create a separate division for gold. Currently, atleast three different departments draft policies with respect to gold. A dedicated department (even if it exists only for a couple of years) will ensure that policies on gold from RBI are comprehensive.

8.2 Gold Accounting

As banks become more and more involved in the business of gold and as new gold based products develop, it would be prudent to develop a gold accounting system. Many existing products operate on gold grammages terms rather than on monetary terms. In order to maintain consistency with the features of the products, it is necessary for banks (and other financial institutions) to device and adopt a gold accounting (also known as metal accounting system) that records gold debits and gold credits.

8.3 NBFCs and Gold

Non-banking financial institutions provide last mile connectivity. Infact they were the first to help in the

[11] During our interactions with the domestic commodity exchanges it emerged that despite banks being allowed to hedge on domestic exchanges to the extent of gold accumulated under GMS, banks were not participating on the exchange. Commodity exchanges believe that this is because RBI has not issued any note on the terms of participation. This was later concurred by banks during our interactions with them. As a matter of immediate priority, RBI must issue guidelines on how banks may hedge their risks on the exchange, even if it is only for GMS.

monetisation of gold by way of offering loan against gold jewellery. Monetisation of gold cannot be the sole responsibility of banks and neither can banks fulfill this objective single handedly. It is therefore important to use the infrastructure of NBFCs to further monetisation. NBFCs can play an important role in promoting the India Gold Coin and in acting as a collection centres for GMS. A framework may be devised such that only certain types of NBFCs may be co-opted into the monetisation process.

8.4 Capital Markets and Gold

Commodity exchanges and gold ETFs have been part of the gold ecosystem for long. Gold ETFs were a means to divert investment demand for gold away from physical gold into a financial instrument. When gold ETFs first came demand was strong. However, over time the demand has slowed down with global gold prices correcting. ETFs must be encouraged in India. Suitable tax breaks, such as equity taxation and equity linked savings scheme (ELSS) status may be considered.

The gold futures market in India is one of the largest in terms of volume. However, since the imposition of the commodity transaction tax (CTT), market volumes have seen a significant drop. CTT was introduced in July 2013. It has led to an increase in cost of trading by almost 300 per cent[12]. It has also resulted in a steep decline in turnover, by over 50 per cent[13], in the same year of introduction of CTT. Even after 3 and half years, the turnover has not been able to reach pre-CTT levels. The result of this has been drying up of liquidity, increase in bid-ask spread from INR 1.5 – 2 in pre-CTT period to INR 5 -7 in the post-CTT period in gold futures. This resulted in increase in cost of participation. The worst affected have been the small and medium jewellers, who have to opt more expensive methods of hedging their risks, usually on international exchanges. In the interest of deepening the gold futures markets and reducing the cost of hedging, CTT must be repealed.

In 2013, the then commodity market regulator Forward Market Commission (FMC), was also of the opinion that CTT must be abolished. It is to be noted that CTT has not been imposed on agricultural and agricultural processing products in order to protect hedgers. On the other hand, many jewellers, including smaller entities infact use the gold futures market to hedge and not for

---

12 MCX trading data

13 IBID

speculative purpose and for this reason, CTT on gold must be abolished.

Another important aspect for consideration under a new policy framework recognize precious metals as a separate category of commodities and not one that can be compared with either agricultural or non-agricultural commodities. Precious metals, including gold, are intrinsically different from other commodities. Hence while drafting any rules or regulations, while macro prudential frameworks may be the same, micro prudential rules will have to be different for precious metals. For this reason too, precious metals must be moved out of the purview of Ministry of Consumer Affairs. The said Ministry oversees all internal trade including that of precious metals. Ideally, precious metals should fall under the purview of the Ministry of Finance or atleast Ministry of Commerce.

8.5 Digital Gold

In the years to come, the new regulatory framework must focus on digital gold. This is a recent product innovation and one that currently has no regulatory framework per se. Notwithstanding, it has been met with considerable success. Digital gold offers consumers the chance to accumulate gold in smaller denominations (as low as 1 g), at their convenience and in a transparent manner. The investments are typically backed by physical gold in the care of custodians and to that extent these products are regulated by SEBI.

Digital gold will facilitate two important changes in monetisation. One, on account of gold holding being dematerialized, transactions will become easier and more efficient since it will only involve a book entry rather than the physical movement of gold. Due to this change, minimum deposit in GMS can be considerably lowered, even to 1g. Any framework that is created for digital gold must facilitate the possibility of consumers being able to dematerialize their existing gold holdings. Dematerialised gold can then be traded on the exchange.

8.6 Gold Monetisation Scheme (GMS)

The GMS has not met with the success that was anticipated. Banks have been unable to garner retail deposits. Under the current framework, the existence of the Collection and Purity Testing Centres (CPTCs) appear to be superfluous, especially since there already exist assaying centres and hallmarking centres. The need for CPTCs in the GMS process must be reexamined. Irrespective of this, it is evident that banks cannot garner retail deposits by themselves. They have neither the reach nor the infrastructure. The scheme requires to be revamped. The foremost task is to co-opt jewellers and other institutions, such as India Post, into GMS. GMS must leverage the network of existing institutions in order to attract retail deposits. Banks must also be allowed to accept gold coins in tamper proof packing without having to involve CPTCs.

In the interest of making GMS a success the way the scheme is structured must be reexamined. Changes to the structure of the scheme must be made to ensure that banks can work with jewellers, with India Post, with NBFCs and other institutions. Banks must also accept vaulted gold in GMS. This would reduce costs of transaction significantly since the deposits would be book entry rather than physical transfer of gold. For this reason, the minimum deposit amount for GMS must be lowered to 1g for vaulted or digital gold. Similarly, the end use of the accumulated gold must be left to the discretion of banks.

8.7 Gold Metal Loan (GML)

The gold Metal Loan is one of the end uses for GMS gold, but given to exporters. GML must be made available to domestic jewellers. One of the suggestions that emerged was that it must be granted priority sector lending status to encourage its uptake. The most important change that must be made to GML would be in its tenure. Typically tenures for loans are left to discretion of the banks. In the case of GML it has been limited to a maximum of 180 days. When demand for gold was strong and price of gold was climbing, jewellers were able to utilise borrowed gold within 180 days. However this is no longer the case. Even so, the important point is that banks must decide on tenures on GML based on their relationship with their customers.

GML is a product that operates in grammage. The loan is given out as metal and therefore it is only right that it is returned in metal. It is for this purpose that metal accounting is important.

8.8 New Products in Gold

If physical investment in gold must reduce, consumers must have gold based financial products to invest in. Hence, product innovation is key. New products must not only divert future investment demand into financial products but must also encourage consumers to bring their above ground stocks of gold into the financial system. Some of these products could be the Gold Savings Account that allows investors to open a metal savings account through which gold may be bought, sold, accumulated and detmaterialised. Reverse mortgage pension products may also be thought off. Similarly, insurance policies with assured metal delivery on maturity (or its monetary equivalent) is another product. It is hoped that with digital gold becoming more and more ubiquitous product innovations can be expected.

9. Infrastructure for Gold

No amount of policy change will help to transform India's gold market if it is not supported by suitable infrastructure. Infrastructure for gold takes many forms, from the creation of new financial institutions that will make the business of gold their main purpose to the creation of a single regulator for gold.

9.1 Gold Board

Multiple regulators and ministries regulating a single product can cause many conflicts. The Financial Stability and Development Council was born because of multiple regulators working in silos and often at cross purposes. The task of effectively monetising gold and creating a gold friendly ecosystem that will encourage standardisation and greater transparency and accountability will require focused effort, and such an effort that is comprehensive and inclusive may not be possible with multiple regulators and ministries. Hence the need for a Gold Board; a single institution that can contribute to policymaking and also work towards the development of gold in India. A single entity that can overlook the regulations of gold will be central to a new regulatory regime. The Gold Board has been envisaged as a single entity under which all existing and future regulations of gold will be subsumed. An ideal structure for the Gold Board would be one that is similar to that of the Tea Board of India. The Gold Board can have representation from various existing regulators of gold and also from industry.

9.2 Bullion Banks

Not all banks may be capable of transacting in gold. Some banks will be better than others. This premise is the reason why bullion banks are necessary in India. Internationally, the bullion banking arm is another division of banks. In India, many banks are reluctant to pursue gold as a business. RBI must consider setting up bullion banks. Licenses for the same maybe issued under the differentiated banking licenses. A bullion bank will be one that has its primary business as all things related to gold (or precious metals). This will help in providing products such as GMS, GML and gold bonds a fresh impetus. The point for consideration and scrutiny is that these licenses if and when issued must not be restricted to only banks and financial institutions. Gold is not an easy business to understand and hence the field must be left wide enough to accommodate any kind of institution (including jewellers) who may want to apply to become a bullion bank. A bullion bank will be an important step in integrating gold into the financial system.

9.3 Vaulting Infrastructure

Creating suitable vaulting infrastructure will be an important component of the regulatory framework. Under the current regime, SEBI oversees bullion vaults by laying down guidelines for exchanges to follow. The regulation of warehouses and by extension vaults, technically falls under the purview of Warehouse Development and Regulatory Authority of India (WDRAI). The warehouses regulator can notify those commodities whose vaults require accreditation. Typically, WDRAI accredits or regulates only those warehouses that wish to issue warehouse trading receipts. So far, the only commodities that WDRAI has notified have been those of agriculture and horticulture. In the interest of developing a gold ecosystem and encouraging digital gold, WDRAI must notify gold as a commodity whose vaults it will regulate. Unlike for other commodities, gold vaults must be regulated irrespective of whether they wish to issue warehouse trading receipts or not. Regulating gold vaults will be easier than that of agro products. This is because gold can be standardised and these standards will survive any duration of time.

Vaulting infrastructure is essential for a spot exchange to work seamlessly. While trading can happen on a platform or exchange, the physical delivery of the gold and its efficiency will depend on the vaulting infrastructure. WDRAI should also issue guidelines for the setting up of private gold vaults.

9.4 Gold Spot Exchange

India has never envisaged a spot exchange. Currently, India has spot markets, and these fall under the regulatory purview of the Ministry of Consumer Affairs. In 2017, the Finance Minister had announced the setting up of a committee that would examine means by which spot and futures markets can be better integrated. In this context, a committee has been set up under the Chairmanship of Shri Ramesh Chand, Member, Niti Aayog. The Committee will be examining the requisite regulatory framework for a spot exchange for not just gold but for all commodities. Since a new regulatory framework for spot exchanges must be drafted, it will be prudent to await the recommendations of this committee.

In the submissions made to this Committee, industry has lauded the need for a bullion spot exchange. It has been widely accepted that a spot exchange will help improve access to gold and will also help in price discovery. It has also been suggested that even if all transactions do not happen on the exchange, all transactions must be recorded on the exchange. This will bring about better transparency in dealings. It has also been recommended that a separate bullion clearing corporation be set up that will support this exchange. However for a bullion spot exchange to be successful, gold must be defined, good delivery standards must be defined, and gold vaults must be regulated.

9.5 Consumer Protection

As the gold markets become more and more organised, consumer complaints are bound to increase, mainly due to disagreements on the purity of gold and its valuation. For this purpose it is important to set up a separate institution or Ombudsman that deals with complaints on gold. This may either be set up separately under the Consumer Protection Cell or it may be set up under the newly envisaged Gold Board. As the government is marketing many products, a proper complaint redressal mechanism is necessary to mitigate any kind of reputation risk that may arise.

10. Tax Issues

Tax issues are under the purview of another sub group. There is only issue that required reiteration. There is little doubt that Indians have significant reserves of gold in their homes. While new regulatory regimes may help in minimizing citizens from adding to this hoard, a means must be devised to encourage people to deposit their gold holdings in the financial system either by dematerializing their holdings or through GMS. A commonly cited reason for the poor performance of GMS is the fear of the tax man. The government must consider announcing some kind of one time amnesty scheme to encourage citizens to declare their gold holding. Without such a scheme, the chances of integrating above ground stock of gold into the financial system may not meet with too much success.

11. Conclusion

India does not have a regulatory framework for gold. What India has are many regulations on gold, many of which are at cross purposes. These regulations have been framed with different objectives in mind. For this reason a regulatory framework is necessary. The objective of this regulatory framework is to transform India's gold market. A regulatory framework can only lay down the salient aspects of what must be regulated. A framework can lay down the macro prudential regulatory structure. The micro prudential regulations will require a lot more deliberation. As the market evolves, the regulations too will have to and this will be the biggest challenge.

Appendix 1: Import of Gold Dore Simplified

- Packing list issued by a Licensed Aggregator in the country of origin to be treated on par with packing list issued by a mining company
- Tariff value for gold (bullion/ articles thereof) notified by Department of Revenue every fortnight excludes doré
- In the past doré import was under countervailing duty (CVD) and the applicable tax was the excise duty on the refined output
- With excise getting subsumed under GST, and 9.35 per cent basic customs duty (BCD) applied on doré, the fortnightly tariff value notified by Department of Revenue must also apply to gold content in doré
- Currently done by customs basis random sample from doré at port of arrival
- The international practice is to melt doré into a homogeneous melt, then draw a representative sample and get it analysed at approved labs. This facility should be extended to approved refineries
- Small scale refiners may be allowed to exercise an option to endorse their import license in favour of a state-owned nominated agency, thereby enabling clubbing of quantity and assuring financial credibility in dealings with mines. This may improve ability to enter into long-term contracts with mining companies.

Appendix 2: Export of Gold Jewellery

On placing an order by an overseas customer an exporter now has three choices:

1. Purchase duty free gold, manufacture those products again and ship.
2. Ask buyer to send advance gold, manufacture the products from that gold and ship.
3. Ship products from ready stock, claim drawback of customs duty.

Case 1:

Exporter wishing to purchase duty free gold has to place order with a nominated agency (let us say, MMTC or Bank of NovaScotia). Nominated agencies supply duty free gold to exporters under a customs bond, and hence the exporter has to deposit the full customs duty paid price to the agency, plus some margin extra to ensure the service conditions of the bond.

Products are manufactured, exported, and the evidence of purchase is endorsed by customs authorities at the customs port. Price of the gold is booked with buyer by exporter, and has to be hedged by exporter to safeguard himself against price volatility, which again means depositing margins with the exchange / agency. Invoice is raised in United States Dollar (USD) and similarly, foreign currency has to be booked in a forward contract, again needing margin money. Exporter gets refund of margin only after a long time from the agency supplying gold.

Problems arising in this case are:

All gold purchases have to be mandatorily be in denominations of 1 kg. Buyer wishing to pick-up smaller denominations can't purchase jewellery in this case. Costs adding to this model of business are in margins placed with nominated agency supplying gold, margins placed for hedging of gold, and margins placed for hedging of foreign exchange.

Case 2:

This is a complex mechanism as the gold received in advance has to be routed through some agency making the exporter to furnish additional guarantees so as to ensure re-export of the exact quantity of gold.

Case 3:

Exporter ships the products, hedge gold prices and foreign exchange. Exporter approaches customs authorities with evidence of export and realisation to claim drawback of duty. Duty on gold is 10 per cent, while drawback available is 8 per cent, meaning a straight forward loss of 2 per cent on duty for exporter. Claiming drawback is a cumbersome process, provisioning takes time, and involves costs. It is understood that claiming drawbacks comes with an element of mistrust as it can be misused by unscrupulous elements. However, a mechanism needs to be put in place to allow a smooth process for genuine exporters.

Although, exports of gold jewellery can be undertaken for jewellery weighing below 1 kg however exporters do not prefer this route as this means a loss of 2 per cent in duty and drawbacks involving other costs.

Practical solutions for this problem are:

1. Abolition of duty on gold as raw material.
2. Avaliability of duty free gold in smaller denominations.
3. Provision of 100 per cent drawback of duty and a time bound, quick processing, with checks on corruption.
4. Settlement of export proceeds of gold jewellery in gold terms.

Appendix 3: Gold Mining in India

Currently, domestic mining in India accounts for less than 1 per cent of India's total consumption of gold. In 2015-16, the production of gold ore in India was 535 thousand tonnes[14] while the production of primary gold was 1323 kilogram[15] valued at 321.46 Crore[16]. The estimated production of primary gold in 2016-17 is 1569.60 kilograms[17], the value for which is roughly INR 436 crore[18]. The Annual Report of 2016-17 by the Ministry of Mines suggests 5 operational gold mines (4 Category A and 1 Category B) in the country. The Hutti Gold Mine, in Raichur district of Karnataka is the main mine (Category B mine). It is supplemented by ore from four satellite mines (Category A) of which two are located in Karnataka and one each is located in Andhra Pradesh and Jharkand respectively.

It is quite evident from the above data that despite of India being one of the largest consumers of gold, it doesn't have the capacity to produce its own gold. The Indian gold mining sector is a difficult business for two reasons. First, it involves getting clearance from multiple ministries and obtaining approval may take years. Second, the leasing process is itself a complex process and can take years to start work. Hence, attracts only a handful of companies to apply for the requisite approvals for mining gold in India.

With an ambition to grow India's gold mine production and bring ease in doing business in the mining sector the Government of India, in 2011, formed a Working Group on Mineral Exploration and Development (other than Coal and Lignite) as part of the 12th Five Year Plan. Section 6 of the Report reads, "Gold has a high commercial status because it has always been in high demand for its fine jewellery characteristics; enjoys high value even for a very small volume; easily encash-able; indestructible and non-corrosive hence lasts forever as a commodity. Because of these qualities gold is often treated as currency. It is important to note that stock of

14 Annual Report, 2016-17, Ministry of Mines, Government of India

15 IBID

16 IBID

17 IBID

18 IBID

gold in a country's treasury and its annual accumulation lead to growth of a Nation's Gross Domestic Product (GDP)…"

Indian Scenario

The total Reserve-Base in the country as on 1.4.2011 is 658 tonnes of gold metal. This tonnage is spread over 13 different States of the Country. Out of this tonnage 167 tonnes is categorized as Reserves in the sense they are economically mineable. The remaining about 491 tonnes of metallic gold is classified as resource of which 265 tonnes is the actual drilled resources and the remaining 226 tonnes is the projected potential resource which falls under 331/332 UNFC categories.

India's contribution to the world mine production is insignificant being 2.22 tonnes which continues to come from only one major producing mine and its two satellite mines viz. (i) Hira-Buddini and (ii) Uti, all belonging to Hutti Gold Mines Ltd. It is significant to note that a major portion of the country's production of gold comes as a by-product from anode slimes resulting from smelting of copper concentrates indigenously produced in Jharkhand State and copper concentrates imported by 48 Hindalco (Birla Group). The by-product gold in 2007-08 was 12.1 tonnes. In 2010-11 Hindalco produced 7 t of gold & 45t of silver. Together with the primary mine production the total production of gold in the country stood at 9.22 t during 2010-11. India imported about 963 tons of gold during 2010.The projected imports at the growth rate of 11% from 2012-2017 are 9305 tons at an average of 1861 tons per year. As per world Gold council estimation, expected gold consumption India during the year 2011 1167 tons, against the 800 tons, projected in 11th plan for the year 2011-12.Considering the production expansions of HGML, BGML and RSMML and opening of new mines from private sector viz. MSPL, Geomysore, Deccan Gold and Manmohan Minerals during the 12th plan period from 2013-14, Gold production is projected at 28.00 tonnes from mines and 16 tonnes from by product totalled 44.00 tonnes by 2015."

As per the report of Sub-Group-II on Metals and Minerals – strategy based upon the demand and supply for mineral sector of the Working Group on Mineral Exploration and Development (other than coal & lignite) for the 12th five year plan, Government of India, Planning Commission the Locations of the future gold mines are presented in Figure 1*(figure in the following page)*.

Besides, the 12th Plan period should lay the foundation for development of 33 new mining centres as listed in Table G 18 by facilitating grant of Exploration Licences & Mining Leases faster than happening at the moment.

The Government of India may set a goal to reach an annual mine production of 100 tonnes gold per annum by year 2025.

Figure 1: Fig.G10: Locations of new gold mines proposed to be opened during 12th plan period

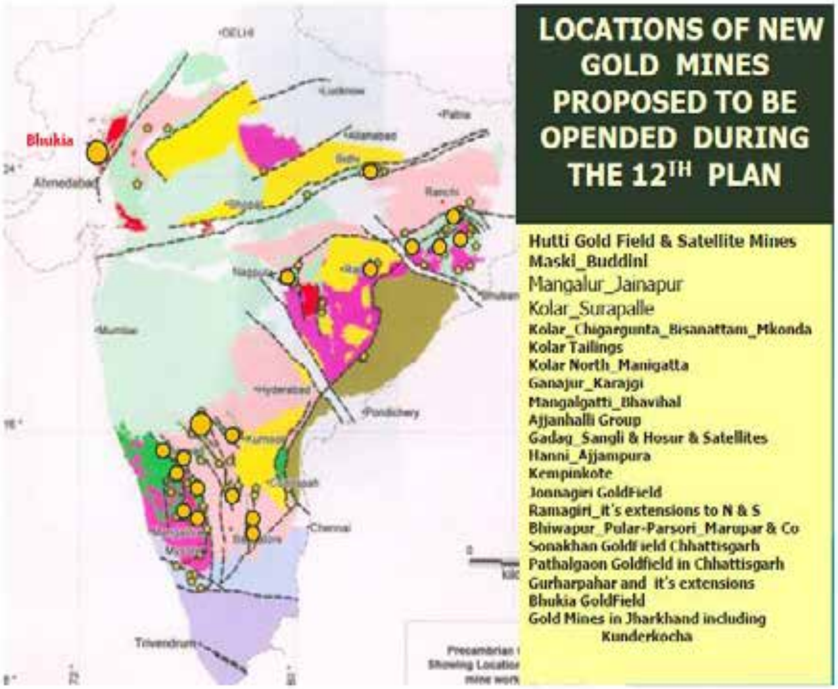

Table 1: Table G17A Summary of Forecast of Production of Gold during the 12th Plan Period

Location of Mine/ Prospect	2012-13	2103-14	2014-15	2015-16	2016-17	Vision 2025-30	Remarks
PSUs							1) Subject to significant expansion & mechanization of the mines; also financial support & speedy clearances from State Govt.
1) Hutti Gold Mines Ltd	3.30	5.20	6.40	9.40	9.40	16.40	
2) Bharat Gold Mines Ltd. (including Tailings)	-	4.35	5.55	5.75	5.75	05.80	
3) RSMML or IndoGold	-	-	-	2.00	2.00	5.00	2) Subject to MOM's decision making to call global tenders 3) Subject to resolution of the conflict between RSMML&IndoGold
SUB TOTAL	**3.30**	**9.55**	**11.95**	**17.15**	**17.15**	**27.20**	
PRIVATE SECTOR							
1) RMML (MSPL)	-	0.8	1.00	1.00	1.00	5.00	
2) Geomysore Services (India) Pvt. Ltd.	-	1.72	2.46	6.34	6.98	7.97	
3) Deccan Gold Mines Ltd. & Deccan Exploration Services	-	1.80	3.00	3.00	3.00	4.00	Subject to Speedy Grant of PL's, ML's& other related clearances
4) Kundarkocha Gold Mine currently held by M/s Manmohan Minerals	0.10	0.10	0.25	0.30	0.30	0.30	
17 new mines + the currently operating gold mines belonging to Hutti Gold Mines Ltd						28.00	
Total of Mine Production	**3.40**	**13.97**	**18.66**	**27.79**	**28.43**	**72.47**	
Byproduct Gold from Hindalco/ Birla & STERLITE	6.0	16.0	16.0	16.0	16.0	28.00	Subject to Copper smelting capacity expansion & Relief on ED + other tax incentives
GRAND TOTAL	**9.40**	**29.97**	**34.66**	**43.79**	**44.43**	**100.47**	

PAHLE INDIA FOUNDATION
FACILITATING POLICY CHANGE

facebook.com/pahleIndia @pahleindia

Tel: +91 11 41551498, 26519889

www.pahleindia.org