THE GOLD PROBLEM IN INDIA

Prof. B. R. Shenoy
M. A. Sreenivasan
Dr. Kersi Doodha
Phiroze J. Shroff

FORUM OF FREE ENTERPRISE
"SOHRAB HOUSE", 235 DR. D. N. ROAD, BOMBAY-1

"**People must** come *to* accept **private** enterprise not as a necessary evil, but **as** an affirmative **good.**"

—EUGENE BLACK

Ex-President, World Bank

Introduction

The gold problem has been the subject of intensive public debate and discussion in recent months. The Forum of Free Enterprise, according to its practice of stimulating public thinking on national economic problems, is, therefore, presenting this booklet on the gold problem. There are four essays, examining the problem from the historic, economic and constitutional view-points. The authors are : Prof. B. R. Shenoy, Director of the School of Social Sciences, Gujarat University, an authority on the gold problem ; Mr. M. **A.** Sreenivasan, eminent industrialist who was formerly the Chairman of the Kolar Gold Mines ; Dr. Kersi Doodha, of the' Department of Economics of the University of Bbmbay, who is author of books on monetary problems, and Mr. Phiroze J. Shroff, well-known economist and authority on constitutional law.

THE GOLD PROBLEM IN INDIA

B. R. SHENOY

We shall examine the Gold Problem under four principal heads : (1) What is the Gold Problem ; (II) How and when did it arise ; (III) What measures have we adopted to tackle it and with what success ; (IV) If these measures have not been successful, what alternative measures could we adopt.

I. What is the Gold Problem

This has been stated for us by the Finance Minister more than once in recent months, in particular, in his broadcast speech on the night of 9th January, 1963, announcing the promulgation of the Gold Control Rules, which was published on 10th January, 1963. Briefly, the problem is two-fold: first, gold smuggling and, second, the attachment of the Indian people for gold. The Finance Minister's concern over gold smuggling and over the Indian people's attachment to gold arises from two considerations. First, gold smuggling involves an enormous wastage of foreign exchange. The amount of gold smuggled into the country is, for obvious reasons, conjectural. Smugglers do not file customs returns nor pay the import duty on the gold they bring in. Nor do they declare their incomes from this traffic to the income-tax officials. I attempted a conjecture some years ago, in the Sir William Mayer Lectures, University of Madras, delivered in 1955-56, on the basis of gold assayed and refined at the two Government mints, one at Alipore, Calcutta, and the other at Bombay, and at a private refinery, the National Refinery, Bombay. Until reuently, gold assayed and refined at these refineries was largely imported gold, though it was brought to the refineries as melted gold ornaments for reasons of legal protection.

Smuggled gold cannot be sold openly in the form in which it was smuggled. Its fineness is usually 999 per 1,000. The fineness of the product of the Indian refineries is 995 or under. Gold used in the South, sovereign gold, is about 917 **fine.** Smugglers are, therefore, anxious to get rid of the tell-tale fineness of the gold and bring it down to the Indian standard& Melting and assaying gold was, thus, some indirect evidence of the inflow of gold from abroad. My conjecture then was that this gold inflow might be of an annual order of 1.23 million ounces valued at Rs. 36 crores. The Forward Markets Commission in its report on the bullion trade states that the value of gold smuggled into India is roughly Rs. 30 to Rs. 40 crores per annum, the figure recently quoted by the Finance Minister. Some have placed it at an order of Rs. 50 crores, which is the figure more usually mentioned today.

The relevant point is that considerable amounts of gold are continually flowing into the country at a conjectured annual rate of, say, Rs. 50 crores. It eats up equivaient foreign exchange. This we can ill afford. Gold imports being banned, foreign exchange to finance gold imports cannot be had from the Reserve Bank or the authorised dealers in foreign exchange, the commercial banks. At the same time, the gold that is brought in is not a free gift. Every tola of it is paid for and in foreign exchange. This foreign exchange is appropriated from the foreign exchange currently accruing to the country. How the smugglers find the exchange is a matter of detail though this is a fascinating inquiry, the more so because we have to conjecture here, too, as we have to conjecture in the matter of the quantum of gold smuggled in. We have the broad picture of it. It is the sort of an exercise of filling in the blanks. I think we can do this with some measure of certainty, though this is a matter of detail.

The first concern of the Finance Minister, then, is the loss of foreign exchange involved in gold smuggling. He is, therefore, out to prevent gold smuggling "at any cost".

The second concern of the Finance Minister arises from the traditional attachment of the Indian people for gold. Though very poor—probably among the poorest in the world —we are a gold hungry nation. Much to the satisfaction of the gold mining industry in South Africa, we absorbed large quantities of gold annually. When the farmers had a good harvest, their budgets showed surpluses ; they converted the surpluses into gold. The family budget surpluses showed themselves up as an export surplus in our international trade. When the harvests were good, exports were good. We converted the trade surplus into gold. Via the bullion market in Bombay, and its country-wide distribution machinery, the imported gold was rationed out to the individual families in accordance with their respective surplus harvests.

We have gone on accumulating gold, nobody knows for how long. Ever since recorded statistics in the middle of the last century, we have been importing gold. However, there was a prolonged break in 1931, which lasted for about a decade. During the decade 1931-41, we have been exporting gold, at. times faster than the output of the mines of South Africa. They were very sad depression years. This phenomenon is again related to the family budget position of the Indian farmers. Agricultural prices having sagged—they fell more than industrial prices—family budgets were in deficits. The deficits were cowed by melting family gold, trinkets, in small quantities. This was a miserable sight to see—of families in want, feeding their hunger or clearing their debt by selling gold. Gold in driblets flowed back to Bombay, month after month, for 10 years. It is said that many of the first line of buildings on Marine Drive, Bombay, were built from the profits on the export of gold.

Though a sad thing for individual families, this phenolmenon gave no small satisfaction to the people in that red budding in New Delhi. The deficit in individual family budgets, due to low agricultural prices, had showed itself up as trade deficits—the resulting gap in our balance of payments was creating a headache to the Finance Member. The exports of gold came as a great relief.

In 1940-41, this reverse flow of gold ended. Wiih the rise in agricultural prices, family budgets were once again in surplus and gold Rowed in to meet the demand from the farmers. In September 1939, the imports of gold were banned by the Goyernor-General in Council under the Defence of India Rules. But this made no difference to the flow of gold. Gold was demanded by the people and the market met the demand. Open imports being not possible, imports came by the backdoors. This did not create much of a headache, as during the war period and the immediate post-war years, we had abundant foreign exchange because of the large. trade surpluses.

The total amount of gold we have hoarded is placed at Rs. 4,100 crores by the Finance Minister at the market price. At the official price, it is about Rs. 1,800 crores. It represents about 4 years' national savings, the annual amount of savings being about Rs. 1,100 crores. Gold being a dead asset, these investments are an enormous waste, especially in a poor country. The savings thus wasted could contribute greatly to our economic development if invested in factories and in agriculture. Hence the concern of the Finance Minister over the attachment of the Indian people for gold. His theory is that if gold smuggling could be stoppled, he would (a) save large amounts of foreign exchange and (b) make available the savings of the people for economic development. The basis for this theory is that hcarded gold in India must come from abroad. The output of the Indian mines is trivial, compared to the total demand. In 1961, at the official price, it was about Rs. 2.6 crores and since June 1958 all the Indian output is appropriated by the state.

II. How and When did the Gold Problem Arise

That, broadly, is the gold problem—gold smuggling and the traditional attachment of the people for gold. How did the gold problem arise? This problem is to be divided into its two aspects, how and why, is gold smuggling taking place and what is the economic basis for the attachment of the Indian people for gold ?

Let us first examine how and why gold smuggling is taking place. Heavy penalties attend gold smuggling. Penalties include confiscation of the gold and imprisonment. If smuggling continued, even so it is because of the enormous profits which this trade brings. The enormous profits result from the phenomenal gap between the landed costs and market prices of gold. The U. S.—U. K. price of gold is Rs. 53.58 per 10 grammes. To acquire the gold, the smugglers have to purchase foreign exchange in the free markets abroad, or the black market in India. They have to pay in Indian money for the foreign exchange in these markets, a premium of about 35 per cent. On this basis, the landed cost of the smuggled gold may be about Rs. 65 per 10 grammes (Rs. 53.58 + Rs. 18.94 on account of exchange premium + Rs. 2.50 on account of transport). The market price in India, at its peak, attained on 31 August 1962 was Rs. 129.90. This makes a gross profit of Rs. 65 on an investment of Rs. 65, i.e., in terms of percentages, '100 per cent gross profits.

To arrive at the profit rate per year, this must be multiplied by the number of times a smuggler is able to repeat the transaction, i.e., the "turnover" in commercial terminology. If a trader is able to convert money into gold and gold back again into money six times in a year, the gross profits he makes will be Rs. 390 on an investment of Rs. 65, or gross profits of 600 per cent per year.

At a price of about Rs. 105 per 10 grammes, the dealer-to-dealer price currently quoted in Bombay, the gross profits per transaction are Rs. 40 on an invesment of Rs. 65, and the annual profit on a turnover of 6 times in a year is Rs. 240, or a gross profit rate of about 370 per cent per year. I do not know if there is any trade or occupation in India which brings this fantastic rate of profits. The phenomenal gap between the landed costs and market prices is the crux of the gold problem. While this gap remains smuggling will continue. If smuggling must stop, this price gap must be eliminated.

How did this price gap arise and who created it? Leaving the inter-war period alone, the price gap arose in 1940-41. There was no price gap in September 1939, when the official price of gold was Rs. 37.22 per 10 grammes and the market price was about the same. A gap between the two prices arose in 1940-41 as a result of the rise in the market price. The market price of gold rose because of war-time inflation ; the price of gold, like the prices of commodities in general, reflecting the state of inflation. As inflation grew the gap grew also reaching a high of Rs. 67 in February 1949. In September 1949 the official price of gold was raised from Rs. 97.22 to Rs. 53.58. This, coupled with inflation control, reduced the price gap, which reached a low of Rs. 18 in June 1954. With the resumption of inflation in 1955-56, the price, gap widened again reaching an all-time peak of Re. 76 on 31 August 1962.

The price gap, then, is the result of two factors : inflation and a rigid official price of gold. If so, the responsibility for the price gap is that of the state, as inflation is caused by it and the official price of gold is fixed by it. If there was no inflation, there would have been no price gap; or, if inflation is forced upon us by circumstances beyond our control, there need be no prick gap too, if the state permitted the official price to move with the market price. In either case we will have no gold smuggling. The responsibility for the phenomenon of gold smuggling thus rests squarely on the shoulders of the state even as, if rain-water leaks from the roof, the responsibility for it lies on the contractor. It is little use blaming the law of gravitation for the leaking roof. It is little use blaming the bullion market, the speculators the smugglers and the goldsmiths, who represent the law of gravitation in our analogy, for the phenomenon of gold smuggling If there are creviues in the roof, for which the contractor is responsible, rain water will leak into the room. If there is a gap between the internal and the external prices of gold. for which the Government is responsible, gold smuggling will take place

We may now pass on to the question of the attachment of the Indian people for gold. Apart from the magical properties of gold this attachment has an economic: basis, the soundness of which cannot be easily set aside. First, the savings of the masses of the people arq meagre. The national average of savings per family is Rs. 120 in a year. This includes the savings of tha upper middle classes and the rich. It follows that the savings of the farming population, who, ordinarily, provide the bulk of the demand for gold, are even smaller per family. And not all the savings of the people are invested in gold. Some of it goes into farm improvement and, maybe, other forms of investment. This demonstrates that the individual family units of investments in gold are rather minute. Even if they had access to the stock market, the individual amounts *seeking investment* would be a fraction of the minimum market lots of the shares.

The other alternative is to put the money in the post office, or in the small savings part of Government debt. How would the farmer have fared if he had taken recourse to this alternative ? Every Rs. 100 invested in gold in August 1939, the month before the declaration of the war, rose in capital value to Rs. 401 in August 1962. Every Rs. 100 invested in small savings in August 1939, on the other hand, remained Rs. 100 in August 1962, if we ignored the handicap of non-negotiability of the latter investments, apart from post office deposits. Stated differently, Rs. 100 invested in gold in August 1939 yielded in August 1962, Rs. 401 or the original sum *plus* compound interest at 6 02 per cent Every Rs. 100 invested in small savings in August 1939 yielded in August 1962, somewhat under Rs. 300 (original sum plus compound interest at 4.5 per cent), even on the basis of the advantageous terms of national savings certificates, the investments in which rise to 1½ times their value every 12 years.

The preference af the Indian public for gold is the result of both these factors. The remedy to the first factor, the minute individual units of savings, will take long to operate, as this remedy lies in increasing the incomes and savings of the masses of the people in the rural areas to the "minimum market lot" level of stock exchange investments The remedy to the second factor lies in creating confidence in the honesty and stability of the Indian rupee. This remedy is entirely in the hands of the Government and is capable of immediate application. The Government must make up its mind to stop inflation, to stop debasing the currency. The value of the rupee today is about the value of 3½—4 annas before the war and the responsibility for it is wholly that of the Government. It is only under a stable rupee that people's savings may be expected to go into small savings. The preference for gold is the result of the bitter experience of the past.

III. Measures Adopted to Tackle the Problem

We have been worried over the phenomenon of gold smuggling for quit: some time now and we have taken a series of measures to tackle it, though, without any success. We shall consider four measures in particular: (a) intensification of customs vigilance and severity of penalties; (b) amendments in April 1955 of the Sea Customs Act, 1878; (c) the issue in May-June 1959 of special rupee currency notes for circulation in the Persian Gulf territories; and (d) the promulgation of the Gold Control Rules on 10th January 1963.

The intensification of vigilance has produced no visible results A by-product of this intensification has been probably the spread of corruption. When gross profits are of fairy-tale dimensions, it becomes possible to buy over men with weaker consciences, men with [expensive habits which the shrinking real value of the salaries cannot finance, and men with large families and dependents to maintain Men of this description exist in all walks of life and, therefore among the Customs vigilance people and they work under pressure of very great temptations, as the Talab smuggling case has revealed. Talab named people in very high places as his collaborators and we have heard of diplomats, visiting dignitaries and their entourage, air pilots and the staff of shipping companies being involved in cases of smuggling. I have heard it said that when gold was smuggled across the Rajasthan frontier, the special constabulary guarding the frontiers had to be changed once every week, for fear of the smugglers establishing intimate contacts with them. Though this doubtless makes a sorry narrative, this is not very much to be surprised at, considering that out of every 100 tolas of gold smuggled about 16 tolas would cover the cost of the smuggling operatian, so that the smuggler has a balance of 84 tolas to play with The use of the mechanical gold detectors at the customs counters at air-ports and elsewhere have not, under these conditions, been very effective.

Confiscation of gold has not proved a deterrent. Even if one in every three consignments were confiscated, our arithmetic of the gross profit rate shows that the smuggler; could still continue in business and prosper. In actual fact, the incidence of confiscation would seem to be much lighter. We have data of the gold confiscated. It averaged about Rs 1.75 crores per year during the three years ending 1958. Expressed as a ratio of the conjectured amounts of the gold flowing into the country, this makes a confiscation incidence of one in every 17 or 20 consignments, which is not by any means harsh.

That confiscation has not proved a deterrent is also conclusively shown by the insurance premium charged by the insurance company, a subsidiary of the smugglers, for insuring against the risk of confiscation. The Chairman of the Gold Control Board, Mr. G.B. Kotak, referring to this strangle insurance undertaking, in an address to Rotarians at Ahmedabad on 20th February, 1963, is reported to have observed that the premium rates charged by the company were 10-15 per cent of the value of the gold smuggled; he added that the consignees received the insurance claim within 24 hours of confiscation of the gold by the Customs. The insurance company would go out of business if one in every 7 to 10 consignments or less was detected and confiscated. The premium charged is evidence that this is not the case. The incidence of confiscation is much less frequent than one in ten. As our conjecture above indicates, this frequency is probably one in every 17 or 20 The insurance company would, thon, retain 41 to 50 per cent of its premium collections towards expenses and profits.

This insurance arrangement is a great convenience to gold smugglers. True to the general principle of insurance, it enables the distribution of incidence of confiscation among the fraternity of smugglers. It enables the unlucky ones among them to continue in business, even if fate decreed that the hand of the police should fall on them with much greater frequency than on the rest of the fraternity. If every smuggler took the insurance cover, none of them trusting to luck, of every 100 tolas of gold smuggled in, 10 tolas would cover the cost of insurance, 16 tolas would cover the cost of the gold and of its transport, and the smuggler would be left with a net gross profit of 74 tolas.

Under the Sea Customs Act, 1878, when the police seized gold on suspicion, they had to prove before a court of law that the seized gold was smuggled gold. If they failed to prove this, gold had to be surrendered back and the party was set free. The police pleaded that this hindered vigilance and prevention operations. The Sea Customs Act was, therefore, amended to shift the onus of proof from the police to the person from whom the gold was seized. The owner of the gold has now. to prove before a court of law that the gold seized from him was not smuggled gold. 'This legal streamlining did no more than clip the civil liberties of the bullion dealers. It did not affect gold smuggling, as it left unaffected the difference between the landed cost and the market price of gold,

Our attention then shifted to the method of financing gold imports. Studies in th Reserve Bank of India seemed to show that finance of gold imports was greatly facilitated by the fact that Indian moneys passed current in the Persian Gulf territories. Gold was sold in India against rupees, rupee notes thus obtained were smuggled out of the country and utilised to buy gold in the Persian Gulf territories. When the rupee notes flowing into these territories proved surplus to' the needs of the local circulation, they accumulated with the banks and the latter passed them on to the Reserve Bank of India in return for foreign exchange. This meant that, indirectly, foreign exchange to finance gold imports came from the Reserve Bank of India through the intermediary of banks in the Persian Gulf territories. The Reserve Bank experts, therefore, thought that gold imports would cease if the rupees in circulation in these territories were rendered ,distinct from the rupees in circulation in India, as this would deprive the gold smuggler of this easy technique of finding foreign exchange finance. Indian notes in circulation in the Persian Gulf area was, therefore, withdrawn in May-June 1959 and was replaced by special types of rupee notes. The latter were dyed red and looked different from Indian rupees.

This did not, however, put a stop to gold imports, for the simple reason that it made no difference to the price gap and to the fairy-tale dimensions of the profits in gold imports. The market was easily able to circumvent this measure of the Government. Hitherto, rupee notes were taken out of the country by the dealers in gold. The notes were brought back by the commercial banks in the Persian Gulf. Under the new handicap, this could no longer be done. The notes were now brought back by the dealers in foreign exchange. This reduced somewhat the profits on gold imports, as, following this measure, the discount on the Indian rupee notes row considerably in the free markets. The steep rise in the discount meant that to obtain foreign exchange to purchase gold with for smuggling into India, the smugglers had now to pay correspondingly more rupees. To that extent, the gross profit margin got reduced.

At one time—in December 1961—the rupee was quoted at HK $ 0.78 or a discount of about 35 per cent, the parity exchange rate being Re. 1 = HK $ 1.20. The discount is currently lower, being about 11 per cent. This, however, could not make much of a dent on gold smuggling since, as we have seen, even on the basis of a discount of 35 per cent, the gross annual profit rate was 370-600 per cent. Moreover there were compensations. Because of continued inflation, the market price of gold kept moving higher, widening the profit margin.

The Gold Control Rules issued on 10th January 1963 are not likely to make any significant impact on the gold trade. Temporarily, these Rules have disorganised the bullion market. The bullion market is no longer a closely integrated entity, with Bombay as the hub of the market, thn prices in the rest of the country differing but fractionally from the Bombay quotations. Gold prices now vary widely from centre to centre,. The dealer-to-dealer price in Bombay, which is currently Rs. 105, is probably the lowest in the price ladder. In Bangalore I understand the current price is Rs. 115. In the other interior centres the prices may be as high as Rs. 125 or more. Thew price divergences are the result of the Rules having banned open transactions in non-ornament gold. Transactions in non-ornament gold having thus become "black," gold cannot be transported through the conventional channels. It has to be carried in person by the traders or their trusted agents from Bombay or other receiving centres to inland areas. Add to this transport cost, the Insurance cost against the risk of police detection and we have an explanation of the vast regional price variations.

Beyond this splintering of a hitherto integrated market which has quite unnecessarily added to the cost burden of acquiring gold, the Gold Control Rule; have not achieved anything purposeful. They are not likely to make any difference to gold smuggling as once the market mechanism gets adjusted to the Rules, the profit margins, which are even now fantastic, will recover to their maximum. These Rules amount lo no more than streamlining, from the standpoint of the Administrator, the machinery of the bullion market, so as to permit administrative contml of all recorded transactions. But dealings in smuggled gold have never been recorded, and, of necessity, cannot be recorded Even as it is no remedy to the thief menace to require that all thieves register at the reception counter, for the benefit of the police, before entering the building, it is no remedy to gold smuggling to require that all dealers record, for the benefit of the Gold Control Board, all their transactions in smuggled gold.

The measures we have adopted against gold snuggling have demonstrably failed without exception. The reason for the failure is the same in every case. The "corrective" measures did not reduce the price gap. Despite the thunder and lightning of official pronouncements and the threats of further drastic action, the price of gold never fell below Rs. 86, which it touched momentarily on 24th November 1962. Since then the price has fluctuated upward, the current Bombay quotation being Rs. 105 and in the interior centres fantastically higher.

Nor has gold smuggling stopped, despite official assertions on the subject. This just cannot be, seeing that, at the current market rates, the gross profit margins per year are of the order of 370 per cent or more of investments. In face of these profit margins, to assert that gold smuggling has stopped seems very much like saying that rain water has beer, stopped from leaking through the roof though the cracks and crevices remain as before. The Press continues to carry reports of detected cases of smuggling. On 16th February 1963 a German couple, visiting India, is reported to have been caught with Rs. 2,508,000 worth of gold, weighing 24 kilos. On 31st March an Indian citizen was reported to have been apprehended by the police at the Bombay airport with Rs. 52,980 worth of gold, weighing 5 kilos ,and 298 grammes.

The Finance Minister, speaking in the Lok Sabha on 24th January 1963, seems to have imparted respaciability to the view that the recent; improvement of the Indian rupee in the free markets for foreign exchange overseas is evidence of the "halt" in gold smuggling, which the Gold Control Rules have supposedly produced. This argument was repeated by the Secretary to the 'Gold Control Board sometime later and has been echoed by some financial commentators since.

On 4th January 1963, the week before the promulgation of the Gold Control Rules, the Indian rupee was quoted in Hong Kong at HK $ 0.86, the parity rate being HK $ 1.20 = Re. 1. This quotation has steadily risen since, the rate on 1st March being HK $ 1.07.

The theory behind this argument is that the smugglers of gold sell the gold in India against rupees, smuggle the rupees out of the country and purchase foreign exchange! against rupees in the free' markets for foreign exchange abroad, using foreign exchange thus acquired to purchase gold to repeat the smuggling transaction. When the smugglers are active, the demand for foreign exchange against rupees gets active, too, and the rupee might weaken in the free markets,. Contrariwise, when smuggling gets halted, the demand for foreign exchange against rupees slackens and the quotations in terms of foreign currencies for rupees move up. It is believed that the converse is also true; that, if the exchange value of the rupee should rise, we have an indication that gold smuggling is getting under control.

The supposed link between the quotations for the rupee in the free markets for foreign exchange and gold smuggling doles not seem to be valid. First, the demand for foreign exchange against rupees in the free markets does not come from the gold smugglers alone. This demand ensues also from the smugglers of a whole series of commodities — art-silk fabrics, cameras, cigarettes, cigarette cases, diamonds, electrical goods, fountain pens, photographic materials, razor blades, spices, transistor radios, watches and so on — and also on the part of those who have illicit remittances to make abroad on current or capital account. If so, the demand for foreign exchange against rupees may not decline, even in the event of a halt in gold smuggling, unless it is established at the same time that there is an all-round slackening of the smuggling traffic and in the illicit demand for funds abroad. The advocates of this theory have not established this.

Secondly, it is possible to argue with justification that a rise in the rupee ,exchange rate in the free markets instead of being an index of halted smuggling, might, indeed, stimulate smuggling as, to the extent of the rise in the exchange rate, the profits on gold imports would be higher. The landed cost of gold in India is the external price (Rs. 53.58 per 10 grammes) plus the premium on foreign exchange in terms of rupees (12.i per cent, when the rupee is quoted at HK 1.07) plus the cost of transport. When the premium on foreign exchange declines, the landed cost is correspondingly less. Some have, in fact, indicated that the recent rise in the rupee exchange rate in the black markets in India and in the free markets abroad having "almoet counterbalanced" the fall in the gold prices in India, the latter have not deterred gold smuggling.

The fact of the matter is that the exchange value of the rupee in the free markets for foreign exchange is not determined by the demand for foreign exchange on the part of the smugglers of gold and of other commodities. The current discount on the rupee in these markets and in the black markets in India is a rough measure of the risk-cost in unauthorised dealings in foreign exchange. This is well evidenced by the trend of the quotations for the rupee, in recent years, in the free markets. We find that until the issue of the distinctive currency notes for circulation in the Persian Gulf territories in May-June 1959, the exchange value of the Indian rupee in Hong Kong remained close to the parity price of Re. 1 = HK $ 1.20. The discount on the rupee during the preceding 4½ years ranged between 0.42 per cent and 1.90 per cent, the highest and the lowest quotations for the rupee being HK $ 1.195 and HK $ 1.772, respectively. This was somewhat below the lower exchange point of the rupee — the Reserve Bank's selling price (Re. 1 = 1s.5-63/64d.) — in terms of Hong Kong dollars, Re. 1 = HK $ 1.199.

But it is not as if the Indian rupee had not, during this period, depreciated in terms of sterling and Hong Kong dollars. The depreciation did not show up in the free market quotations. This was so because when Indian money became surplus to the needs of the circulation in the Persian Gulf territories, it accumulated with the commercial banks and the latter passed it on to the Reserve Bank at the prevailing official exchange rate. The difference between the free market and the Reserve Bank's selling price for sterling represented the commission of the dealers on the transaction. This mechanism of convertibility, which is what kept the rupee in circulation in these territories despite its progressive debasement, prevented the rupee from failing below the official market rate. Since rupee notes are, in effect, freely transferable between Hong Kong and the Persian Gulf territories, the Hong Kong rates cannot fall below the official rates prevailing in the Persian Gulf area by more than the risk-cost of transferring rupees from the former to the latter.

With the introduction of the special currency notes, this convertibility support no longer applied to the Indian rupee abroad. It applied only to the (new) special currency notes. From May-June 1959, we see that the free market quotations for the latter remain close to their official parity.

With the introduction of the special notes in the Persian Gulf area, the smugglers obtained foreign exchange from the free markets overseas, against Indian rupees, smuggled by them out of India. The indirect support of the rupee being now removed, the Hong Kong quotations for the (old) Indian rupees suddenly dropped from HK $ 1.19 on 28th May 1959 to HK $ 1.09 on 25th June, a discount of 9.2 per cent. Thereafter, they progressively declined, reaching a low of HK $ 0.78 on 28th December 1961, a discount of 35 per cent. An individual who conceals $ 100 from the exchange control, through under-invoicing, over-invoicing, or otherwise, will obtain from the official market Rs. 1,333.33 ; the same sum will fetch Rs. 1,494.67 in the free markets, a premium of over 12 per cent, at the rates ruling on 1st March 1963.

Supplies of foreign exchange came to these markets from Indian traders, who had acquired foreign exchange through under-invoicing exports and over-invoicing imports ; supplies of foreign exchange also came from the Indian settlers overseas who have remittances to make to India, the temptation to sell this foreign exchange in the free markets being the heavy premiums on foreign exchange, in terms of the Indian rupee, ruling in these markets.

Under the new arrangement of special rupee notes in the Persian Gulf area, the (old) Indian rupees obtained in the free markets for foreign exchange had now to be smuggled back into India to meet the needs of those who had sold foreign exchange in these markets. This was done by, or on behalf of, the sellers of the latter. Every smuggling in of gold, therefore, now involved two smugglings of currency notes, first outside the country by the gold smugglers, and for a second time by the dealers in foreign exchange overseas. This double smuggling added to the risk-cost of the transaction. This explains the heavy discounts which appeared on the (old) Indian rupee since June 1959.

Since 28th December 1961, the Hong Kong quotations for the rupee have been steadily rising, the discount declining from 35 per cent as on that date to 10.8 per cent on 1st March 1963. This improvement of the rupee is no evidence of any improvement in the intrinsic value of the currency. Since December 1961, the general index of prices rose from 124.6 to 126.5 in February 1963 (1952-53 = 100) and money supply from Rs. 2,955 crores to Rs. 3,208 crores. If the free market quotations were a reflection of the intrinsic worth of tht currency, these quotations should have fallen further, instead of rising.

It is factually incorrect, too, to link the improvement in the free market quotations for the rupee with the promulgation of the Gold Control Rules on 10th January 1963 on the false theory that this had reduced the demand for foreign exchange on the supposed halting of gold smuggling. The improvement in the quotations began much earlier and seems to be wholly unrelated to the present series of sledge-hammer gold policy measures of the Government, the latter dating with the announcement on 21st August 1962 by the Finance Minister t~ the Consultative Committee of Parliament on Finance that the Government was contemplating measures to check the rise in gold prices. The improvement in the exchange rate possibly reflects the streamlining of the technique of smuggling rupee notes in and out of the country. It is not basically related to the purchase of foreign exchange by gold smugglers. Nor is the demand for gold linked up with the free market exchange rate of the rupee. This de and rests on a complex of factors operating in the domestic economy, one of them being inflation.

As the dealers in the bullion market well know, the Gold Control Rules have not halted smuggling. With the steady recovery in the domestic price of gold and the improvement in the free market quotations for the rupee, the gross profits on gold smuggling continue to be of fairy-tale dimensions ; assuming a turnover of six times in a year, the annual gross profit rate may be-of the order of 370 per cent at the prevailing Bombay price of Rs. 105 p.-r 10 grammes Since the Gold Control Rules have left the profit margin unaffected, gold smuggling continues ; concrete evidence of it is in the reports of detections, which continue to appear in the press.

IV. New Policy to Prevent Gold Smuggling

The foregoing discussion demonstrates conclusively that gold smuggling cannot be stopped unless the phenomenal gap between the official and the market prices of gold is eliminated. If a commodity commands at one and the same time two prices widely separated from one another, economic stability demands elimination of this price gap. This can be achieved by beating down the higher price—in the present case, the market price of gold; or by lifting up the lower prick—in the present case, the official price of gold. The Government seeks to close the price gap by hammering down the official price of gold. The announcement on 21st August that ihe Government was considering measures for mobilising private gold for Plan finance; the appeal of the Finance Minister on 26th October for subscriptions in gold and gold ornaments to the National Defence Fund ; the issue on 12th November of Gold Bonds ; the valuation of the gold subscriptions to the Bonds at the official price of Rs. 53.58 per 10 grammes ; the Reserve

Bank ban on commercial bank credit against gold ; the ban on forward transactions in gold and on specific delivery contracts ; the announcement on 20th November, and the reiteration of this on 2nd December, that the Government would introduce "within a month" some drastic measures to bring down gold prices further, citing Rs. 60 per 10 grammes[1] as the target ; and the issue of the Gold Control Rules on 10th January 1963 were all aimed at "tumbling down" gold prices and were interpreted by the market as such.

These attempts have not been met with any noteworthy success, though some of them did produce temporary shock effects on gold prices.[2] Thus, the Finance Minister's appeals, following the declaration of a state of Emergency on 26th October 1962, for subscriptions in gold and gold ornaments to the National Defence Fund, caused gold prices to fall by Rs. 2 in a day to Rs. 116.50. This linking of gold with the Emergency led the dealers and the people to think that the Government might take drastic action to tackle the gold problem. As earlier, this fall, too, was followed by a recovery. But the announcemnt, on 3rd November 1962. of the issue of Gold Bonds caused near-panic conditions. There were hardly any buyers for two days and gold prices collapsed from Rs. 121.50 on 3rd November 1362 to Rs. 102.75 on 6th November. This, however, attracted both investment and speculative support and prices recovered to Rs. 108.75 on 8th November.

After some fluctuation, prices went tumbling down again when the market received the biggest ever jolt of this series, the announcement of the Finance Minister on 20th November, referred to above, that the Government would introduce "within a month" some drastic measures to bring down gold prices. This produced panic of a degree not seen before and prices fell on 21st November to Rs. 97.25 from the overnight closing price of Rs. 106.00. Subsequently, they touched, as noted above, a low of Rs. 86, the lowest price since 1956-57, the low for the latter year being Rs. 84.83. Every time prices have sagged, they have recovered and have always fluctuated upward.

The market price of gold, like commodity prices in general, reflects the effects of past and current inflation. In

[1] Presumably, this price target was arrived at on the basis of the prevailing premiums on foreign exchange in terms of rupees in the free markets for foreign exchange.

[2] See my article on "The Frice of Gold" in the *1962 Annual Number of "Commerce."*

order to be able to beat down the market price to the official price fixed in September 1949, the tide of inflation must: recede from the bullion market to the level prevailing at that date. Money, like water, being all-pervasive, it is not possible to keep bullion price — the level of water in a part of the tank —at the 1949 level, while commodity prices in general —the level of water in the rest of the tank — are about 30 per cent higher. A fall in gold prices, in isolation, by more than 50 per cent is not economically feasible.

If the gap between the official and the market prices of gold must be eliminated, we must take two measures. First, we must put a stop to inflation. This will prevent a further rise in gold prices. Secondly, we must lift up the official price of gold to its natural market level. If the price gap cannot be covered by beating down markets prices, it is obvious that this must be achieved by raising the official price. If, however, inflation is forced on us by circumstances beyond our control, we must allow the official price of gold to move with market conditions. These measures will eliminate the gap between the external and the internal prices of gold and gold smuggling will cease. There is no other remedy to gold smuggling.

The cessation of inflation and the elimination of the unreality in the exchange value of the rupee might, in due course, create confidence in the continued stability of the rupee and induce people to invest their savings in fruitful ways, rather than hold them in a dead asset, gold. But in view of the deep-seated and age-old distrust in the honesty of the rupee and the bitter experience of the investors in stock-exchanga securities—especially in recent years — thanks td the vagaries and the rigour of taxation, which have brought share values tumbling down, it may take long before the traditional allegiance to gold gets shifted to more lucrative investments. This shift cannot be achieved by legislating against the manufacture of gold ornaments of 22 carat and 24 carat fineness. By adding to the scarcity value and the appeal of the latter, this may, in due course, if not immediately, induce illicit manufacture of ornaments of such fineness. Banning the manufacture of ornaments of above 14 carat fineness seems to be a queer way of winning a gold-hungry people away from their attachment for gold. Even if illicit manufacture of ornaments of higher fineness were not open, it may cause people to own more units of ornaments of the lesser fineness rather than cause them to abandon the gold-using habit. In so far as the investment of illicit savings in gold is concerned, the limitation on fineness

is likely to be ineffectual as such investments are always concealed and mill remain so, so that this category of demand for gold will remain unaffected by the Gold Control Rules.

The question arises whether the remedy of lifting up the; official price of gold has a fair chance of early implementation, especially as the foregoing analysis demonstrates that there is no alternative to this remedy. It is not easy to answer this question as this remedy has serious political consequences. If we lift up the official price of gold to its natural level so as to eliminate the gap between the official and the market prices of gold, and stop further inflation, it may simultaneously eliminate the phenomenal gap; between tha landed costs and the market prices of import goods in general. 'This would be particularly the case if' the improvement in the balance of payments position, which is most likely to ensue from this monetary and exchange reform, should lead to liberalisation of imports as it might. This will reduce the value of the import licences to almost nil and the scramble for them will cease. Import licences today are the most highly sought-after instruments of political patronage, and the corrupt functionaries of the state will be deprived of their most highly valued portfolios of patronage. The greatest obstacles to the adoption of our remedy to gold smuggling are these vested interests in the maintenance of import controls, exchange restrictions and the over-valuation of the rupee. If the pressure of these vested interests is set aside, the adoption of the only remedy to gold smuggling becomes politically feasible.

Another obstacle to this remedy is foreign aid, in particular, general purpose foreign aid, which is not tied to any projects. The overvaluation of the rupee, the artificially low official price of gold, together with the continuing inflation, which accentuates the degree of this over-valuation, are the basic forces behind the acute scarcity of foreign exchange and the continuing deficits in our balance of payments. Contray to popular opinion, there is no mystery in this phenomenon, to make it beyond the reach of common understanding. If the state intervened in the market and fixed the price of any commodity, say, electric bulbs, at significantly below its marginal cost of production, the demand for it will soon far exceed its supply. The scramble for electric bulbs will necessitate their drastic rationing. With the price remaining below marginal costs, the ciomestic output of electric bulbs will fall short of domestic needs ar the Government will be compelled to meet the problem by cutting down "non-essential" uses of electric bulbs, by electric bulb production-promotion campaigns, by nationalising industries basic to the production of electric bulbs and by seeking foreign aid in electric bulbs in order to save the country from darkness. Well-meaning foreign govnrnments and humanitarian enthusiasts abroad will organise kid-India Clubs under the aegis of the World Bank for electric supplies to provide India with enough electric bulbs to prevent the Indian people from being plunged into darkness, pending self-sufficiency of the country in electric bulbs, which, according to the expert assessment of the World Bank Mission, is certain to be achieved by the close of, say, the Fifth Plan.

Obviously, whatever measures the Government mav adopt, the scarcity in electric bulbs will continue so long as its price—fixed and enforced by the Government — remained below marginal costs of production. Entrepreneurs, instead of producing electric bulbs, will produce with the resources which would be ordinarily utilised for manufacturing electric bulbs, other commodities, — their prices not being artificially held down by the Government — which offer a reasonable return on investments. In the absence of foreign aid in electric bulbs, the Government's system of rationing will soon break down and the Government will be compelled to resort to the only certain solution of the problem, namely, lifting up the official price of electric bulbs to their marginal cost of production, or which would be the ideal thing to do, abandoning the policy of intervention in the market for electric bulbs so that the supply of, and the demand for, electric bulbs are continually equated through the mechanism of price variations. Foreign aid, thus, acts as a great obstacle to the solution of the problem of scarcity of electric bulbs.

It is no exaggeration to say that this parable of scarcity of electric bulbs applies in all its essentials to the prevailing scarcity of foreign exchange in India, of which the phenomenal gap between the landed costs and the market prices of gold and the phenomenon of gold smuggling are concomitant adjuncts or manifestations. The price of foreign exchange is artificially held below the market price by the Government and we seek to meet the problem of scarcity by drastic import cuts, — i.e., rigoroua rationing of foreign exchange, by export promotion measure, by drastic penalties on gold smuggling, by imposing restrictions on the bullion trade and by seeking foreign aid, instead of by raising the official price to the market price. As foreign aid has been flowing in generously, a disservice in disguise, replenishing our reserves everytime they touched rock

bottom, thanks to the Aid-India Club, the Goveinment has never been driven to accepting the only lasting solution to this vexed problem, namely, lifting up the official price of gold and the exchange value of the rupee — to its natural market level. One is driven to exclaim with Voltaire : "May God defend me from my friends; I can defend myself from my enemies."

Conclusions

The conclusions emerging from the foregoing discussion may be stated briefly :

1. The gold problem is two-fold : prevention of gold smuggling, which eats up foreign exchange of about Rs. 50 crores annually, and rescuing the Indian people from their traditional attachment far gold.

2. The crux of the problem of gold smuggling is the vast gap between the, official and the market price of gold. At the prevailing Bombay price of about Rs. 105 per 10 grammes, the price gap is Rs. 51.42 nP. Allowance being made for the necessary foreign exchange in the free markets at premiums of about 35 per cent, the landed cost of gold is about Rs. 65 per 10 grammes; assuming a turn-over of six times in a year, the gross annual profits on gold smuggling are; about Rs. 240.30 on an investment of Rs. 65, or 370 per cent. At the peak price of Rs. 129.00, attained on 31st August 1962, the gross annual profit was about 600 per cent.

3. The traditional attachment of the Indian people to gold is the outcome of distrust in the honesty of the rupee, the bitter experience of the investors in stock-exchange securities, wha have had their fingers burnt more than once from drastic falls in share values, the result of the vagaries of the fiscal, monetary and economic policies of the Government; it is also due to the rather tiny magnitude of the individual units of savings, which are a fraction of the minimum investment lots on the stock exchange. Gold trinkets are the best instruments for the investmknt of such tiny units.

4. An individual who invested Rs. 100 of his saving in gold in August 1939, received in August 1962, Rs. 401 for the gold, or compound interest of a little over 6 per cent per annum; an individual who invested his savrngs in Small Savings in August 1933, received at the close of the same interval, Lomewhat less than Rs. 300, or compound interest of 4.5 per cent per snnum. This explains the widespread preference, of savers

for gold.

5. Gold smuggling cannot be prevented unless the phenomenal difference between the official and the market prices of gold is eliminated. The traditional attachment of the people for gold cannot be corrected unless we create an enduring confidence in the stability of the rupee and in the security against loss, from the periodical budget-created stock-exchange crises, on investments in shares.

6. The measures adopted to tackle the problem of gold smuggling have all failed because they have left untouched the gap between the official and the market prices and, therefore, the fairy-tale scale of the margin of profits, which is what keeps smuggling going despite the heavy penalties, obtains.

7. Confiscation of gold is no deterrent because the incidence of confiscation is one in every 17 or 20 consignments. This is not much of a burden, Of every 100 tolas of gold smuggled, 16 tolas would cover their landed costs; if 10 tolas are set aside to take care of confiscation, the smugglers still have 74 tolas to play with. This explain; how easily the smugglers are able to buy zway the vigilance people and how people in respectable professions are tempted to engage themselves in smuggling.

8. The 1955 amendment to the Sea Customs Act, 1878, shifting from the police to the owners of gold the onus of proof that gold seized an suspicion was not smuggled gold, was merely a case of iegal administrative streamlining. It did not affect the price gap.

9. The printing of special currency notes for circulation in the Persian Gulf territories, too, has made iittle difference to smuggling. Though hitherto the commercial banks in these territories had been getting foreign exchange from the Reserve Bank against the notes smuggled out by the gold smugglers and, in effect, had been acting as the agents of the latter to obtain foreign exchange finance for gold smuggling, the removal of this facility merely meant that the rupee notes taken out of the country had to be smuggled again into India. The gold smugglers obtained foreign exchange through the free markets for foreign exchange, the latter being supplied with foreign exchange by traders through under-invoicing or over-invoicing, and by Indian settlers overseas who had remittances to make to India. The new arrangement caused a heavy premium to appear on foreign exchange in the free markets in terms of Indian money and lifted up the landed cost of gold by tho amount of this premium, which at one time was high as 54 per cent, instead

of by about 0.8 per cent, the amount of the premium on foreign exchange hitherto. Nevertheless, the annual profit rate on gold smuggling was of the fairy-tale order of 370-600 per cent. This measure did not check gold smuggling.

10. The Gold Control Rules, have had no impact on gold smuggling, as they, too, have not affected the price gap. Detected cases of smuggling continue to be reported in the Press. These Rules have done no more than streamlina the machinery of the bullion trade for better control by the administrators of recorded tr sactions in gold. Transactions in smuggled gold have never been recorded'; the new Rules, therefore, cannot affect gold smuggling.

11. The recent improvement in the free market quotations for the rupee is no evidence of any halt in gold smuggling as has been wrongly believed by official spokesmen and some financial commentators. The free market quotations for the rupee do not reflect the ebb and flow of gold smuggling. They are a rough measure of the risk-cost of unauthorised dealings in foreign exchange. This is evidenced by the trend in the free market quotations for the rupee during the past several years. The improvement in the free market value of the rupee dates with December 1961 or much earlier than the present series of gold policy measures which began with August 1962. The improvement in the value of the rupee is evidence of the streamlining of the technique of smuggling in and smuggling out rupee notes so as to reduce the risk of detection.

12. Nor can these Rubes affect the age-old attachment of the people to gold. The 14 carat gold rule is likely to induce illicit fabrication of 22 carat or 24 carat gold. The preference for gold cannot change unless the basic factors responsible for it — absence of confidence in the rupee, absence of confidence in the security against loss of investments in stock-exchange documents, and the tiny individual units of savings—are eliminated.

13. Gold smuggling cannot be tackled without eliminating the gap between the official and the market prices of gold. Since the latter cannot be brought down, the only solution is to lift up the official price of gold to its natural level. To prevent a price gap emerging again, this reform must be accompanied by abandoning the policy of inflation. If, however, inflation is forced on us by circumstance; beyond our control, the remedy to gold smuggling lies in allowing the price of gold to fluctuata with market conditions, i.e., to have no fixed official price of

gold or exchange rate. The exchange rate, then, should be free to float in response to market conditions reflecting the state of inflation and other relevant factors.

14. . Chances of this reform being readily adopted are rather meagre because of its political repercussions. A rise in the official price of gold to its natural market price, through an improvement in our balance of payments position and a consequent liberalisation of our imports, would eliminate the gap between the landed costs and the market price of import goods. This will eliminate the prices which import licences fetch to-day and, therefore, will remove perhaps the most important item from the portfolio of political patronage. The vested interests which have grown up around import restrictions, exchange control, and an unrealistic exchange rate will resist to the last ditch any attempt to lift up the official price of gold.

15. Another obstacle to this reform is foreign aid, which keeps from growing to their campelling limits, the economic pressures forcing the hands of the Government to take recourse to the only remedy to gold smuggling, namely, lifting up the official price of gold and stopping inflation, or, if inflation is unavoidable, allowing the price of gold and the exchange value of the rupee to float.

(Based on a *lecture delivered under* the auspices of the *Forum* of *Free Enterprise in* Bangalore in March 31, 1963.)

GOLD, GOLD, GOLD

M. A. SREENIVASAN

Gold is in the news again !

In the past few year; not much was heard, or seen in the papers about gold, except the usual market quotations for sovereigns—enlivened now and then by reports of seizure, by the Customs authorities, of smuggled gold, involving enterprising ship's captain or a romantic foreign diplomat. Gold was looked upon as little more than raw material of trinketry and adornment, advertisement of wealth and vanity, stock-in-trade of hoarders and tax evaders. Mining of the metal was regarded as a non-essential industry, catering to a luxury market.

Not many people knew that there is gold-bearing ore in

several places in South India from Raichur in the old Hyderabad State (now Mysore), along Anantpur in Andhra, Shimoga, Chitaldrug, Tumkur and Kolar districts in Mysore, to Nilampur in the Kerala State, or that place names like Honnalli, Honnegudda, Jalagargundi are reminders that gold was found and won in those places in olden times, or that Oorgaum, in the Kolar Gold Field, is derived from the Tamil word for melting.

Though modern advances in the technique of deep mining, coupled with the rise in the price of gold, held brightened prospects of re-opening and succ'essfully working gold mines once neglected or abandoned, and of exploiting other known gold bearing lodes, proposals for such schemes met with little support owing to the general attitude of coolness towards gold and gold mining. "Can you eat gold ?" jested a Union Minister, and did not pause for an answer. Another, quoting Croesus, said "Gold ? Give me steel and I shall be master of all your gold." It is no wonder that in such climate and environment the mining of gold did not get much sympathy or encouragement, and that at least one gold mine of promise in Jalagargundi was doomed to submersion and the development of another at Bellara was dropped too soon after it was begun.

Gone now is that climate and that attitude. The diabolically planned invasion of our land by a treacherous enemy, whom we had hugged to our bosom as friend, has brought about a complete transformation in the attitude towards gold. Disdain has turned to respect. Instead of lofty coolness, there is now ardent desire, and recognition of the role and the value of gold as a precious, untarnishable medium of international currency and credit. It seems as though the yellow peril has taught respect for the yellow metal.

Gold is now making the headlines. Not a day passes without photographs in the papers of a Governor or Chief Minister smilingly accepting gold trinkets and ornaments, not excluding *thalis*, from women and children, or announcements that one or another of them is to be weighed against gold by adoring admirers, and the gold given to the National Defence Fund. Collecting of gold and ornaments is now the urgent and engrossing preoccupation of Chief Ministers, Ministers and Deputy Ministers, a job which gives full scope to their talents and training, and in the performance of which they have excelled themselves. Wherever one goes, one now reads or hears the word gold—for the Jawans, gold ornament for armament. So great and catching is the enthusiasm that not only the convicts in our prisons, but also beggars in our streets have come forward to hand over touching gifts and donations to our leaders on the dais It seems that for one Central Minister for Steel there are a hundred State Ministers for Gold. It is not Croesus seeking steel to get gold. It is now Croesus in reverse.

In the drive for gold, the Government of India has persuaded itself to offer gold bonds in exchange for the yellow metal The Government's official estimates say tbat over thousand crores of rupees worth of gold is hoarded in India, and that no small part of it is hidden or buried by tax-dodgers and black-market-wallahs To draw out these hoards of gold from the dark places where they have been concealed, the Union Finance Minister has given an assurance that buyers of gold bonds will be asked no questions now or later. This class of investors in gold -bonds will thereby get what may be called "guilt-edged security."

Perhaps it is the tempo of the current gold rush that has brought about the long-talked-of "take-over" of the Kolar gold mines by the Central Governmknt. The Kolar Gold Field is also in the news again The last time it came into the news was six years ago when it was taken over by the Mysore Government, under an Act of nationalisation. The present take-over of the State Government's mines by the Central Government is in the nature of an act of cannibalisation. And, as is to be expected in such cases, it has some unusual and interesting festures that are worthy of note.

At the time the Kolar gold mining companies were nationalised, gold had already been mined in the Field for over 75 vears. Some of the old mines were exhausted and closed. Others had reached great depths; one of them was already the deepest in the world—nearly two miles in depth. There had been many years in which the companies had made good profits and paid high dividends. But those years had long gone by. Increasing depths had greatly increased costs and hazards. New lodes were hard and expensive to find, and even more expensive to win.

All the gold produced was being sold in Bombay at the ruling price. The State was getting an increasing share of the earnings and the companies were getting less and less. The Government of Mysore had entered into a new agreement with the companies in the year 1949. At the time of nationalisation, the State was receiving the bulk of the net learnings of the gold mines in the form of royalty, additional royalty and contribution,—apart from the income-tax taken by the Central

Government. The dividends paid by the companies—there were three functioning at the time,—ranged from 'nil' in the case of one company to six or eight per cent in the case of others. An important fact was that the mining leases themselves were due to expire early in 1970, when all the mines would automatically revert to the State, with no question of any compensation.

All these facts were known or explained to those at the head of the State Government at the time. But it was clear that the move to nationalise the mines was based neither on logic, nor ethics, nor economics, and that it arose from the cock-pit of local politics, and was pushed through as a measure of face-saving. The late Dr. John Mathai who was Finance Minister of the Government of India before the nationalisation and who had carefully studied the industry declared "it is difficult to imagine a case less suitable for nationalisation." But his voice was unheard in the local shouting and hullabaloo. Whatever the nationalisation achieved, it certainly did not diminish the problems of gold mining, nor enhance the income of the State, nor increase production or employment. On the contrary, it created new problems of which the most awkward—strangely enough—was the selling of the Gold.

As India is a member of the International Monetary Fund, the State Government could not sell, nor the Central Government buy gold at a price higher than the pegged price of 35 dollars an ounce, which was about half the market price of gold in the Bombay Bullion Exhange. What made the position worse was that it was also much less than the actual cost of production of the metal. In response to the representations of the State Government, the Central Government arranged to pay the State Government the difference bktween the cost of production and the market price in the shape of a subsidy. Apparently, this arrangement was not found to be an acceptable solution of the problem; and so long as the mines remained nationalised, the only way of getting over the difficulty was for the Central Government to take over and operate them directly as one of the Government's department activities.

An extraordinary fdature of this transaction is that the State Government is reported to have claimed a compensation of six crores of rupees and the Central Government is reported to have agreed to pay compensation of three and a half crores of rupees for the Undertaking.

At the time of nationalisation of the mines, six years ago, the mining companies asked for compensation on the basis of valuation made by an internationally known firm of valuation experts, but the State Government exultantly pointed to Section 31-A of the Amendment to the Constitution, which had just then been enacted, which made the quantum of compensation for mining properties non-justifiable, and took it out of the jurisdiction of the courts. On the pleading of the companies that it would be confiscatory to dispossess, without compensation, thousands of shareholders of valuable assets created and held by them, the State Government offered 50 or 60 lakhs of rupees for all the gold mines, their extensive installations, buildings, stores, equipment and other assets. This figure was raised, by stages, and after intervention by the Central Government, to Rs. 1 crore and 64 lakhs. The State Government complained at the time that the sum was excessive.

It is well known that mines are wasting assets; and the Kolar gold mines are no exception. In the six years since nationalisation, over 30 crores of rupees worth of gold have admittedly been taken out of the mines. If the compensation of 164 lakhs of rupees was excessive in 1956, it would be interesting to know how, in 1962 the State Godemment claimed Rs. 600 lakhs or the Central Government agreed to pay Rs. 350 lakhs,—unless, during these six years the State Government has unearthed a new gold mine, which is not the case, or has been busy refilling the mines with gold instead of depleting them; or unless, of course, the arithmetic of Governments is some Higher Arithmetic beyond the grasp of common men.

Arithmetic, or gimmick, no one—certainly no Mysorean—will object to the transfer of a few crores of rupees from Delhi to Bangalore—even should it be in the nature of a paper transaction. And it is evidence of the new respect for gold that gold mining—unlike all other mining—is elevated to the portfolio of the Union Finance Minister who is himself the Chairman of the re-taken-over Undertaking. It is rather lucky this is so as the Undertaking—especially, after the very serious recent rockbursts—will need resources that only Delhi can now provide, to rehabilitate it and run it in the coming years.

But despite these resources, the day has come when it must be recognised that these mines, by reason of their being wasting assets, and of the length of time during which they have been worked, may not be viable for much longer than say ten, twenty or thirty year; at the most.

There are few scenes more desolate and depressing than the ruins of shafts and workings of dead mines and deserted mining townships. Geologists and mining men who went to inspect the abandoned gold mine at Bellara have vivid yecollections of a tiger that had taken charge of the area. When President Rajendra Praaad visited the Kolar Gold Field in 1954 the mining companies took the occasion respectfully to urge that the Government should be careful to prevent the Lizard and the Jackal from keeping Court in the place where they had the honour to receive him; and the President readily agreed that that should be done It is necessary and urgent that plans are now made to establish a few large industries to fill the void that will be created by the inevitable closure of the gold mining industry, including some that could utilise, as raw material, the mountains of mine tailings that have risen in the area.

It is pleasing to see that the true worth of gold has again been recognised and this queen of metals is re-enthroned; and that those who scoffed that it was not edible, and only ornamental, now pray to get as much of it as they can. Mysore is fortunately endowed with several gold-blearing areas. Luckily, it got (from old Hyderabad) the valuable gold mines at Hutti which, though much State-ised, is still a company that has not suffered nationalisation. Now that the State Government has had time to appreciate, not only of the importance of the yellow metal, but also the futility, if not folly, of nationalisation, it may be well-advised to set apart the who8 or at least a part of the largesse irom Delhi as a Gold Mining Development Fund. The main purpose of the Fund would be a patient and thorough investigation and survey, by a team of experts, of the auriferous areas in the State, and the preparation of authentic data with a view to attract and assist investors and entrepreneurs to prospect and win the precious metal that lies buried in the earth.

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THE GOLD POLICY

Dr. KERSI DOODHA

Primitive sooieties largely depended upon barter to exchange goods produced by one another. Unfortunately experience revealed this to be a cumbersome and a tardy way of doing things. The inconveniences were largely associated with the finding of parties mutually desiring to trade and the factor of indivisibility. Mankind, therefore, sought to discover a common medium capable of being universally accepted and one that could be considered a standard of measarement. This search lasted for many years until finally gold was selected as a representative unit of account. The choice fell on gold because it is easily identifiable,, can be easily carried or transported (large value in small quantity), does not get destroyed due to constant handling and almost preserves an invariant value.

Traditionally, Indians preferred the use of silver as a medium of exchange. However, due to the constant efforts made by the foreign regime to introduce the use of gold a bi-metallic standard resulted, that is the use of both gold and silver as legal tender. Generally, it may be stated that while gold was considered to be a store of value, silver was reckoned to be a medium of exchange. Further, India began to pile up huge surpluses on the balance of payments account since customarily she tended to export more than she imported. This surplus was invariably converted into bullion and imported into the country. Observers like J. C. Coyajee have pointed out that the habit of importing bullion was due to the absence of investing the trade surplus in foreign countries. This tendency tended to be historically perpetuated and India became, in the words of Stanley Jevons, "the sink of the precious metals."

Various attempts have been made from time to time to measure the amount of gold and silver hoards in this country. Some were based on conjectures while others were based on fact. In order to place the picture in its proper perspective the Reserve Bank of India sought to estimate the bullion hoards in India. Its study, published in 1958, indicated that the extent of gold hoardings was likely to be 105 million ounces. If the then average ruling market price of Rs. 289 per oz. was accepted, the market value of gold hoardings would amount to Rs. 3,035 crores.

In order to bring this estimate up-to-dare, we have to account for four factors : the net import or export of gold, the addition to total caused by domestic production, the movement in the price of gold and unofficial entry of gold. By and large, the first two factors can be omitted as they have a negligible impact. For example, the Reserve Bank hardly gives permission for importing or 'exporting gold, while the increase in domestic production is barely worth Rs. 50 lakhs per annum. In so far as the third factor is concerned, we find that between the years March 1958 to January 1963, the price of gold increased

by about 16 17 per cent. Opinion seems to widely differ on the amount of gold smuggled into the country. Estimates range from a low of Rs. 30 crores to a high of Rs. 50 crores per annum. If the lower estimate is accepted, then awing to the sum sf the influence of all the lour factors stated above, we find that the stock of gold by the end of 1962 may be valued at Rs. 3,665.13 crores in terms of the theoretical domestic price of Rs. 125 pier tola.

It is dangerous to accept this figure at its face value because over a period of time, certain leakages existed in the system which tended to reduce the hoards. At least three important leakages may be identified, namely industrial uses of gold, trans-border trade and clandestine exports. I believe that in this way gold worth Rs 500 crores may be unaccounted in our estimate If we further exclude from the hoards the gold kept as monetary reserves, we can approximately say that total gold hoards in this country may be placed at about Rs 3,000 crores. This estimate is considerably lower than some official estimates indicated at the level of Rs. 5,030 crores

Even if this lower estimate is accepted, it can be seen that in terms of magnitcde it represents an import t idle resource that can be usefully harnessed in the national interest. It is by now well known that the goal of the community is to rapidly raise the standard of living of the masses. In modern times this is measured in terms of the movement in the national income. In the case of India the planners visualise an average annual growth in net national income of 5 per cent at least up to the end of the Fourth Plan. This target can be achieved if we as a nation invest a given magnitude of our available resources It is believed that by the end of the Third Plan (1965-66), we shall be investing at a rate of 14 per cent of our net national income But while investment is expected to be of the above order, savings during the same period are placed at 9.5 to 10 per cent only.

This is likely to cause a divergence between the rate of savings and the rate of investment This gap is dangerous for it means that our total expenditure is greater than total income. Just as it is true of an individual, so it is true of a nation that it is not advisable to live beyond one's means. For if a nation as a whole spends more than it earns, then the balance between the forces of effective demand and aggregate supply is disturbed. This tends to have an impact on the price level. If the aggregate demand is greater than aggregate supply, then the price level tends to move up. It is recognised by most people that this is not desirable, for inflation causes pioblems in allocation of resources and distribution of income.

Unfortunately, a desired rate of growth does not necessarily coincide with a desired level of prices in a developing 'economy such as ours. This is due to the fact that the *desired* level of investment is bound to be greater than the *actual* level of savings. The picture becomes complicated if the country is assumed to be an open economy, that is one in which international trade takes place. The reason is that a developing country usually lacks the capital equipment necessary to build up an industrial and a technological society. By virtue of these imports at a level sufficiently higher than can be paid for (i.e. exports) the balance of payments is thrown into a disequilibrium. Up to 1958 we did not worry about this problem because the excess of imports lover exports was paid for by the drawing down of the sterling balances. But once these wkre liquidated, the cushioning effect was no longer available. An exchange crisis developed and has persisted ever since. Actually a part of the present sluggishness in the economy is directly attributable to this crisis.

The Government has been seriously thinking of devising ways and means by which the gap in the payments position could be breached. Official thinking apparently veered round to the aspect of mobilieing gold hoards. The argument is that gold commands a universal acceptance so that if the hoards were mobilised they could be exchanged for goods and services badly needed for our productive apparatus. Unfortunately, it seems, no positive decision could be taken, nor was a serious examination of the probable measure and its implications ever considered. Consequently, when Chinese aggression commenced in the autumn of 1962, the defence of the country loomed large on the Indian horizon. Since it provided a heaven-sent opportunity to depend on unconventional ways of finding resources, the decision was quickly taken to announce a policy relevant to mobilising the gold hoardings.

Broadly speaking, the gold hoards mobilisation technique was announded in two steps : the issue of gold blonds and the passage of gold control rules. By and large, the Government's motive behind the action is to centralise the availability of gold within the country for emergency use, to prevknt smuggling which constitutes a drain on our foreign exchange resource and to bring down the domestic price of gold to international parity. Let us at first critically review each of these measures and then

examine whether the motives behind them are likely to be realised.

The gold bonds contain the following terms and conditions of issue :

1. The bonds are to be subscribed only by surrender of gold or jewellery valued at the international fixed price of Rs. 53.55 for every 10 grammes, or Rs. 62.50 per tola.
2. The subscriber to the bond is not expected to divulge the origin of gold.
3. Gold bonds are bonds which are fully negotiable on endorsement and acceptable as a trustee security.
4. The bonds are to be issued at par.
5. There is no ceiling on investmknt in gold bonds.
6. Gold bonds are to carry a rate of interest of 6.5 per cent per annum.
7. The interest is taxable for resident holders, unless the total value of the bonds held does not exceed Rs. 10,000. In that event it is taxable at the assessee's income slab.
8. Investments in gold bonds are to be excluded from the levy of wealth and capital gains taxes.
9. The blonds are to be redeemed at par after a period of 15 years.
10. Repayment on redemption will be in the farm of rupees and *not* in terms of gold.

The terms and conditions of the issue may be said to be favourable for all those individuals who have accumulated ill-gotten gains. They do not have to divulge their source of income and tney are promised a return which is marginally superior to that -earned on government securities. For an average citizen the bonds hold no attraction because they involve a substantial loss of capital owing to the bond's purchase price being fixed in terms of the international price instead of the domestic price. Moreover, for those who do not wish to accept risks and who look upon gold as a constant store of value, the gold bonds provide a poor substitute.

As a result of the inadequate response to the gold bonds issue, the gold control rules were promulgated. Broadly, the purpose of the rules is to make illegal the use of gold above 14 carat purity and to prohibit individuals from owning primary gold (except the stipulated exemptions of 20 grammes for minors and 50 grammes for adults) without a permit from the Gold Control Board. In future, all transactions in primary gold above 14 carat purity between refiners, dealers and permit holders will be closely regulated as to the identity of the buyer and seller, as well as the quantity involved. This will prevent primary gold from being utilised as an ill-gotten asset.

The rules preventing the use of gold above 14 carat purity are aimed at discouraging hoardings in the form of ornaments. The ban which does not apply to gold of 14 carat and below will assist in reducing the cost of using gold in various sectors, since it will be an alloy constituting cnly 60 per cent gold, the other components being silver and copper.

A brief perusal of the rules and the subsequent 'do s'' and "dont's" elaborated through the Gold Control Ecard seem to leave the impression that the gold control rules are very loosely framed. They thus provide sufficient loopholes to defeat the objective. The principal defect of the policy is to omit the placement of a ceiling on ornaments that an individual can possess. The second weakness is that it attempts to artificially create a division between 14 carat gold and that above it. Thirdly, the policy has not adequately analysed the possible side effects in the form of unemployment and a breakdown in the law enforcement agencies. For ultimately the policy amounts to changing the habits, tastes, rustcms and fashions of the people. This requires the unstinted support of the people. Such a support would have unreservedly been forthcoming, if the means adopted to realize the end were in conformity with their requirements. This, the new gold policy fails to provide. On the contrary, it has generated sufficient public antipathy by now to make the measure self-defeating. If those in power believe that there are short cuts to success, they are mistaken. The path of mobilising gold is beset with great dangers. It is a painful process of re-educating the public which can be done through socio-economic regeneration.

If this is the verdict on the gold policy, then there is no doubt that the attempt of the authorities to reduce the demand for gold will not be achieved. They have failed to provide a perfect or a reasonably perfect substitute for gold. From the above proposition it further follows, that the expectation of dealing a crushing blow bo the nefarious activity of gold smuggling and reducing the domestic price of gold to the international parity will likewise remain unrealised. It is not too much not to expect our national government to swear by its prestige, but to recognise the wind of change and make a fresh approach to the vexing gold problem.

(Based on a talk delivered under the auspices of the Forum of Free Enterprise in Bombay on February 11, 1963).

CONSTITUTIONAL AND LEGAL ASPECTS OF THE GOLD CONTROL RULES

PHIROZE J. SHROFF

The Gold Control Rules have been promulgated by the Government of India in exercise of powers conferred on it by section 3 of the Defence of India Act, 1962. These Rules which came into force on 10th January 1963 have imposed severe restrictions on possession, use, sale, purchase and hypothecation of gold. The restrictions are so drastic and far-reaching that they have brought to a virtual standstill the age-old business of goldsmiths and jewellers.

The Rules prohibit a dealer from making any article of gold other than ornaments. They prohibit dealers from making or preparing or selling or otherwise transferring or exporting or offering for sale any ornament having gold of a purity exceeding fourteen carats. Dealers in gold and refineries are prohibited from carrying on their business without a valid licence issued by the Gold Board. Dealers and refiners are required to keep elaborate and detailed accounts in respect of their transactions. People possessing gold in non-ornament form are required to make a declaration to the Board in regard to quantity, description and other prescribed particulars of gold within thirty days of coming into effect of the Gold Rules. No such declaration is required if the non-ornamental gold in possession of an adult person does not exceed fifty grammes. The exemption limit in case of minors is twenty grammes. No person other than a licensed dealer or a refiner can acquire or have in his possession any quantity of gold, which is required to be declared under the Gold Rules, unless such gold has already been declared.

Without discussing the impact of the Proclamation of Emergency by the President on the relevant provisions of the Constitution it oan be said that the Gold Control Rules are violative of some of the fundamental rights of the citizens. Seeing that these Rules extensively interfere with the right of the citizens to acquire, hold and dispose of property in the form of gold and with the right to carry on occupation, trade or business in respect of gold, the Government should have taken the matter before the Parliament before promulgating the Gold Control Rules rather than face the legislature with a *fait accompli.* The people's representatives in the Parliament should have been given an opportunity to discuss and express their considered opinion on the policy underlying the Gold Control Rules. This thk Government has failed to do, thus giving rise to country-wide discontent particularly amongst goldsmiths and dealers who, with their dependents, number about two and a half millions.

Our Supreme Court has held that the exercise of the fundamental right of the enjoyment of private property cannot be made dependent on the mere pleasure and discretion of the executive. Restriction on fundamental rights must not violate principles of natural justice. A citizen's right to property cannot be curtailed without giving him an opportunity to be heard. The American Supreme Court has held that the Legislature may not, under the guise of protecting public interests, arbitrarily interfere with private business, or impose unusual or unnecessary restrictions upon lawful occupations. Assuming some goldsmiths or dealers in gold made use of smuggled gold for the purpose of their occupation or trade, the duty of the Government is to stop smuggling and bring the offenders to book in accordance with the law of the land. Already there are very stringent provisions in the statute. book against smugglers and the Government must do the needful to enforce these provisions. But it cannot penalise the entire community of dealers and goldsmiths for the sins of m e of the wrongdoers. Further, in pursuit of its misconceived policy the Government cannot deprive all the citizens of their fundamental right in respect of acquiring, holding or disposing of property.

The Constitution clearly states that the State shall not make any law which takes away or abridges the rights conferred by the chapter on Fundamental Rights, and any law made in contravention of this provision shall, to the extent of contravention, be void. The Constitution also provides that the State shall not deny to any person 'quality before law or the equal protection of the laws within the territory of India. Holding out the excuse: that it is necessary to stamp out the smuggling of gold the Government has taken a most drastic action against the goldsmiths and dealers in gold and by im-

plication has denied them equality before law and equal protection of the laws. This hard-working and law-abiding class of citizens has been subjected to great economic distress at a moment's notice.

The promulgation of the Gold Control Rules amounts to a complete disregard of two of the important Directive Principles of State policy as laid down in the Constitution. Article 39 **inter** *alia* states that the State shall, in particular, direct its policy towards securing that the citizens, men and women equally, have the right to an adequate means of livelihood. Article 41 provides that the State shall, within the limits of its economic capacity and development, make effective provision for securing the right to work, to education and to public assistance in cases of unemployment, old age, sickness and disablement, and in other cases of undeserved want. The Government's gold policy, which has brought about widespread unemployment amongst goldsmiths and has caused great economic distress, is clearly violative of these Directive Principles of State policy.

The Gold Control Rules are also open to attack on the ground that they are violative of Article 25(1) of the Constitution which provides that subject to public ordkr, morality and health and to the other provisions of the Part on Fundamental Rights, all persons are equally entitled to freedom of conscience and the right freely to profess, practise and propagate religion. It has been contended on behalf of certain religious sects that their religion enjoins on them the duty of offering pure gold ornaments to deities on ceremonial occasions and that the provisions of the Gold Control Rules interfere with the practice of their religion. It has also been contended that in accordance with religious usage and practice the *Mangalsutram* worn by married Hindu women requires to be carefully considered not only from the point of view of the relevant constitutional provisions but also human values and religious sentiments.

The powers of search, seizure and confiscation which are given to the executive officers under the Gold Control Rules are extraordinary and are likely to be abused by unscrupulous persons. These powers can be resorted to with a view to harass and terrorise all citizens and particularly women and children in the homes of goldsmiths and dealers doing business on a small scale. In order to preserve the spirit of the rule of law in our country, officers should be empowered to exercise these powers only when they are armed with judicial authority issued in due course of law as in case of other breaches of law. The principle of law that a man is deemed to be innocent till he is proved to be guilty should also be made applicable to the enforcement of the Gold Control Rules. The punishments laid down under the Gold Control Rules for various breaches are extremely draconian even if the breach may be inadvertent or may be committed in ignorance of law. The above points require to be suitably considered only if the Gold Control Rules are held to be legally and constitutionally valid. Indeed, these Rules provide remedies which are much worse than the disease and deserve to be scrapped an economic, social and legal grounds. The right way to deal with smuggling is to do away with the inflationary policies and programmes which give continuous incentive to smuggling. It is not the path of wisdom or commensense to chop off the head to cure headache.

The views expressed in this booklet a7e not necessarily the views of the Forum of Free Enterprise.

"Free Enterprise was born with man and shall survive as long as man survives."

—A. D. SHROFF

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