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Relevance and Impact of Global Gold Policies on India's Gold Industry

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The Indian gold industry imports an average of 800 tonnes gold annually (worth $ 40 billion ~ 1.6% of GDP) and has private holdings of gold estimated at over 25000 tonnes valued at about $1 trillion.It employs more than 5 million people and its output is more than $ 75 billion which is about 3% of GDP. The lion's share of gold imports is consumed for jewellery manufacturing followed by investment, industrial and medical use. Gems & Jewellery segment of the industry is the third largest foreign exchange earner contributing to about 15% exports worth about $43 billion.

The key global gold policies that impact India's gold industry have been mapped as:

1. central banks holding of gold
2. policies relating to taxation on gold production and consumption in different countries
3. policies relating to customs duty and import and export of gold and
4. policies relating to use of gold as a currency and of exchanges for price setting and selling.

1. To elaborate the context of central banks holding of gold and its significance, it is worth mentioning central banks' agreements on gold. On 19th May 2014, the European Central Bank and 20 other central banks announced the signing of the fourth Central Bank Gold Agreement[1]. This agreement, which applies as of 27 September 2014 is valid for five years with an understanding that the signatories do not have any plans to sell significant amounts of gold. At the end of 2015, central banks held around 31,400 tonnes of gold collectively, which is approximately one-fifth of all the gold ever mined. These holdings are highly concentrated in the advanced economies of Western Europe and North America, a legacy of the days of the gold standard[2]. This means that central banks have immense pricing power in the gold markets and have a commitment to being facilitators of stable markets, in particular where it involves their own investment behaviour. The agreements have provided the global gold market with much needed transparency and a commitment from global central banks that they will not engage in uncoordinated large-scale gold sales. The agreements have benefitted all stakeholders of the gold market from

[1]https://www.gold.org/what-we-do/official-institutions/central-bank-gold-agreements
[2]https://www.gold.org/what-we-do/official-institutions/central-bank-gold-agreements

gold producers, fabricators, investors and consumers and in particular to heavily indebted poor countries (HIPC), several of whom are large exporters of gold[3]. Central banks have been beneficiaries themselves due to the enhanced stability brought to the gold market and to the value of reserves.Central banks holding agreements also earmarks the importance of gold as an asset in global monetary reserves. USA tops the charts in central bank holding with 8133.5t which constitutes to 75.1% of its total reserves followed by Germany with 3373.7t accounting for 70% of its reserve followed by IMF, Italy, France, China, Russia, Switzerland, Japan and Netherlands. India ranks 11th with 557.8t which accounts for 5.9% of central bank's total reserves[4].

2. Talking of global policies relating to taxation on gold production and consumption across the gold markets internationally, there is no overarching tax regulation binding on production or mining of gold but multiple aspects of it applicable to mining in different countries. The exploration of gold mining is governed by myriad laws embedded in national mining policy varying from country to country. Mining regulation encompasses licensing of mining assets, foreign ownership of land, auctions of assets for lease, environment safety and health regulations, royalty fees etc. Responsible sourcing of minerals in the supply chains of gold widely advocated as the 'OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High Risk Areaswas operationalised by the World Gold Council, LBMA and Responsible Jewellery Council.

Segments of market infrastructure that operate to buy and sell gold are regulated too. The bullion banks and exchanges that buy and sell gold or gold products, as well as financial advisors and wealth managers, are typically regulated by their home regulators. In the UK, the Financial Conduct Authority (FCA)[5] regulates the conduct of several organisations involved in the gold market, including: Exchanges e.g. The London Precious Metals Exchange (LME), bullion banks, the "clearing" banks, financial advisors, and investment and wealth managers. The FCA also regulates the LBMA Gold Price, the internationally recognised global price benchmark for gold.The gold market is inherently global and gold is traded continuously throughout all time zones. Gold's diverse trading centres globally are linked as market participants drive convergence of local gold prices through arbitrage activity. However, there are vital distinctions across geographies such as trade restrictions based on every country's foreign trade policy, bilateral trade policies with trading nations, taxes on gold and differing bar standards such that a single integrated gold trading market does not exist. Gold is subject to a range of taxes at various different stages of the exploration and production cycle, in its import and export and in its purchase and sale. Gold is freely imported and exported by many countries, making it a truly global market, but importantly this is not always the case. Investment gold is often free of Value Added Tax (VAT) or Goods and Services Tax (GST), but this still exists in some countries. VAT and GST can also differ from product to product, e.g. between coins and bars, so it is important to check local tax rules. To illustrate this, we can compare China and India's production, consumption and broad tax structures on gold.China is the world's largest jewellery and physical bullion investment market. This ace status of China has been achieved in the last decade by its aggressive policies and by building a supporting infrastructure for mining

[3]https://www.gold.org/what-we-do/official-institutions/central-bank-gold-agreements
[4]https://www.gold.org/data/gold-reserves
[5]https://www.gold.org/about-gold/gold-tax-and-regulation

and trading. At a country level, China was the largest producer in the world in 2016 and accounted for around 14 per cent of total global production which was 463.7t[6]. Having a synergy with Chinese consumption but with negligent mining and production of less than 3t annually, India is exploring some good practices for optimal use of its natural resources from its lead counterpart which will be conducive in creating robust gold trade and industry in India. The Current VAT system in China was adopted in 1994 as part of the economic reform and is often regarded as one of the most complex systems in the world. When gold producers and gold traders (general VAT taxpayers and small scale VAT payers) sell non-standard gold off-SGE (Shanghai Gold Exchange) the VAT is exempt. Gold imported into the domestic market (non-standard and standard gold), for the ones that have an import license, is also VAT exempt. If standard gold is not sold through the Shanghai Gold Exchange (or Shanghai Futures Exchange), a 17 % VAT[7] tax rate is applicable. If standard gold is sold through the Shanghai Gold Exchange (or the Shanghai Futures Exchange), then the VAT is exempt. But it is the invoicing procedure that is quite complex.In comparison, currently the GST on standard gold in India is 3%.

3. In India Basic Customs Duty (BCD) of HS Code 71081200 (gold) is 10%. IGST of 3% added to it makes the effective tax imposed at 13%. GST replaces the excise duty and VAT components, but sits on top of the import duty.Government raised import duties on gold to 10 percent in a series of hikes to August 2013, looking to curb demand to narrow a gaping current account deficit.India's trade deficit narrowed more-than-expected to $12.96[8] billion in June 2017 as gold imports nearly halved from a month earlier.India's falling trade deficit is giving the world's second-biggest gold consumer room to lower its import duty on bullion opined by a regulator recently.Gold smuggling has been rife since India raised the import duty on the metal. The World Gold Council estimates that up to 120 tonnes of gold was smuggled into India in 2016. FTA (Free Trade Agreements) of countries in international trade plays a vital role in global gold trade and likewise impacts the gold industry in India. Elimination of duty on gold could become a major issue in the on-going negotiations over a free trade agreement (FTA) between New Delhi and European countries at a time when India is grappling with a spike in imports from other countries with which it has similar deals.India is in talks with the European Free Trade Association (EFTA) countries — Switzerland, Norway, Iceland and Liechtenstein – for a FTA, officially known as the Trade and Economic Partnership Agreement (TEPA). India has introduced curbs on gold imports to keep a check on its current account deficit, which tends to go awry mostly because of large-scale gold imports, and analysts expect elimination of duty on gold could become a major issue in the ongoing negotiations for a free trade agreement between India and the EFTA group. India is already fraught with a surge in gold imports from its FTA partners, including South Korea and Indonesia. Considering that there's been a significant increase in imports of gold from some of the free trade pact partners recently, it will be difficult for Indian negotiators to agree to complete elimination of duties on gold from the EFTA group, analysts have said.In the EFTA bloc, Switzerl and is a major exporter of gold items, including gold bars. Switzerland is a leading centre in the world for gold refining and India remains one of its major export destinations. The two-way trade

[6]https://www.gold.org/about-gold/gold-supply/gold-mining/gold-mining-map

[7]https://www.bullionstar.com/blogs/koos-jansen/the-value-added-tax-system-in-chinas-domestic-gold-market/

[8]http://profit.ndtv.com/news/economy/article-falling-trade-deficit-opens-space-to-reduce-gold-import-tax-official-1730059

between India and EFTA slumped to USD 19 billion in 2016-17, from USD 21.5 billion in 2015-16[9]. The trade gap is highly in favour of the EFTA. Under a free trade pact, partners offer market access to each other by eliminating or significantly reducing duties with a view to promoting bilateral trade in goods. Besides, both sides liberalise norms to enhance trade in services and shore up investments.

4. Policies relating to use of gold as a currency and of exchanges for price setting and selling globally affords a point of departure for the interpretation of the inception of policies to control gold trade in India in the backdrop of international trade. The preclusion on the import of gold existed in India since the time of India's independence from 1947. The traditional demand for gold was savings demand and not speculative demand witnessed in decades that followed. The increasing demand for gold led to the policy of refusing gold import licensing then and consequently as licenses were not introduced, gold was mainly brought by illegal transit or smuggling. Summarising the first stage of India's gold policy during the period from independence to late sixties, various policy approaches including the Gold Control Act in 1968 made, were devised for controlling the gold market in India. Historical price analysis of subsequent timelines of gold policies in India would be testimonial to the correlation with international gold prices in other currencies, USD emerging as a dominant one. A historic global landmark gold agreement was signed in 1944 with the establishment of International Monetary Fund (IMF)[10] which was created in order to rebuild the global monetary system after the Second World War, and its articles laid down that all member countries should establish 'par values' for their currencies in terms of gold, or in terms of the US dollar which was itself pegged to gold. One dollar was valued at 0.888671 gram of fine gold, or US$35 an ounce. The agreement confirmed the price of gold as established by President Roosevelt in 1933, and gold became the foundation of the first international monetary system established by international agreement. It was the 'glue' that held the system of exchange rates together. To give the new IMF usable resources to enable it to start lending, members were also required to pay 25 per cent of their subscription to the fund in gold. Members had to trade gold at the fixed price, plus or minus a margin set by the IMF. Thus, Gold was established as the ultimate reserve asset. A parallel can be drawn with the fact that India joined as a member of IMF in 1945[11].

We can delve into India's daily goldprice traded as a key constituency impacted by global benchmark pricing policy apart from other tactical factors influencing it. The LBMA Gold price is set twice daily at 10:30 and 15:00 in an auction independently operated and administered by ICE Benchmark Administration (IBA). The price[12] is set in US dollars per fine troy ounce. IBA also publish the price in a range of other currencies.Indian gold traders, jewellers, bullion banks and the value chain have been following the LBMA gold fix for business transactions. However there have been some debates in industry forums lobbying for an ***India fix*** in the coming years which would put the industry in a vantage position as price fixer and not as price taker, considering that India is the second largest market of gold in the world.

[9]https://www.indoasiancommodities.com/2017/10/01/european-free-trade-association-might-put-india-spot-duty-cut-gold/

[10]https://www.gold.org/what-we-do/official-institutions/central-bank-gold-agreements/historic-agreements

[11]https://www.imf.org/external/np/sec/memdir/memdate.htm

[12]http://www.lbma.org.uk/lbma-gold-price

Another recent development is China's launch of 'petro-yuan'.Earlier this year, the Chinese government announced plans to start a crude oil futures contract priced in yuan convertible into gold. The contract will enable the country's trading partners to pay with gold or to convert yuan into gold without the necessity to keep money in Chinese assets or turn it into US dollars. The new benchmark will reportedly allow exporters, such as Russia, Iran or Venezuela to avoid US sanctions by trading oil in yuan thereby setting a new global commodity trade order. The new contract would be able to serve as a hedging tool for Chinese corporations, as well as support the government's broader plans to extend the use of the national currency in trade settlement. Would this call for wider use of Yuan as a common international currency vis-à-vis US dollar hitherto? One has to wait and watch this out.

The unprecedented rise of digital currencies thriving on block chain technology widely known as Cryptocurrencies is another phenomenon impacting gold trade globally. There are upwards of 2,100 digital currencies being traded in the world right now, with a combined market cap of nearly $150 billion, according to Coinranking.com Bitcoin traders in India are watching with bated breath as the cryptocurrency underwent a second hard fork, creating a new offshoot bitcoin gold, which comes less than three months after bitcoin cash was created. The latest split has created three variants of the virtual currency — bitcoin, bitcoin cash (BCH) and **bitcoin gold** (BTG)[13]. The new cryptocurrency was formed after certain developers split the bitcoin's block chain, the technology and underlying code for the digital currency. BTG comes less than three months after BCH was created, while the very first one was mined on August 1, 2017.

Considering a few other significant ongoing transformations in the global gold policies such as Good Delivery Rules by LBMA/ Responsible Sourcing of Minerals (OECD DDG) and the ongoing deliberations by stakeholders and interlocutors of Indian gold industry to draft, formalise, adopt and proactively monitor these norms has set the tone for catapulting India's gold industry to a higher platform in the global gold sector. An accentuation of engagements with policy makers lobbying concerns, advocating greater integrity and international standards in gold trade,honing skills of craftsmen and so on is slowly replacing the Indian gold industry afflicted by illegal trade and unethical practices with a more transparent efficient gold ecosystem. Grey market exists even now but there is a parallel awakening of a large number of players to 'clean up' and redefine gold business.In hindsight, India's gold industry is gearing up to the standards of global gold policies and practices which is likely to benefit the stakeholders and economy in the long run.

Disclaimer: Views are personal and not the views of the publisher.

[13]Bitcoin traders in India watch second fork with bated breath | Business Line http://www.thehindubusinessline.com/money-and-banking/bitcoin-traders-in-india-watch-second-fork-with-bated-breath/article9921927.ece