A Neo-liberal Golden Trap in India – Some Insights.

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Abstract

Neoliberalism has many traps and one of them is the idea of monetizing existing stock of gold. India is caught in this '**Golden Trap**' and as a result we find futile debates and pointless policies. The present paper argues that there should be useful debates and effective policies to increase the market for gold and thereby to enhance economic growth and development in the country. In the first part, neoliberalism's role in building and sustaining the '**Golden Trap**' in India is explained. An **alternative paradigm** to increase market for gold in India is explored in the second part. At the end of the paper, some recommendations and suggestions for further research are given.

Introduction

When demand for gold increases, the market for gold expands. This leads to economic growth and, in course of time, economic development of a country. Neo-liberal policies advocate minimal state in order to promote private property and free market. Monetizing the existing stock of gold through voluntary surrender of gold jewellery for insurance or pension purposes is one such neo-liberal policy. This is called a 'Golden Trap' in this paper because it is counterproductive. An outline of the development of neo-liberalism and the need to come out of the Golden Trap are explained in the first part of the paper. A progressive and effective policy to promote the market for gold in India, on the basis of an alternative paradigm is explained in the second part. In the final part, some recommendations and suggestions for further research are given.

Part – I

A Golden Trap in the context of Neo-liberalism

It is interesting to have an insight on what academics and researchers think they know about the economic and social aspects of the market for gold and its impact on the economy. Gold appears to be a research topic in studies which broadly fall under the following areas of enquiry : 1.The economic and financial aspects of gold market 2.Monetary use of gold. 3.The impact of gold mining on the environmental condition of a region.[1] The focus of the present paper is on the first and second areas. Monetary uses of gold are receding. In the first area, the main topics are gold as a diversifier (in an equity portfolio), as a hedge against inflation (and changes in exchange rate), relationship with other assets and the efficiency of the gold market. Neo-liberal agenda has several items and one of them is monetization of gold stock for enhancing liquidity and economic growth in the country. Various schemes were suggested to monetize gold in India since the Gold Deposit Scheme which was first introduced in 1999. Several schemes have been introduced to attract gold deposits with an incentive of interest on the value of gold deposited. It is well-known that these schemes have achieved only limited success. These schemes are a part of the 'Golden Trap' elaborated in the present paper. One such fantastic scheme is using threshold stock of gold for the purpose of financing old-age pension of elderly members of the family. This scheme is explained in some detail in order to show how some initiatives suggested (and also sometimes implemented) under the spell of neo-liberalism are misleading and counterproductive. Neo-liberalism's rise may be briefly discussed.

Though John Maynard Keynes called gold a "barbarous relic" most economists recognize the vital role it played (and plays) in the development of the economy and the society. In the case of monetary history of the world, gold has been playing different roles – as coins, as a lever in gold standard mechanism and now as a reference point in bitcoin and other forms of digital money in the era of internet. It is observed that for the first time in 2500 years, gold was practically demonetized in 1971, when US President Nixon cut the legal link between dollar and gold. Milton Friedman, who insisted Nixon to make the announcement felt that leaving the gold standard would actually strengthen the dollar and stabilize the US economy and the world economy. From Friedman to Paul Krugman and Ben Bernanke, many economists consider that the restrictions on money supply imposed under gold standard was a major cause of the Great Depression of the 1930s. Now we see a move towards a modern version of gold standard, supported by bitcoin and other internet digital currency standards to provide a semblance of stability in the fast expanding global trade and investment activities. Globalization process is a product of expansion of international capitalism. Capitalism has been undergoing changes in its growth over the centuries. It is appropriate to briefly mention the stages in the development of capitalism. Anatole Kaletsky, for example, divides the development of capitalism into four stages. 2.The first stage began from the defeat of Napoleon in 1815 to the end of World War I. The second stage began with the New Deal of the 1930's and ended with the stagnation of 1970s. During this period military Keynesianism helped western capitalism and European welfare states helped liberal democracy. The period beginning in 1979 is remarkable in modern world history for more than one reason. This period witnessed the emergence of Margaret Thatcher in the UK and Ronald Reagan in the USA who pushed forward privatization and monetarist counter-revolution in economic policy. This period of ultra-liberalism came to a devastating stage with the global financial crisis of 2007-09. In Kaletsky's view, the momentous liberal era of market fundamentalism which came to a crucial moment in the Great Recession has given rise to the fourth stage of capitalism where symptoms of de-globalization, regionalism, protectionism and the rise of right-of-center leadership in countries are witnessed. Donald Trump becoming the President of America, Britain exiting the EU and emergence of China are a few global indications of things which are going to happen in future. In this VUCA world, emergence of regionalism is one of the outcomes.

After the collapse of the Doha Round and other similar WTO initiatives, the very assumption that WTO would increase international trade is being questioned by some observers. One study points out that the WTO (and its earlier version GATT) has had no significantly positive effect on promoting global trade.[3] In a way it means that one does not need to be particularly sorry over the slow-down of multilateralism and the accelerated growth of regionalism in recent years. Regionalism seems to be more rewarding from the point of view of multi-national corporations (MNCs). The leading MNCs may have activity all over the world, but their center of gravity seems to be their native region. According to one study many leading MNCs headquartered in EU and NAFTA countries generate the major portion of their revenue from their home region.[4] One finds reason to believe that regionalism and protectionism trends seem to be more rewarding to international business than multi-nationalism and globalization. American President Donald Trump's policies towards protectionism and Britain's exit from EU are described to be in the interest of business enterprises and the people of respective countries. A few recent examples of increasing regionalism trends can be briefly mentioned to highlight the issue.

One can find display of nationalism, regionalism and also populism in the pronouncements of leaders of major countries. From America's Donald Trump to Vladimir Putin of Russia, Shinzo Abe of Japan, Xi Jinping of China, Erdogan of Turkey and Narendra Modi of India seem to display trust in regionalism and nationalism. China is promoting 'Belt and Road Initiative' (BR1) with a missionary zeal. Chinese President Xi declares the China Pakistan Economic Corridor (CPEC) to be BRI's flagship project. Some observer compare China's BRI to America's Marshall Plan. When China builds Gwadar Port in Pakistan, India builds Chahbahar Port in Iran. The Transnational Turkmenistan – Afganistan-Pakistan-India (TAPI) pipeline project is another similar initiative. Indian leaders often mention the phrase "vasudhaiva kutumbakam" (the world is 'one family') to elucidate the country's global outlook. There has been a paradigm shift in recent years and it is displayed in the ongoing regionalism and globalization contestation. The interests of people and protection of environment should not be lost in this contestation. Automation and other improvements in technology like Artificial Intelligence and 3-D manufacturing seem to take away jobs. Real wages are either stagnant or falling. Globalization seem to benefit not all but only a few. The question whether regionalism and protectionism have better records is yet to be answered. Currencies have no link with gold. Communism has fallen. Asia is emerging. Blockchain technology is disrupting. The world economic system is far from stability and sustainable growth.

Under capitalism, the more man gains control over nature, the more he becomes dependent on capital. The material-technical features of capital are highlighted ignoring the social-relations features of capital in the bourgeois discourses. The value of capital is linked to gold, a mere metal but a powerful fetish. The price and availability of this metal influences money supply, credit supply, valuation of capital, currency depreciation, international trade patterns, unemployment and other economic issues. One finds that globalization has become the key phrase in organizing one's thought as to understand how the world works, even among leftist and progressive writers. The words like "imperialism"

,"colonialism" and "post-colonialism" have been increasingly replaced by the word "globalization" in discourses. Multinational corporations (MNCs) have emerged as leading players in the global economy. These corporations expand international division of labour in order to get maximum surplus value through maximum exploitation of human and other natural resources. The processes of internationalization of production and financial globalization go together. The unproductive (and harmful) parasitism of financial speculations is displayed in the global stock markets. There are disruptive trends like increasing inequalities, stagnant real wages, increasing exploitation of informal sector workers, growing instability in political and economic relations between countries and increasing environmental degradation. These are instances of distortions caused by a global monetary system which is, directly or indirectly, linked to the price and availability of gold. And gold is a master fetish of capitalism. Bitcoin and other forms of digital money are the latest dimension of fetishism in the era of internet and other advanced technologies. Globalization and technology are the two processes which expand exploitation of resources including human resources. Neo-liberalism as a successful paradigm explains and justifies these arrangements in the name of efficiency. The idea of monetizing existing stock of gold, through physical transfer of gold in the form of jewellery or bars is not in the theory and practice of neo-liberalism in advanced countries. Nowhere in the West one surrenders his gold to the government to get a pension. It is surprising that such fancy schemes are debated in India in the name of neo-liberalism and innovation, ignoring the cultural realities obtained in the country.

A 'Golden Trap' is defined in this paper as an intellectual effort which is based on unrealistic assumptions and recommends impractical policies. For the sake of brevity, only such trap is elaborated to highlight the futility and dangers involved in getting caught in a 'Golden Trap'. One such fantastic effort is the recommendation of introducing Gold-backed Pension Product (GBPP) scheme. Under this scheme, a customer surrenders his or her gold to the bank on an agreement that he or she would receive streams of monthly pension till his or her death.[5] The bank can sell the jewels or convert them into gold coins for resale. Details about how the generated returns will be adjusted for inflation over a long period of 25-30 years are not explained. There would be a tripartite agreement involving the individual customer, the bank and the life insurance company. In this arrangement, gold is treated as a capital asset like a house or a factory. This approach considers gold as a pension asset. Needless to say, this scheme neglects the social and economic realities obtained in India.

The perception of gold in the West and in India are very different. There are deep social, cultural and psychological dimensions of ownership of gold in India. For example, the concept of *Stridhana* has been developed over centuries in India. Gold has been used to transfer a part of the family wealth to the girl at the time of marriage. Gold is seen not only as a sign of wealth and prosperity but also as an inalienable family right and family tradition. Emotional and sentimental attachment to gold and family jewels is stronger than one's need and desire for old age pension. This means that the GBPP scheme is neither logical nor practical in the Indian context. And such a scheme has not been used anywhere in the world. However, this scheme is described as an innovative instrument to monetize the existing gold objects and to bring about a social and economic revolution in the country. As already mentioned schemes of similar kind have failed to bring expected results in the past.[6] A recent report says that the government is planning to re-launch gold monetisation scheme. The programme was launched originally on November 5, 2015 by the Prime Minister and the banks were told to expedite the collection of gold as deposits under three schemes. Under the first scheme only 14.4 tonnes of gold was collected, under the second scheme 23.5 tonnes and under the third scheme a mere 0.7 tonnes of gold was collected. The total volume of gold with the households may be around 30000 tonnes. Therefore the collection from the three schemes under gold monetisation programme comes to 0.04%, 0.078% and 0.002% of the total amount, respectively. It is obvious the schemes do not work in the Indian context. The power of neo-liberalism is such that a lot of intellectual effort and government money are spent on such dubious ideas. It is important that debates and policy recommendations on gold come out of the 'Golden Trap' manufactured by the neo-liberal tradition. Less government does not mean more market and efficiency. Policies relevant to gold must be realistic and effective in expanding the market for gold in the country. The next section attempts to elaborate such a policy based on an alternative paradigm.

Part – II

An Alternative Paradigm

To begin with, one should know some data on stock and value of gold in the existing system. The total physical amount of gold in the world is about 1,89,000 tonnes of which about 30,000 tonnes are in India. The total value of gold in the world is about $7.5 trillion and that of India is about $1.2 trillion or about 40% of the country's GDP.[7] Sociocultural factors explain that about 70% demand for gold comes from jewellery production and the primary source of global demand is Asia, with China and India constituting the largest market. Islamic finance is an alternative paradigm which can provide a basis for developing practical and effective policies on gold. It is estimated that Islamic finance industry is worth $3 trillion and gold can play a big role in its growth. The World Gold Council (WGC), a market development body and the Accounting and Auditing Organisation for Islamic Financial Institution (AAOIFI) have been working on policies on gold-based products suitable for investors. A committee set up by the Planning Commission on financial sector reforms headed by Raghuram Rajan recommended option of some Islamic banking practices in India.[8] The Deepak Mohanty committee also has recommended introduction of financial products under interest-free banking. A distinctive feature of this paradigm is that there is no place in it to deliberately introduce any measures to monetize gold stocks in the system as in the case of neo-liberal policy. There is no 'Golden Trap' in interest-free and equity-based financial practices. Gold is a commodity and its price moves up and down in the market depending on demand and supply conditions. There is no scope, for example, for introducing gold-based pension scheme in this paradigm. Gold is not a pension asset; it is only a commodity which has value in the market.

The Islamic tradition permits increase in capital through trade. It does not permit increase in capital through lending money on interest or speculation. Men are prohibited from wearing gold ornaments. Gold coins can be in circulation because they perform the function of money which facilitates trade. Gold, like any other metal can be purchased and sold in the course of trade. However, gold cannot be used as a reference point or a source of influence to decide the quantity of money in circulation or for speculation purpose. Through these sanctions on gold, the Islamic tradition takes the wind out of the sail and gold is reduced to the status of any other metal. The price of gold depends on the demand and supply conditions as in the case of other commodities. Thus this alternative paradigm views gold differently. Islamic finance paradigm provides a road map to increase in the size of market for gold prosperity, stability and harmony to the economy and the society.

Low and falling rates of interest (and in some countries, negative rate of interest), uncontrolled expansion of debt, introduction of complex financial innovations, lack of transparency, high leverage, high debt-GDP ratios, increasing income inequalities, possible deflation, excessive nationalism leading to protectionism and even trends towards deglobalization are mentioned in financial periodicals as causes and signs of global economic instability in recent times. Even mainstream and highly respected periodicals like *The Financial Times* and *The Economist* write editorials expressing concerns especially after Brexit and Donald Trump's win in American Presidential election. It is necessary to quote the Nobel Prize-winning economist Paul Krugman at some length. He says,

"Thirty-plus years ago, when I was a graduate student in economics, only the least ambitious of my classmates sought careers in the financial world. Even then, investment banks paid more than teaching or public service – but not that much more…everyone knew that banking was boring. In the years that followed, of course, banking became anything but boring. And we were assured that our supersized financial sector was the key to prosperity. Instead, however, finance turned into the monster that ate the world economy".[9]

Islamic banking is boring. It is boring because being boring it helps the individual, the society and the economy to achieve prosperity, stability and harmony. The neo-liberal concept of banking has been "anything but boring" because it does what it need not be doing. It does the three major things which Islam prohibits namely building a financial system based on interest, forward trading and speculation, and thereby it becomes exciting and also disruptive. The alternative paradigm may be briefly described as follows.

I. Riba (interest) – Interest may be fixed or floating, simple or compound. Interest in all form is prohibited in Islamic tradition. High and exploitative rate of interest is called usury but in Islamic tradition all levels of interest is usurious and is prohibited. Those who save and those who invest are different groups of people. Those who save deposit their money with a bank and the bank, in turn, lends the money to the investor in conventional banking practices and the difference in the interest rates changed becomes the profit for the bank. In Islamic tradition the bank, instead of lending money, will buy a capital asset required by the prospective borrower and leases it to him and he will pay rent instead of interest. A part of the rent collected in this way will be given to the depositor.

a. Ijara (lease)**:** Ijara is an Islamic lease agreement. As explained above, the bank earns rent on assets leased to the customer.
b. Murabaha (purchase and resale): In this arrangement the bank purchases the capital asset (for which a loan would have been raised) and resells to the customer at a higher price. The customer pays this higher price over a period of time in periodic

instalments. The depositor will get payments from the bank over the same period of time. The difference between the two amounts is the profit for the bank with which it runs its business.

II. Gharar (uncertainty): In Islamic finance, making money on the basis uncertainty is prohibited. Future is uncertain and only God knows what will happen in future. In any financial transaction the level of risk involved should be understood by all the parties concerned. Forward trading, hedging, swaps, options and derivatives of different kinds will find no legitimate place in Islamic tradition.

a. Musharaka – (Profit and Loss sharing)

It is a partnership in which profits and losses are shared as per agreed ratios among the partners. Buying stocks or shares of a limited company will also come under this arrangement. Shareholders can get dividend and companies can mobilize equity finance.

b. Takaful (insurance) **-** This is different from conventional insurance policy involving premium based on risk factors. This is a charitable arrangement in which individuals pool their funds based on the principle of mutual assistance.

III. Maysir (gambling) – In Islamic tradition gambling is strictly prohibited. Buying and selling of shares in stock market should be on genuine purposes and there should be no gain through speculative trading. Financial instability in the present day casino capitalism, created in stock markets where computers trade with computers using algorithms and nano second profit making deals take place, is impossible under the Islamic financial system.

Ethnocentricity of economics has been mentioned by several scholars in recent times. The mainstream social theorizing and particularly neo-liberal economic theory should accommodate non-western traditions like the Islamic tradition and the Hindu tradition for mutual benefit. Post-modernist thinkers like Foucault emphasize the close relationship between power and knowledge. Ultimately, it is the political power which determines what kind of knowledge should prevail. Europe and the United States have been playing a major role in the development of social sciences, particularly economics. The calculating and maximizing rational individual is assumed in building theories. Developments in behavioural economics show that economic rationality may not be suitable in all situations. Recent global financial issues make one to rethink the validity of the prevailing neo-liberal paradigm. Finance is an area which needs a paradigm shift. Islamic finance may offer some insights which may be of use. However, more study and research would be needed in this exciting area of enquiry.

Expected Beneficial Outcomes

Market for gold will expand which will bring beneficial effects on economic growth and eventually economic development in the country. Foreign Direct Investment (FDI) and Foreign Institutional Investment (FII) especially from Gulf cooperation council countries will increase. Renowned business houses from countries like Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and UAE will participate and the inflow of funds will increase. Equity-based microfinance organisations at the grassroot levels will expand and under *ijara* (lease) and *murabaha* (purchase and lease) arrangements small manufacturers and traders will get tools, equipments and machinery. This would be a huge encouragement to Micro, Small and Medium Enterprises (MSME) in the country. Muslims (making up 14.9% of the population) of India, in general, avoid banking as their faith prohibits interest-based transactions of all forms. As per the Sachar committee report (2006), there are several indications of economic backwardness of muslims in the country. Finance based on equity and not interest will improve the socio-economic status of the community. The exploitative system of village money lenders will be discouraged with the growth of equity-based micro-finance organisations. The positive impact of equity-based finance on the growth of the economy in general and market for gold in the country needs further study and analysis. Demand for gold for production of jewellery for export may increase with increased availability of finance for upgrading techniques which may improve productivity and quality of the products.

Conclusion

All that glitters is not gold. The paper elaborated the dangers of getting caught within a ‘Golden Trap’ which is an intellectual trap leading to illogical reasoning and impractical policy recommendations. Neo-liberalism advocates less government, but it does not mean more market when policies are not right. The GBPP is taken as a case in point. In the sociocultural context prevailing in India, schemes like GBPP cannot bring expected outcomes. Equity-based finance may provide opportunities for economic growth in general and expand market for gold in particular. However, further study and analysis are needed to develop a suitable model for such initiatives in India. More specifically, the positive impact of equity-based finance on gold market in India needs further research. The recent efforts of WGC in producing suitable gold-based products for Indian investors through working with AAOIFI seem to be in the right direction.

Notes

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