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SOLVING INDIA'S GOLD SMUGGLING PROBLEM v1

Gold smuggling carries heavy risks. It's a high-stakes trade where the financial risks are higher than the possibility of getting convicted and sentenced. We examine the mathematics behind smuggling.

Gold smuggling into India has increased considerably since the initial rise in import duty back in January 2012, which instigated the first recent wave of unofficial gold imports. The newest generation of officers have never previously exposed to gold smuggling at such levels, and the learning curve has been steep. The information system is technologically so intensive that it is difficult to make breakthroughs unless insiders are involved.

Some sources suggest unofficial imports could be as high as 400 metric tons. However, according to extensive field research from GFMS at Thomson Reuters, we estimate this parallel trade is closer to 120 metric tons.

The golden numbers

Explaining the numbers behind the smuggling trade is quite complex. To start, we need to define the following constants:

- The price of gold at $1,200/oz
- Customs Duty at 10%
- Value Added Tax at 1%
- Octroi (a local tax levied on imported goods) and Stamp Duty at 0.3%
- Spot market premia of $15.40 an ounce (1.3% of $1,200)
- Carrier charge of 1.2%
- Hawala premia or dollar transfer of 3% (hawala is an unofficial channel used to transfer currency physically)
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The primary revenue for the smuggler is the total duty he aims to evade, i.e. 11.3% valued at $135.60. Add to that the spot market premium of $15.40 an ounce (~1.3% of $1,200), and his gain is $151 for an ounce or 12.5%. In other words, gold that was bought at $1,200 gets sold in the domestic market for $1,350.50. Thus the gross earning is $150 per ounce.

On this basis, the cost of smuggling including the carrier charge is $14.40/oz, which in essence means the margin is 11%. However, after including the hawala premium of 3% (anecdotal evidence suggests this is common practice), the margin falls to 8%.

At the outset a margin of 8% may seem like a healthy profit, but this has to be evaluated against the value of gold that gets seized. Thus, the margin in value terms is Rs. 1,964/10 grams (difference between the spot rate and landed rate by smuggling) or 19,642/100 grams. The GFMS team at Thomson Reuters developed a scenario based on the percentage of gold that gets apprehended by customs, and its impact on profitability. It revealed that on apprehending just 1%, which means only 1 gram out of every 100 grams would have helped smugglers enjoy a profit of Rs. 34,355 from the other 99 consignments. As we scale this higher towards 7%, smugglers would not make any money over the longer term.

In reality, smugglers don't import the same volume every time. They initially test the waters before gradually increasing volumes. Should a consignment be seized by customs then their costing spirals out of control. In most cases the offender is released on bail within 60 days, but the individual remains on the custom authority's radar, making it difficult to recommence trade.

Melting through the cracks

Looking at the points of entry, there are 18 international airports in India. If we assume 7 kg is slipping past customs at each, the annual total is about 45 metric tons. Land borders and sea transport can add to these volumes, although Hawala transaction rates are higher here, due in part to local demographics. For instance, a border town like Moreh along the India-Burma border is a place largely inhabited by Tamil people, and Tamil Nadu is in the top three states for per capita consumption of gold.

Similarly, India shares a 4,000 kilometer stretch of border with Bangladesh, only half of which is known to be fenced. This border is susceptible to higher smuggling volumes, but it is important to note that the higher the volumes transported means higher the risk of loss. Similarly, unofficial flows through Nepal and Pakistan face the same challenges.