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Gold Imports :- Boon or Bane

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ABSTRACT

Gold imports have always been a topic of concern in the Indian and global economy and India with the kind of gold her people possess can be completely designed like a golden bird. The study majorly focuses on the gold import of the Indian Economy since liberalization period.Data has been derived from RBI handbook of statistics and speciafically seen trend of gold imports in the economy since 2000 (liberalization period only represented by 1990-91 data) with the structural break in and around the year 2010.The study initially demonstrates how gold imports in India has increased overtime and how the global crisis has impacted the imports in the economy.

Introduction

Appetite for gold in India is unlimited. 800-900 tonne of gold is imported every year as domestic production is close to nil. In 2018 July our trade deficit (the difference between imports and exports) stood at 11.9 billion dollars compared to 7.7 billion Dollars in the same month last year, according to the Ministry of Commerce. The gap was lower than 12.9 billion Dollars in June. The value of gold imports nearly doubled in July last year to 2.1 billion Dollars. Economists/Planners & Government are naturally concerned as an increasing trade deficit means our Rupee has to be devalued to increase exports and reduce imports. This is never considered a healthy sign for any economy. Therefore everybody says that gold import increase must be curbed as it is dangerous for our economy. Even the Prime minister recently said that people should buy less gold and keep their savings in Banks.

Why gold import is considered so dangerous for the economy? Beside the increase in trade deficit it is traditionally believed by economists that:-

(a) It affects our foreign exchange reserve and therefore country cannot spend in importing other essential items like food grain/equipments/technology etc.

(b) India's savings rate is between 30-35%.This saving invested in Banks /Shares/Bonds/Property can propel the economy. However if 36% of this (present estimate) is in invested in gold which is locked up in homes or bank lockers, the investment climate becomes less liquid.

(c) If the trade deficit increases our credibility in international market goes down and our rating also goes down. Therefore the cost of borrowing for our companies abroad goes up & therefore our cost of production based on imported goods/services goes up.

Therefore the general accepted view is that the gold imports must be curbed by increasing import duty, introducing gold bonds so that a person wanting to purchase physical gold can invest in a gold bond and get it converted into gold,when the occasion arises(like marriage etc.).

However I, in this paper want to give a counter view as I consider that gold imports in the long run are going to be a boon for the country and not a curse as is being traditionally argued. My reasons to give these counterviews are as follows:-

Historical perspective

India in the B.C. Era was considered to be a"Golden Bird" or "Sonay Ki Chidiya", wherewe had advanced handicrafts/handloom products/commodities to be exported and in return we were getting back gold to the country. It was a prosperous India, which had lot of gold, and a lot of international trade. In the beginning of Christian era India's GDP was 60% of world GDP. After thousands of years of loot by invaders, it still was having 40% of share in world GDP in 1757, when the Britishers started occupying our country. In the next 100 years i.e. by 1857 our share in world GDP had gone down to 25% & it was less than 1% when we got independence.

We have barely reached 7.4% of world GDP level that too after nearly 71 years of efforts. In the process market exchange rates of Rupee vis a vis Dollar or Pound went down as our official gold reserve was very low & trade deficit was going up. No correlation had been made between the market exchange rate with a country and gold reserve as gold standard had long been abolished. Yet it is apparent on the face of record that a prosperous country like U.S.A. has a higher gold reserve as compared to developing countries like India. This partly explains the phenomenon of a prosperous country like U.S.A. having a much higher exchange rate than the purchasing power parity with a developing country like India. Therefore India of the yore with its huge gold reserve commanded a much higher exchange rate as the barter trade of those times gave us better price for our commodity. Once the invaders looted the gold from India, these favourable terms of trade also went down. Thus history teaches us that higher the gold availability in a country the better its terms of trade.

Psychological

Why do Indians have an unlimited appetite for the yellow metal? Is it a problem or just a symptom of the deep rooted instinct for real savings .These questions have never been answered but the blame game starts for Indian people spending their precious savings in pursuit of a static commodity like gold which does not activate the economy. I think that people as a whole cannot be wrong. Their instincts cannot be questioned, the psychological makeup of our people has to be appreciated rather than being frowned upon.

Indians prefer in investing in gold as its inherent value is more permanent than other assets like moveable and immovable property, shares, bonds etc. The total availability of gold world over including private and government holdings is estimated to be 1.7 – 2 lakh tonnes. Less than 1% of this is added annually to the kitty due to global production. Thus on the supply side gold availability is nearly inelastic. Therefore, this is the only commodity which is available even to the common masses whose value in relation to other assets, (whose supply is ever increasing), is continuously bound to increase. Indians realized this & therefore they preferred to put their savings in gold after meeting their consumption requirements.

In a country like India where less than 20% families have a social security system in the form of Provident Fund/Pensions etc., gold provides an excellent social security. Wives/mothers/ grandmothers keep some amount of gold hidden in their boxes, several times for generations, so that in the case of emergency like illness/natural calamity/pressing needs for consumption, the same can be used. People feel confident that an investment made in gold today will never decrease in value & in the long term it will always appreciate more than the inflation rates.

This is why Indians prefer to keep at least a part of their savings in gold. The psychology of our people & the logic behind it must be understood before any call for curbing imports is made. Even if government increases import duty the gold will be smuggled. India needs gold. It has been Indian people's social security. Even the humble farmer wants to give a small gift of gold to his daughter at the time of marriage so that she holds it as a war chest, popularly known as “Streedhan” (legally permissible) & use it for herself or for her family when the need so arises.

Economic

Gold imports are frowned upon mostly by economists. This is because the amount of foreign exchange outgo appears large & more visible. However they forget the following:-

(i) Other imports like oil, machinery, technology, consumer durables, luxury items, fertilizers, food grains, oilseeds, electronic goods are mostly consumption items. In each one of these, efforts to increase domestic production/productivity & quality is possible. Affirmative action by government to increase domestic production & productivity is required. Development of appropriate technology must be encouraged. This will add value to our economy. Gold import is only converting part of our savings into something valuable which will remain valuable in future too. Thus the country looses value in its savings when we import all other consumable things. Country adds value to its savings when we import gold. Gold is not only the social security not for a family but also for the nation as a whole.

I admit that some of the very essential items like fertilizers/oil/seeds which are essential for the economy & which at present are in short supply have to be imported However import replacement by increasing their production or finding substitutes (like Biodiesel from Agricrops for oil) is very much possible. We should not have the easy way out for these essential commodities by resorting to imports. There should be a long term policy to reduce imports of these as these are being consumed with much less value addition in the long run. Even if domestic substitutes or increasing production of the same is costlier today than the international prices of the same, it is better to subsidise these, and with Research and Development efforts to increase production/productivity to such level as to bring them at par with international price over a period of 5-10 years. This is very much possible, but not enough priority is given to this.

Exchange rates & Gold reserve The market exchange rates of developed countries vis a vis developed countries are not reflective of the real purchasing power of respective countries. This means more imports of consumption items brings less value in the country than what flows out. So a developing country importing heavily will always remain in an unfavourable position.

To illustrate my point I would say that US Dollar to Rupee rate is between Rs. 70-72 of late. However what one Dollar can buy in US is equal to Rs. 14-15 worth purchase in India. Therefore, when India imports a consumable it gets a value of Rs. 14-15 (for a Dollar) & it has to export- a value of Rs 70-72 (for a Dollar). Thus more value will always keep on going out from the country than what will flow in. This is economically unsustainable. The developing country will never develop fully and will remain in an economically slave status to the economic master. Gold imports do not carry that burden as gold is bringing the same value within the country (In the form of physical gold) as is flowing out (price of gold imported in Dollars).

We must also understand as to why there is such an order of magnitude difference in market exchange rate and purchasing power parity rate. The story begins with the colonization by European powers in India for example started coming under East India Company's jurisdiction from 1757. It took only 50 years for them to hold 60% of India as their dominion and rest 40% with local kings but under company's influence. In 1858 after the 1857 war of independence the ruling power passed from the company to the British monarchy. Relative purchasing power of Indian Rupee vis a vis British pound was 1 Rupee for 2 pound in 1757 however when company imposed penalty on Indian kings, like that of Awadh in1790, they insisted that 10 Rupees were hugely equal to a Pound. Thus, Indian exports were heavily undervalued and British imports were overvalued. Therefore, value started drifting to the British colonial masters.

Nobody was there to question the Britishers as to how 10 Rupees in early 19th century was equal in value to one Pound. They were the masters and we were the slaves. Other European colonial powers like France, Germany, Dutch, Portuguese, and Spain etc. were following the same process of economic dacoity in relation to their colonies. Europe became prosperous & colonies became paupers. USA on the other hand was not a colonial power but was heavily influenced by European powers particularly England. To justify their loot & the illogical exchange rates they came out with gold standard. It was claimed by US that for every 35Dollars printed by US at their treasury at fort knox is supported by an ounce of gold. US Dollar thus established its hegemony in the international monetary system on the basis of their gold reserves. Since US Dollar was linked to British Pound & other European currencies through their mutually agreed rates the Dollar became the dominant international currency and it remains to be so, till date.

However in 1930 the great depression hit US due to increased capacity(created for meeting World War demands becoming idle) and at the same time European powers like Germany and Asian powers like Japan amassed a lot of Dollar as an after math of First world war the US and England found that they would not be able to convert all the Dollars and Pounds, their dollar holdings abroad, into gold. They conveniently gave up the gold standard and created international agencies like IMF/world bank. The monetary exchange advantage that US/UK had enjoyed for a long time by claiming to have sufficient gold reserves was found unsustainable when the reality loomed large before them. However 150 years of colonial rules had given huge leg up to US and its friendly European powers. Rest of the world, recently decolonized in the late half of 20th century was at their doorstep to seek help. Now they became world's money lenders and could dictate economic terms for their currencies based on their production capacities and technology.

Objectives:

1) To conceptually analyse gold imports in the Indian economy

2) To derive the trend of gold imports since the study period taken

3) To understand the impact of global economic crisis on indian gold imports.

Methodology:

We have adopted regression model to identify trend of gold import in the Indian economy and also dummy variable model to identify the impact of global financial crisis and Euro crisis on the gold imports of the indian economy Model Specification

Model I:

$$GI_{t=2000\text{-}18} = \alpha_1 + \beta_1 T + \mu_1$$

Where GI is gold Imports in US million Dolaars

T is time

t is the years taken

Model II:

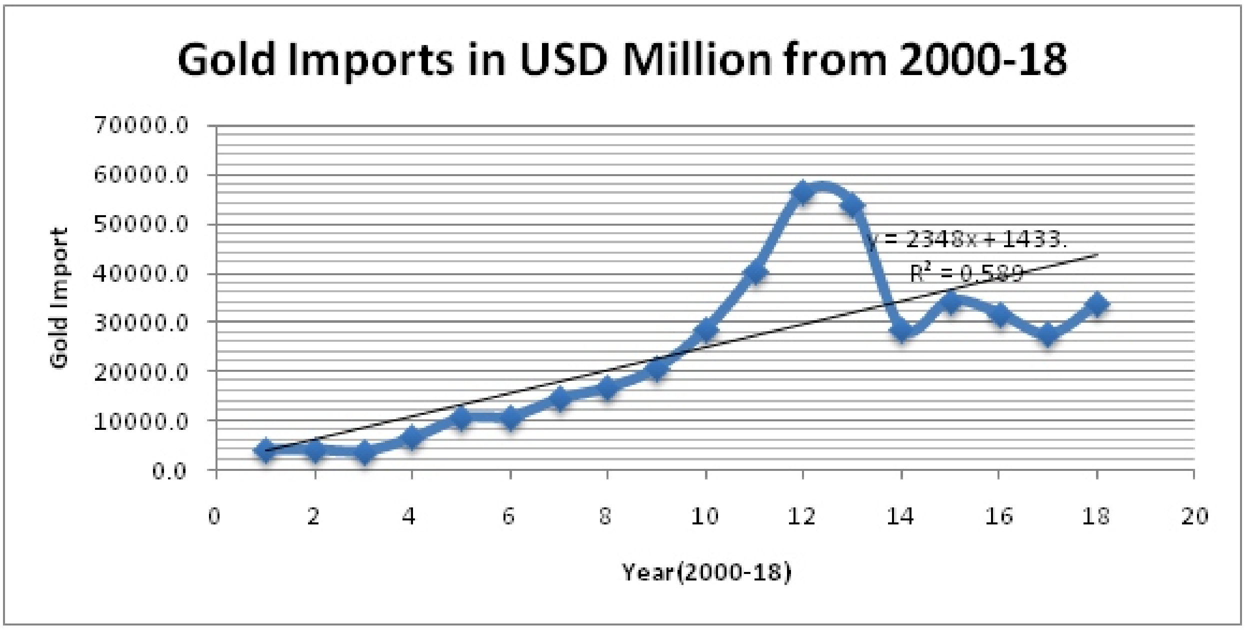
$$GI_{t=2000\text{-}18} = \alpha_2 + \beta_2 D + \mu_2$$

Where D is the dummy year identified as the structural break year to evaluate the change in trend of gold imports in the indian economy.

Data and Analysis:

Gold imports in the indian economy has increased over time with a huge mountin inand around the year 2012.Indian policies however has accomodated the imports yet increasing duties has done wonders in mounting global values of indian imported gold.

Figure 1: Gold Imports from 2000-2018



Source: Compiled from RBI handbook of data

However the trend of increasing imports is defined in the above figure which has been rising through years of resonance.Value of gold imports mounted in the year 2010-11 reached the heights in 2012-13 and again slammered in the year 2013-14

Gold Imports of Indian Economy

2000-01	4121.6
2001-02	4170.4
2002-03	3844.9
2003-04	6516.9
2004-05	10537.7
2005-06	10830.5
2006-07	14461.9
2007-08	16723.6
2008-09	20725.6
2009-10	28640.0
2010-11	40546.9
2011-12	56319.8
2012-13	53820.6
2013-14	28704.7
2014-15	34407.2
2015-16	31770.7
2016-17	27518.0
2017-18	33657.2

Source: RBI handbook of Data and statistics

We can therefore see that gold being of limited global supply in an ever economically expanding world, has a value which keeps on going up. The artificial exchange rate of thirty five Dollars for an ounce of gold kept theoretically alive till early 1970, has now become 1200-1300 Dollar per ounce and only a few years back had touched 1800 Dollar per ounce. The market estimate is that the short term losses in gold prices are only temporary and within 8 to 10 years gold will be selling in international market for 6000-7000 Dollars per ounce. Therefore, gold being imported in India, is retaining the savings in India which will appreciate in Dollar terms by several times over the next decade.

To understand the problem more clearly we can look at two facts. US official gold reserves are nearby 12 times of Indian official gold reserve while US Dollar in purchasing power parity terms is overvalued by 5 times. As US budget deficit is already at an alarming level (898 billion Dollars) the long terms monopoly US Dollar in the world currency market is going to get diluted. Chinese economy that is fast catching up Europe is relatively slowing down. India is also rising reasonably well even if not that well as Chinese.

Therefore, in times to come there may be a need to consider alternate forms of exchange currency rather than Dollar alone. If Chinese Yuan, US Dollar, Japanese Yen, Indian Rupee, Brazilian dollar, Russian Rouble, British Pound, German Mark, French Frank etc are all going to compete against each other, the need for a common platform of exchange will be revived. 225 years after artificial exchange rates were introduced, they are moving towards a collapse. The only universally recognized commodity with an ever increasing inherent value will again be Gold. Chinese are therefore buying more gold than India. Thus, the country having more gold will enjoy more respect for its currency than others which will not have this scarce commodity. US/England/Europe dominated the monetary scene for more than 200 years due to their political clout but in the era of independent sovereign countries,this artificial domination is on its way out.

To further analyse the trend of the gold imports in the economy the trend analysis follows

Model I : $GI_{t=2000-18} = \alpha_1 + \beta_1 T + \mu_1$

Table I: Regression output:Regressing Gold Imports on time

Regression Statistics				
Multiple R	0.767562363			
R Square	0.589151981			
Adjusted R Square	0.56347398			
Standard Error	10789.96798			
Observations	18			
ANOVA				
	df	*SS*	*MS*	*F*
Regression	1	2671200205	2671200205	22.94384117
Residual	16	1862774545	116423409	*Significance F*
Total	17	4533974750		0.000200383
	Coefficients	*Standard Error*	*t Stat*	*P-value*
Intercept	1433.474183	5306.098437	0.270155972	0.790493873
T	2348.04453	490.199953	4.789972982	0.000200383

There is a positive trend in imports of gold in india since eighteen years.The output demonstrates positive value in trend justifying a significant p value(>.05).The dependent variable is explained 58% by the independent variable which is a decent rate.Hence gold imports in India has increased over ages showing a positive trend.

Further we have created a dummy regression model and a identified in the graph we see a structural break in and around the year 2010-11 respectively.Assuming the structural break year we have run regression and derived significant output.

Model II : $GI_{t=2000-18} = \alpha_2 + \beta_2 D + \mu$

Table II: Regression output:Regressing Gold Imports to identify gold imports before and after structural break year (2010-11)

Regression Statistics				
Multiple R	0.549837375			
R Square	0.302321139			
Adjusted R Square	0.25871621			
Standard Error	14060.71286			
Observations	18			
ANOVA				
	df	*SS*	*MS*	*F*
Regression	1	1370716410	1370716410	6.933187306
Residual	16	3163258340	197703646.2	*Significance F*
Total	17	4533974750		0.018081689
	Coefficients	*Standard Error*	*t Stat*	*P-value*
Intercept	17218.97812	4137.233557	4.161954573	0.000734711
D	3786.340122	1437.98103	2.633094625	0.018081689

The value of intercept added with the coefficient value (21005 Million USD) defines a positive increase in gold imports after the crisis period. The significant p value compells us to consider the change in imports of gold in the Indian economy in pre and post crisis year.A global slowdown faced in two phases namely

2008(Financial crisis in USA) and 2012 (Euro crisis) had slowed the economy yet gold imports in India increased in terms of its value and considering the value we cannot ignore the impact of alteration in changed economic policies (increasing gold import duties) in the indian economies during 2012.However gold imports have decreased drastically after 2014 due to policy changes and growth slowdownin the Indian economy thereafter followed further decrease.

Now beginning with the conceptual logic of how much gold India should have , India has one-sixth of world population, so logically it should have one-sixth of gold which means around 35000 tonnes of gold. India holds approximately 25000 tonnes of gold in its treasury and with its citizens. In the next 10 years or so with the present level of imports India will touch this level. Indian Rupee will become more and more equal to its inherent value (purchasing power parity basis) Therefore, I see no logic in seeing present inflow of gold to our country as a Bane. It, in fact is a Boon.

The only question which remains to be answered is whether the gold held by private citizens can bring strength to our rupees or not? My answer is that there are many ways to treat this private treasure as of public utility. There can be gold bonds/patron bonds where citizens can be asked to pledge their gold for use by the country, if ever a need arises, to redeem rupee holdings accumulated abroad (in case of trade deficits). Such occasions do not arise normally. Yet the data about gold availability in the country which is now widely known to international players because of transparent data on gold imports exports will inspire confidence in other countries about our currency's stability.

Conclusion:

In the end I will like to add that the theory propounded by me may seem to be unrealistic to some but I have given due weightage to all factors like historical/ psychological / economic/ exchange rate determinant and I am of the view that for the next 10 years or so country will keep on importing gold at the present pace and thereafter it will start slowing down as saturation levels would come. Recycling of gold within the country will meet the needs then. Lakhs of artisans employed in every village /town of the country will keep getting their daily bread. Gold import is a boon & will remain a boon for the country till then.

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