



## CHALLENGES FACED BY GOLD ECONOMY IN INDIA



***Neha Elizabeth Emmanuel<sup>1</sup>***

*<sup>1</sup>Research Scholar, Department of Economics, University of Calicut, Dr. John Matthai Centre, Thrissur, Kerala, India*

### ABSTRACT

The gold sector has been playing a very crucial role in the Indian economy and has been contributing to 6% to 7% of the country's GDP, apart from large scale employment generations and foreign exchange earnings. But the fact that the value created by Gems & Jewellery sector estimated at about Rs1, 00,000 crores is as high as the apparel sector and much higher than many other sectors in India. The steps taken by the Indian Government to liberate Indian Gems & Jewellery sector in the 90's, is one of the important reason for the increase export contribution by this sector. The liberalization has also resulted in shift from the unorganized to a more organized set of sellers which resulted in greater transparency and adaption of higher quality and design standards. The recent steps taken by Government to restrict import of gold are definitely having a negative impact on Gems & Jewellery sector.

**KEYWORDS:** Gold, Government, Challenges, Jewelry, Economy, India

### INTRODUCTION

Indians have a vehement adhesion with gold owing to the traditional ethics it has come to gain over centuries. Hence, when the demand for gold in India is not very amenable to variations in the price of gold it is not bizarre. It is evident from RBI 2013 data that during 2001-2012 periods, the annual demand for gold prevailed almost immutable at around 700 to

900 tonnes, despite a continual rise in the price of gold. Economists have analyzed that the increasing inflation, paucity of alternative financial products and sagacity of gold as a safe and highly liquid asset are some of the crucial economic reasons that lead to the demand for gold to escalate even with an increase in prices. India is one of the biggest markets for

gold and gold loans. According to the World Gold Council, India accounts for 10% of the total gold stock in the world, of which rural India accounts for 65% (2010). Acumen for this is extended across various social, economic and cultural dimensions. A major part of the Indian economy is played by the gems and jewellery industries. Along with vaunting a large gems and jewellery market, India has a solitary situation in terms of both demand and supply. The domestic gems and jewellery industry had a market size of Rs251, 000 Cr in 2013, with a potential to grow to Rs500, 000–530,000 Cr by 2018. The jewellery industry also provides large scale employment, foreign exchange earnings through exports, and value addition, hence crucial to the Indian economy. About 2.5 million are directly employed by the industry and has the potential to generate employment of 0.7–1.5 million over the next five years. When compared to the 2.1 million employments provided by IT services this is large and 2.5 times greater than the employment provided by basic iron and steel manufacturing and automotive manufacturing. In 2012–2013, the jewellery industry exports took off to a level which accounted Rs227, 000 Cr, surpassing textiles and garment exports by 25%. The gold industry also increased the value addition of more than Rs99, 000 Cr, which is more than many other large industries. The present study is to know the importance of the gold industry; various challenges the industry faces which impacts the economy's growth and several government measures and regulations to maintain a balanced gold market.

## **SIGNIFICANCE OF THE INDUSTRY**

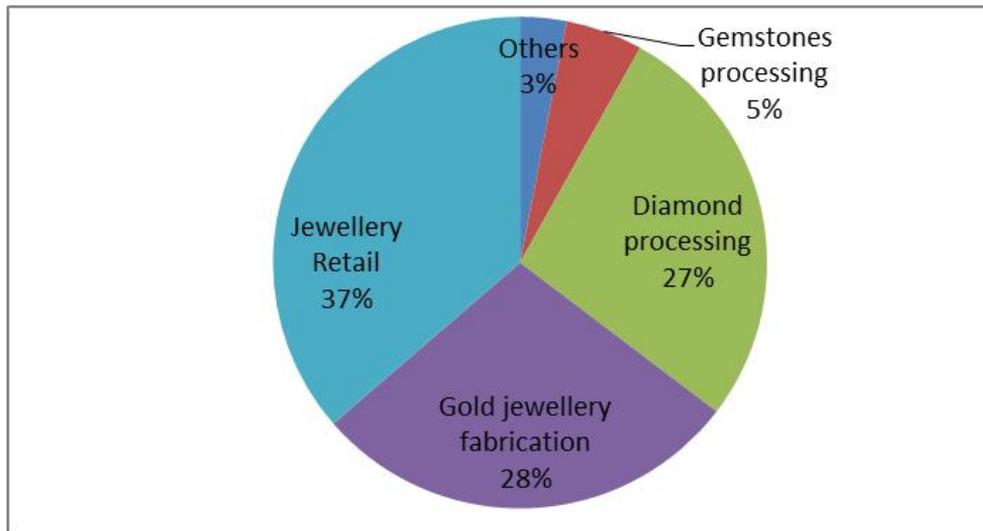
The importance of the gold industry can be divided in three dimensions:

### **1. Size of the jewellery industry:-**

This includes the current demand and its key characteristics including consumption and investment behavior in India and regional preferences. The jewellery industry in India indulges to both domestic and export demand. The industry has three key markets: Domestic gems and jewellery market of around Rs251, 000 Crores in 2012–2013; Export market for cut and polished diamonds and other gemstones, with exports of Rs126, 000 Crores in 2012–2013 and Jewellery export market, with exports of Rs73,000 Crores in 2012–2013.

### **2. Importance of jewellery industry in the Indian economy:-**

The gold industry plays a major role in the Indian economy. It mainly includes contributions of the industry, specifically in employment generation, exports, and value addition. One of the most important contributions of the industry to the economy is employment generation. The labor-intensive nature of the industry and the large share of small sellers, particularly in jewellery manufacturing lead to significant employment generation. There are about 2.5 million people directly employed by the industry. Diamond processing, gold jewellery fabrication and jewellery retail account for 92 percent of the total employee. It is expected that the industry can generate 0.7–1.5 million additional direct jobs over the next five to seven years.

**Figure 1: Employment in different sectors of gold industry**

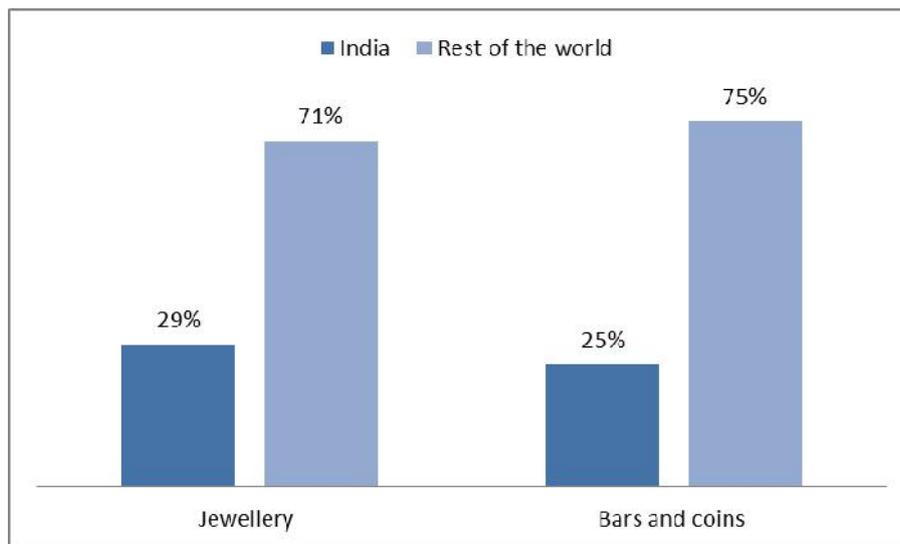
Source: World Gold Council

### 1. Gold industry and its impact on economy's growth :-

In order to analyze the growth drivers, the correlation between gold volume and various parameters like GDP per capita, private final consumption expenditure, gross domestic savings, gold price and number of high income households is assessed. Empirical literatures show that, there is limited relationship between the gold demand in volume terms and these economic parameters. The gold price in India depends not only on the gold price in dollar terms but also on the rupee dollar exchange rates and the import duty on gold. It is however very interesting that the historical jewellery demand in value terms was found to be highly correlated to gross domestic percapita and not

as much to other consumption drivers like private final consumption expenditure, gross domestic savings, and number of high income households. The relative inelasticity of gold demand to price is explained by the religious and cultural significance of gold; occasions such as weddings, where gold is purchased for adornment and for gifting purpose, and festivals like Akshay Trithya and Dhanteras. In the case of majority Indians weddings are financed through savings or loans. The spending on weddings is less dependent on the current income of the spender and the amount spend on wedding jewellery is highly consistent within a community and differs across communities. The demand for gold bars and coins in India contribute to 25 percent of world demand.

**Figure 2: Indian and World gold consumption**



Source: World Gold Council

The domestic gems and jewellery market is the largest segment of the Indian industry, accounting for 56 percent of gems and jewellery output of Rs451, 000 Cr in 2012-2013. It is comprised of gold, silver, and platinum jewellery, either plain or studded with diamonds or other gemstones, and is driven by gold and diamond, which account for 94 percent of total market value.

### DEMAND FACTORS

Gold is purchased as an embellishment for cultural, prestige and decorative reasons. It is also owned as an investment for store of value, savings and money purposes. For most consumers, the adoptions are entwined. Consumer demeanor to gold vary among the young/old, rich/poor, and rural/urban, and by region and State. Even though it seems everybody is buying gold the fact is that the gold market confides primarily on the top 60%. Retailers observe that the primary target market is not the very rich or the very poor, but the emerging middle class (upper middle, middle and lower middle).50 percent of annual sales accounts to new purchases made by households associated with marriage purposes. In total, more than 70% of all purchases is widely

witnessed as marriage akin because jewellery tends to be accrued over many years. The jewellery market also depends on gifts. Retailers recognize that the self-purchase of jewellery for adornment purposes is also extremely important. Economic and social changes during the 1990s have encouraged many women to acquire items that are suited to a variety of social and work-related occasions. This has led to increasing purchases of lighter weight and smaller items. Most retailers view light weight wearable jewellery as an important new market segment.

### CHALLENGES FACED BY THE INDUSTRY

The jewellery industry has compelling potency for growth and the coterminous increase in employment generation, exports and value addition. Yet, there are certain fundamental threats that are keeping the industry from attaining its full potential. In addition, there are recent regulatory challenges that could further cripple the outlook for the industry. To cure these challenges curbed in the consumption and investment patterns seven important problems has to be solved. This would ensure a sustainable growth for the industry.

### **1. High dependence on imports:-**

This is the biggest challenge faced by the industry. Compared to an average of about two tons of domestic production of gold, roughly 1,000 tons of gold was imported in 2012-2013. Gold was the second-largest import item after crude, with an import bill of Rs307,000 Cr in 2012-2013. Of this, around Rs152,000 Cr of imported gold was for jewellery manufacturing catering to the domestic market and around Rs92,000 Cr was for bars and coins with the remaining gold exported primarily as jewellery. The high dependence on imports makes the jewellery industry naive to any regulations that constrain gold imports. The high current account deficit which is 4.8 percent of GDP in India has led to concerns over the import bill of gold that caters to the domestic gems and jewellery industry and bars and coins manufacturing. Consequently, a series of regulatory measures have been taken to reduce gold imports. While the regulations aim to reduce the current account deficit, they will also have restrictive influences on the growth of the gems and jewellery industry.

### **2. Consumption overtaking the development of the industry:-**

The industry faces regulatory challenge due to lack of differentiation between consumption and investment resulting in overregulated consumption and under-developed investment industry. There is a lack of regulatory differentiation between the consumption and investment industries. While a large share of imports feeds investment needs of customers, import restriction-led initiatives go on to affect the consumption side of demand as well. Restrictive regulatory actions have hindered growth of the consumption value chain, slowed the move toward higher industry transparency, and reduced financial sustainability for jewellery manufacturers. In

addition, there is no clear policy to specifically cater to the investment demand and develop this market. There is a large supply market, including jewellers, catering to the investment demand for gold, which is not well monitored. Overall, it can be said that the consumption industry is overregulated and the investment industry is under-developed.

### **3. Unbalanced demand and supply factors:-**

There is a large investment demand for physical gold in the form of bars, coins, and jewellery. In 2012, there was gold demand of 312 tons for investment as bars and coins and 385 to 390 tons for investment in jewellery form. The demand for bars and coins has grown from 100 tons in 2004 to 312 tons in 2012; with 15 percent in volume terms compared to overall gold demand growth of 4 percent. The investment demand has been driven by bars and coins since there is lower loss on making charges as compared to that on jewellery.

### **4. Uncertainties:-**

The industry is fragmented, with the small and medium enterprises segment dominating and most jewellery manufacturers and retailers run as family businesses. This is because in manufacturing, there is low cost of capital requirement compared to other common manufacturing industries. Also, stemming from local tastes and preferences, a major part of manufacturing is handcrafted by artisans and craftsmen. Most of the family-owned businesses are not listed on domestic stock markets. The business on the export side is well documented due to statutory requirements. On the domestic side, the industry has seen an increase in the share of organized sector with several large national and regional sellers. These large sellers are increasing the transparency in the industry by

sharing data on industry and company performance with investors, banks and general public thus leading to higher transparency. Value drivers in the industry are not well understood. As a result, the industry is perceived as being opaque by the Government, other industries, investors and the general public.

### **5. Restricted Finance:-**

The industry is facing challenges in availability of low-cost financing. Traditionally, there were two types of financing available to jewelers: gold loans and short-term bank loans. However, gold loans have been made unavailable for domestic jewelers, leaving only the short-term bank credit option. The short-term bank credits like cash credits, letters of credit with interests ranging from 10 to 15 percent are very costly for the industry (compared to 3 to 5 percent interest on gold loans) as the raw material costs are very high, leading to financing challenges for jewelers.

### **6. Insufficient skilled and talented workers:-**

The gems and jewellery industry employs around 2.5 million directly and it is estimated that 0.7-1.5 million additional jobs will be created in the next five to seven years. Further, the consumption demand for jewellery is fast evolving, and there is a growing demand for new designs and higher value addition. These changing customer requirements are increasingly creating a need for a more highly skilled workforce. However, there is a growing gap in skill availability as the skill development process in the fragmented part of the industry is primarily achieved through an apprenticeship model and on-the-job training. This leads to longer training time and gaps in the availability of modern jewellery manufacturing and diamond cutting and polishing skills.

### **7. Limited research and technology adoption:-**

Technology and research-led innovation are key factors in the long-term future of an industry, where they are needed in both design and manufacturing. While use of better designs can enable jewelers to differentiate in the market and attract higher premiums, technology can enhance productivity and the quality of jewellery produced.

### **GOVERNMENT REGULATION AND INTERVENTION FOR A SUSTAINED GOLD ECONOMY**

As construed by the Deputy Governor of the Reserve Bank of India (RBI) in 1997, the progression of the Government's gold control policy since 1947 focused around 5 main objectives: "To wean people away from gold, to regulate supply of gold, to reduce smuggling, to reduce the demand for gold, and to reduce the domestic price for gold." Since 1990, the Government has embraced hardheaded policies devised to increase the share of official gold imports, amend its revenue from Customs duty, trigger the export of gold jewellery, improve the overall quality of gold jewellery fabricated in India, and encourage the recycling of gold jewellery in private hands, particularly through the Gold Deposit Scheme. Important initiatives include the introduction of official import schemes, especially the Non-Resident Indian (NRI) Scheme in 1992 and the authorization of banks in 1997, the Gold Deposit Scheme in 1999, the hallmarking initiative in 2000, and on-going support for gold jewellery exporters.

The extent of government regulation of the gold industry has varied greatly, reflecting different policies adopted over 3 broad periods.

- ✧ **1947 - 1963 (16 years):** Although the import and export of gold was banned under the Foreign Exchange Regulation Act in March 1947, the private ownership of gold and the way that the domestic gold industry operated were subject to few restrictions.
- ✧ **1963 - 1990 (27 years):** In January 1963, Gold Control Rules were promulgated, the final provisions enacted under the Gold (Control) Act 1968 in September 1968. During this period of 27 years, the domestic gold market was rigorously controlled. Private gold ownership was restricted to gold jewellery, and gold coins already in circulation. Owning gold bars became illegal. Gold jewellery fabricators and retailers required licenses in order to operate, and were strictly regulated. The manufacture of minted bars and medallions was prohibited. The forward sale of gold was banned. Most refiners, unless authorized to refine old gold scrap, closed down. Almost all bullion dealers stopped trading - at least officially. In order to manufacture new jewellery, the gold industry was obliged theoretically to rely entirely on the recycling of old gold scrap.
- ✧ **Since 1990:** In June 1990, the Gold (Control) Act was repealed. There were many reasons. The gold industry had gone underground. The unofficial import of gold for sale, sometimes 50% and more above the international gold price, had not been stopped. The Government accepted that the Act had, at great expense, impeded but had not controlled the gold industry. Its repeal

also fell within the new national policy of economic deregulation. Accordingly, restrictions on the private ownership of gold fell away, and trade participants no longer required licenses to operate domestically. However, it was not until March 1992 that it became possible for gold for the first time in decades to be imported officially for the domestic market, when NRI's were allowed to import up to 5 kg every 6 months.

### **STIMULATING THE EXPORT OF GOLD JEWELLERY**

Access to imported duty-free gold for the fabrication of jewellery for export has been available since at least 1978 when the State Bank of India was permitted to import gold for this purpose. Subsequently, Public Sector Undertakings (PSU's) were also authorized: HHEC (1982), MMTTC (1989) and STC (1997). Several duty-free import schemes are defined in the Government's EXIM (Export/Import) Policy. To facilitate the fabrication of export products (including jewellery) for international markets, "export zones" have been established, notably in Special Economic Zones (SEZ), and Export Processing Zones (EPZ) since the late 1980s. The most important is SEEPZ (in Mumbai), converted to SEZ status in 2000, where almost 50% of the value of gold jewellery exports is fabricated.

### **RECENT GOVERNMENT MEASURES TO CURB GOLD DEMAND**

Looking at Indian consumers' appetite for the yellow metal, the government has introduced various measures in the past one year to control the demand for gold. Some of the prominent ones are as follows:

- \* Hiking import duty on gold imports to 15%
- \* Restricting regional rural banks to provide gold loans

- \* Restricting the amount of gold that is imported by banks in a single consignment/ order, such that only genuine needs of exporters of gold jewellery are met
- \* Ruling out provision of credit for gold imports, unless the purpose is to make jewellery for export
- \* Restricting lending against gold coins to 50 grams per customer
- \* Loan to value ratio not to exceed 60% of the total value of gold

## CONCLUSION

In conclusion, the industry plays a significant role in the Indian economy by providing large scale employment, earning significant foreign exchange through exports and providing high value addition. The industry has even greater potential for growth. However, this requires an industry transformation through coordinated efforts from all the stakeholders. The industry transformation will usher the industry into a new phase and will lead to an even higher contribution to the Indian economy.

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