



INTERIM REPORT
OF
INFORMAL COMMITTEE
ON
GOLD CONTROL

Ministry of Finance
(Department of Revenue and Insurance)

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In July 1966, the Government of India in the Ministry of Finance constituted itself into an Informal Committee to consider the question of discontinuing or modifying Gold Control in its present form, having regard to the economic and financial interests of the community and in the light of the actual working of the measure. No time limit was fixed for submission of the report. We have not yet completed our work, but are submitting this Interim Report, as desired by Government, setting out the conclusions we have so far reached. This Interim Report has been prepared at short notice and is not written with a view to publication.

2. Gold Control was introduced in January 1963 under the Defence of India Rules as an instrument for implementing the long term gold policy having as its objective, the weaning of people away from gold and ultimately mobilising a part of the vast accumulation of gold in the country for the development of the economy and for building adequate reserves to insulate the economy from fluctuations in foreign trade. In the immediate context, however, Gold Control sought to bring about a reduction in the smuggling of gold and ensure that the large, growing and potentially alarming drain of scarce foreign exchange resources was halted.

3. At the time Gold Control was introduced, the value of gold smuggled was estimated at about Rs. 50 crores per annum at international price. Various amendments had been made to the laws relating to customs and foreign exchange and the enforcement machinery had also been strengthened. In 1959, the Indian currency notes circulating in the Persian Gulf area which provided an easy means of financing illegal gold transactions were replaced by a special currency. These measures, however, failed to produce the desired impact on smuggling, partly because prices of gold in India ruled so much above world prices as to make smuggling highly profitable, and partly because in the absence of any control over internal transactions in gold, once contraband gold managed to cross the customs frontier, it could circulate freely within the country. Gold Control was introduced as a comprehensive measure as Government were convinced that smuggling could be controlled only by sustained efforts over a long period to reduce the consumer demand for gold accompanied with a detailed system of control over internal transactions so as to make the circulation of smuggled gold difficult, if not impossible.

4. It is unnecessary here to give a detailed description of the various provisions of the Gold Control Order as in force at present or of the Gold (Control) Act, 1965, which has not yet been brought into force. Broadly speaking, the Gold Control Order provides for control over bullion and regulation of the manufacture of ornaments. On the promulgation of the Order, all persons possessing gold in a form other than ornaments were required to make a declaration of their holdings, except that holdings of gold not exceeding 50 grams per adult and 20 grams per minor were exempted from declaration. A ban was imposed on purchase or any other form of acquisition of gold (except through inheritance) by persons other than licensed dealers and refiners. Loans against hypothecation or pledging of undeclared gold were prohibited. As regards the manufacture of ornaments, a ban was imposed on the manufacture of new ornaments of gold of a purity exceeding 14 carats.

5. The promulgation of the Gold Control Order gave rise to protests and representations from various sections of the gold trade and particularly from goldsmiths. Following the submission of a report of an Informal Group of Government officials in September, 1963, a concession was made to self-employed goldsmiths by permitting them to manufacture ornaments of over 14 carat purity out of ornaments of like purity. Unlike dealers and refiners who were required to obtain licences to carry on their business, to maintain accounts and to submit periodical returns, self-employed goldsmiths were required to obtain certificates and to maintain certain simple accounts.

6. Before examining the actual working of the Gold Control Order, it is necessary to consider the principles governing the gold policy, having regard to the economic and financial interests of the community. The basic fact to be faced in this context is that while the demand for gold in India has been growing year by year, India's domestic production (about 5000 kilograms per year) is sufficient to meet only a fraction of this demand. (The entire production is, in fact, earmarked for Government reserves and industrial users). The country cannot now or in the foreseeable future afford the heavy expenditure of foreign exchange which would be required if this demand were to be met from outside sources. If no steps are taken to hold it in check, the demand will indeed continue to grow, because of the growth of population and the rise in the purchasing power of the people. A further contributing factor is the current inflationary situation and the existence of unaccounted money which encourage a tendency to hoard gold. Private imports have remained banned since 1939 and as internal prices have been much higher than international price, smuggling of gold has become highly profitable. It must not be forgotten that the foreign exchange used for smuggling comes out of the country's actual earnings or potential receipts. At a time when the country is facing serious difficulties in raising sufficient foreign exchange for its development plans, it would obviously be unwise to permit any dissipation of foreign exchange through smuggling of gold. Since the widening gap between demand and supply and the large difference between internal and external price of gold provide the very basis for smuggling, we are convinced that the scheme of gold control is rightly aimed at bringing about a reduction in demand as the most vital condition for elimination of illicit imports of gold.

7. Apart from the economic factors mentioned above, the practical difficulties involved in preventing smuggling are all the greater because of India's vast coast line and extensive land frontier. Consequently, the amount of gold which can be seized at the frontier will always be small in relation to the total amount that may enter the country. For a successful attack on the problem of smuggling, therefore, a multi-pronged drive is necessary in the following direction:

- (a) Reduction in the differential between the internal and international prices of gold;
- (b) Restraint on internal demand;
- (c) Stringent measures for prevention of circulation within the country of gold which escapes detection at the customs frontier; and
- (d) A well planned strengthening of the machinery for detection and prevention of smuggling.

8. We feel that Gold Control in its original form (i.e., prior to its modification in September, 1963 permitting self-employed goldsmiths to manufacture ornaments of more than 14 carat purity out of old ornaments of like purity) was well conceived as an integrated scheme. It sought to attain the twin objects of restraining internal demand and checking circulation of smuggled gold inter alia by limiting the purity of new gold ornaments to 14 carats. Since the final use of gold in India is principally for the making of ornaments, any action to restrain demand must impinge on the manufacture and sale of ornaments. Those who finance the smuggling operations, including the middlemen and tax-dodgers, are encouraged to do so because of the high and assured demand which exists for the end product, namely, the ornaments. One way of weaning people away from the gold habit is by education and propaganda; another is by prohibiting the making of new ornaments of more than a prescribed purity; and yet another is by imposing a quantitative control on manufacture and individual acquisition or holding of ornaments. We have not yet examined the various implications of the third method and are unable to make any recommendation at this stage. We do, however, think that the power to ask for declaration of individual holdings of ornaments in excess of specified limits, which exists in the Gold (Control) Act, is a step in the right direction. We feel that in the present circumstances a combination of educative propaganda and legal measures has to be used to bring about a reduction in the demand for gold. Having regard to the urgency of stopping the drain on foreign exchange, propaganda alone cannot be relied upon and exercise of compulsion is unavoidable. The 14 carat rule has the effect of reducing the quantity of pure gold required to make ornaments of a given weight and also of decreasing the overall demand as a result of disinclination of people to wearing ornaments of lower purity. The 14 carat rule is also a vital element in the strategy for checking the circulation of smuggled gold in the country. The ban on the making of new ornaments of more than 14 carat purity has the corollary that except for primary gold previously declared, all primary gold remaining with dealers or sold by one dealer to another or by refiners to dealers shall be only of 14 carat purity. Smuggled gold is thus easily distinguished from licit gold and this operates as an effective check on the circulation of smuggled gold. In view of this important advantage of the 14 carat rule, we do not agree with those who would like manufacture and sale of new ornaments of 22 carat purity to be allowed; if this is done it will entail the risk of smuggled gold being sold in the guise of primary gold obtained by melting old ornaments. The risk remains even when the manufacture of new ornaments of 22 carat purity is allowed only by conversion of old ornaments of like purity. We are convinced that regardless of any action that may be taken to check smuggling, freedom to manufacture 22 carat ornaments for domestic consumption under any conditions would take the country away from immediate as well as long-term objective of reducing the demand for gold and could also undermine the strategy of preventing circulation of smuggled gold within the country. We, therefore suggest that the original 14 carat rule be accepted as an essential part of the long term gold policy.

9. We have considered whether a relaxation could be made to permit manufacture of new ornaments upto 18 carat purity. We have come to the conclusion that no such modification should be made. While it is doubtful whether the 18 carat ornament would be more acceptable to the public than the 14 carat one, it is certain that it would involve an increase in the consumption of gold. This to our mind is a conclusive reason why the suggestion should not be adopted.

10. On the other hand, there are suggestions for incorporating measures of stricter control over dealings in primary gold and for concentration of the entire business in

primary gold in the hands of State owned or State controlled agencies as a supplementary measure or as an alternative to the restriction on the purity of new ornaments. We have not been able to examine these suggestions adequately. We are, however, conscious of some of the difficulties in adopting these suggestions. One of these is that the International Monetary Fund Agreement precludes purchase of gold by member Governments at rates exceeding the par value by more than one per cent. Even if this difficulty did not exist, it might not be advisable for the Government to take over privately-held gold at this stage at the current high prices if the long term policy is aimed at bringing down the internal price of gold.

11. The question has been raised whether the smugglers would not be able to overcome the 14 carat hurdle by importing primary gold bars of 14 carat purity or by arranging to convert higher purity gold into 14 carat gold after importation into India. Both these possibilities exist; however, if availed of they would make the smugglers' operations more difficult and risky. The smuggler normally buys his supply in one of the principal markets of the world where gold is sold in standard purity and with internationally accepted markings. The gold becomes more easily saleable with such markings than it would be without them. Any attempt to secure gold bullion in 14 carat form not only involves greater cost but is also likely to make the smugglers' activities more vulnerable to detection. There is also the greater risk in importing larger quantities because of the lower purity. We do not, therefore, visualise any serious likelihood of shift to smuggling to 14 carat gold in the immediate future. If, despite these considerations, gold begins to be smuggled in the form of 14 carat bars, the problem of smuggling will have assumed a different complexion and will need to be tackled on a different footing.

12. We now come to the working of the Gold Control Order. We do not propose to burden this short report with statistical details about the working of the measure which are easily available from other sources. However, a few observations may not be out of place. Firstly, gold control is a measure of far reaching social reform aimed at weaning people away from centuries-old social habit. It will not be fair, therefore, to evaluate the utility of this measure from its working over a short period of three or four years. Secondly, even during this short period, gold control as originally conceived has not had a fair trial. As stated earlier, the modification made in September 1963, compromised the efficacy of the 14 carat rule which was the core of this measure. The concession given to self-employed goldsmiths of making ornaments of like to like fineness has not only retarded the trend towards decreasing demand for gold but has also complicated the task of enforcement. By making it difficult to determine whether gold ornaments have been made by melting old ones or from freshly acquired gold bullion, a loophole has been opened for goldsmiths to circumvent the provisions of Gold Control and for smugglers to dispose of their contraband. Thirdly, the common man finds it difficult to appreciate the economic justification of this measure and its importance to the economy, and no serious efforts has so far been made to explain the matter to him with the result that the whole case for gold control is in danger of going by default. Fourthly, although the measure has been in force for over three and a half years, an adequate machinery has not been set up to enforce its provisions. The existing Central Excise staff with hardly any augmentation was called upon to shoulder the additional responsibility of enforcing this measure. A more systematic and regular scrutiny of the returns submitted by dealers and refiners and more frequent checks of refiners, dealers and goldsmiths would have been conducive to a greater success of the measure. There has

been no regular renewal of the certificates of goldsmiths and the validity of the existing certificates has had to be extended from time to time by issue of notifications. There also appears to have been no organised effort at verifying the declarations of gold bullion made by persons other than dealers. We understand that these shortcomings were largely due to inadequacy of the enforcement staff. These important considerations should be borne in mind in assessing the working of the Gold Control Order.

13. We have no statistical evidence that gold control has made any significant impact so far on peoples' attachment to gold ornaments, but the ban on the use of gold for non-ornament purposes has served a useful purpose. Gold is no longer used for the production of luxury articles intended for ostentatious purposes. The consumption of gold for industrial use has been brought down by 50 per cent. We have been informed that Rs. 14 crores worth of 14 carat ornaments were manufactured during the year ending September 1965. This is an encouraging sign, though this is still a small proportion of the total value of new ornaments made in the country. The incentive for holding gold as a source of credit has received some set-back as revealed by the fact that advances against the security of gold and ornaments have come down from Rs. 42 crores to about Rs. 20 crores. The number of refiners has come down from 1000 to 102 and of dealers from 27000 to 14000. The stock of gold and gold ornaments with dealers which was about 28,000 Kgs. on the eve of Gold Control is now about 4,000 Kgs. We do not take these statistics at their face value; but they do tend to show that gold control has already resulted in restricting demand to some extent.

14. It has been said that gold control has not succeeded in bringing down the internal price of gold. It is a fact that although price of gold went down considerably immediately after the promulgation of the Gold Control Order (the price between November 1962 and November-December, 1963 fluctuated between Rs. 95 and Rs. 114 per 10 grams), it began to move up in 1964 and touched Rs. 125 during the year; in 1965 it went up to Rs. 142. Prices are the net result of a variety of factors and in this case not enough is known about what really is happening in regard to important factors like the use of pure gold ornaments or the use of gold as a medium of circulation for unaccounted money on the demand side, and the sales or conversion of old gold ornaments (which used to meet a large part of the annual demand for new ornaments) or the extent of smuggling on the supply side. We would like to point out that having regard to the numerous factors operating on the side of demand and supply, a rise in prices in the short run should not be taken as an indication of the failure of gold control because a reduction in the present disparity between Indian and international prices can be achieved only when there is a genuine reduction in the internal demand for gold and when a proper machinery is in operation to enforce the control in all essential respects.

15. As regards smuggling, no evidence is, or is likely to be, available to establish beyond doubt either that smuggling has increased or that it has decreased after the introduction of control. From January 1963 to December 1965 the seizures made under the Gold Control Order (apart from those made under the Customs Act) amounted to 2197 Kgs. This quantity, we believe, would not have been seized but for existence of Gold Control. The quantity seized under the Customs Act during the same period was 5048 Kgs. A part of this can also be attributed to gold control. The practice is to show the seizures with foreign markings as seizures under the Customs Act (because it is the Customs Act which is invoked in respect of such seizures), even though some of these

may have been effected at inland centres by Central Excise staff who had sufficient powers under the Gold Control Order to carry out the seizures. Whereas it is difficult to state whether smuggling has gone down, there is no doubt that gold control has been a valuable aid for detection and it has added to the obstacles in the path of the smugglers. We would, however, reiterate that even if there were an increase in smuggling in the short run, it would be no indication that gold control has failed. The battle against smuggling, as that against the high internal prices of gold, is bound to be a long-drawn one and has to be persevered with if the ultimate objective is to be achieved.

16. Mention should be made of the impact of Gold Control on goldsmiths. According to 1961 census, there were some 451,000 goldsmiths, silversmiths, dealers and other persons associated with gold, silver and precious stones. Separate figures of goldsmiths are not available. However, judging from the number of persons who applied for certificates to work as self-employed goldsmiths after the announcement of the special concession, and taking into account those who were employees or out-workers of dealers and others who did not apply for such certificates in time, the total number of goldsmiths is estimated to be in the neighbourhood of 300,000. After the announcement of the special concession in September 1963, about 256,000 goldsmiths applied for certificates to work as self-employed goldsmiths. The main source of legitimate employment for goldsmiths was the making of new ornaments out of old ornaments. With this facility allowed to them in September, 1963, employment opportunities were restored to them. Such of the goldsmiths as elected to change their occupation have been given financial and other assistance. We are informed that a sum of Rs. 11 crores has been advanced to the State/Union Territory Governments for disbursement as loans on easy terms, to the affected goldsmiths and 87,000 persons have availed of this loan facility so far. 15,000 goldsmiths/their dependents and children have received alternative employment through Employment Exchanges and 11,000 goldsmiths have received other assistance like settlement on land, etc. Goldsmiths and their dependents and children have also received educational assistance and technical training facilities on a large scale. The goldsmiths may nevertheless have some genuine grievances in the matter of grant of loans, issue of certificates, educational facilities and other procedural difficulties in their day to day working. We feel that these should be looked into by the Government sympathetically and genuine hardships redressed. On the broader question of employment opportunities of goldsmiths in the long run, it has to be recognised that in the very nature of things, irrespective of whether there is gold control or not, the goldsmiths' profession cannot sustain a large number of persons in employment unless reliance is placed on the illicit channels of supply of smuggled gold. It was in this background that the Government's policy, besides affording loans and other assistance to displaced goldsmiths, aimed at providing educational assistance, technical training, alternative employment etc. to the younger generation of goldsmiths, their children and dependents. We feel that the active support by Government to goldsmiths to adopt alternative vocations should continue. It is desirable that the gains achieved in diverting the goldsmiths and their children to other vocations should be consolidated and the trend should not be allowed to be reversed.

17. For meeting export requirements, dealers have been permitted, on application, to manufacture, under supervision, ornaments of purity higher than 14 carats. Over 80 dealers have taken advantage of this scheme. This scheme for export has good potential and can provide larger scope for preserving the skill and craft of goldsmiths.

18. Our analysis so far leads us to the following conclusions:—

(1) Gold Control was placed on a permanent statutory footing in September, 1965

when the Parliament passed the Gold (Control) Act, 1965 after an elaborate consideration, at all stages, including examination by a Joint Committee, which not only considered various representations from all shades of public opinion but also took oral evidence. We feel there has been no economic or financial development of any significance during the intervening period which would warrant rethinking on the basic gold policy. On the contrary, the worsening foreign exchange situation reinforces the need for stricter adherence to that policy. Indeed, the recent devaluation of the rupee has created better conditions for the reduction of smuggling and it would be most unfortunate if we were to compromise the basic objectives of gold control policy precisely at a time when a greater determination could yield rich dividends.

- (2) From the long-term view, it is of utmost importance to wean people away from gold, reduce the internal demand for gold and mobilise a part of the past savings of the people incorporated in the vast hoarding of gold for productive purposes.
- (3) Having regard to the big loss of foreign exchange caused by smuggling of gold (estimated at nearly Rs. 100 crores per year in post devaluation rupees), it would be a retrograde step to give up gold control or significantly dilute its provisions, so as to make it ineffective for reducing internal demand for gold and erecting barriers to the circulation of smuggled gold within the country.
- (4) The 14-carat rule should be accepted as an essential ingredient of India's long-term gold policy and no exceptions should be allowed which would either take us away from the long-term goal of reducing the demand for gold or would facilitate circulation of smuggled gold. The relaxation made in September, 1963 in favour of self-employed goldsmiths has, in our opinion, seriously prejudiced the efficacy of the 14 carat rule and we, therefore, consider that the relaxation should be withdrawn.
- (5) In view of our recommendation to withdraw the September, 1963 concession to self-employed goldsmiths, we suggest that they should be permitted to acquire 14 carat primary gold from licensed dealers and refiners up to a specified limit to enable them to manufacture 14 carat ornaments in addition to their manufacturing such ornaments from the old ornaments tendered by customers. Limited purchase of old ornaments incidental to the business of remanufacturing ornaments from old ornaments might also be allowed. These facilities will also meet the requirements of rural society where generally licensed dealers do not operate.
- (6) Since the goldsmiths' profession in the nature of things cannot sustain large numbers in employment, Government should continue to encourage the goldsmiths to change over to other vocations. Particular attention should be paid to diverting the younger generation to other productive occupations. Further, legitimate grievances of goldsmiths in the matter of grant of loans, issue of certificates, educational facilities and procedural matters deserve to be looked into sympathetically.
- (7) Effective control over primary gold is equally important. The existing provisions of the Gold Control Order need to be further tightened by removing the exemption limits allowed for declaration of primary gold. A complete ban on

the holding of any primary gold (whether of 14 carat or higher purity), without declaration, can cause no real hardship and would be in accord with the law and practice in many other countries. Since the rules regarding declaration were in effect relaxed for a few months in connection with the Gold Bond scheme, and a tightening of the existing rules of declaration has been recommended by us, we would suggest that another opportunity may be given for declaration of primary gold. (The declarations made on the last occasion amounted to only Rs. 8.15 crores which is too small a proportion of the total quantity of gold believed to be held in primary form in the country). Declaration should also be called for in respect of gold ornaments in excess of specified limits as otherwise some holders of primary gold may evade declaration by converting their holdings into ornaments.

- (8) Refineries constitute a vital link in the chain of agencies which handle primary gold and it is, therefore, of the utmost importance to ensure that these facilities are not misused. Moreover, since a good part of gold in circulation undergoes refining, Government should have full knowledge of the entire turnover and operations of the refineries. We recommend, therefore, that early steps be taken to run the refineries as Government owned or State controlled enterprises.
- (9) We are of the view that for the success of a measure like Gold Control simultaneous action is required on several fronts, as for instance, further reinforcement of the Customs administration in the matter of manpower, equipment, training and intelligence set-up, scientific research to improve methods of detection, more concerted attack on the pipeline for payment for smuggling, mopping up of unaccounted money which, in final analysis, is largely financing smuggling, and more extensive drive to channel the savings of the household sector, particularly in rural areas into more productive investments.

19. We have no illusions that the objectives of gold control, whether in terms of reduction in the demand for gold, or of lowering of prices, or of prevention of smuggling, are to be achieved either easily or quickly by the mere passing of the necessary laws or the provision of the necessary staff for enforcement. As stated earlier, the ultimate goal is to wean people away from an age old habit, the harmful effects of which on the economy of the country are still not appreciated by the common man. For the time being, compulsion and education have both to be employed to achieve results. The public mind should receive enlightenment and guidance on the vital economic issues involved. This is particularly necessary as the real issues tend to be clouded because of the doubt and confusion which vested interests are able to create in people's mind.

Sd/- L. P. Singh
Chairman

B. N. Adarkar
Member

Pitambar Pant
Member

Jasjit Singh
Member-Secretary

New Delhi
30th August, 1966.