CHAPTER I
INTRODUCTION

1.1 Gems and Jewellery: the eternal fascination

Mankind has been captivated by gems and jewellery from time immemorial. India has given the world the Kohinoor and the Hope diamond, with their associated legends and fables. Today, gems and jewellery are a global industry with mining of gold, diamonds and platinum in Africa, Russia, Canada and Australia, polishing and jewellery manufacturing in Belgium, Netherlands, Israel, India, China and Turkey and retailing all over the world.

The industry contributes over 15 per cent of our total exports and employs 1.3 million people. It is second only to Information Technology (IT) related exports and contributes 3.75 per cent to our Gross Domestic Product (GDP). Gold jewellery represents about 80 per cent of the market and the balance comprises studded diamond and gemstone jewellery. While most of the gold jewellery manufactured in India is consumed in the domestic market, a major portion of rough, uncut diamonds produced in India is processed and exported as polished diamonds and finished diamond jewellery. India is the world's largest diamond processing (cutting and polishing) centre handling over 57 per cent of the world's rough diamonds by value.

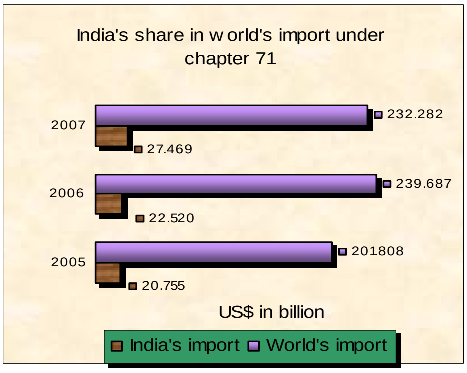
1.2 The key players

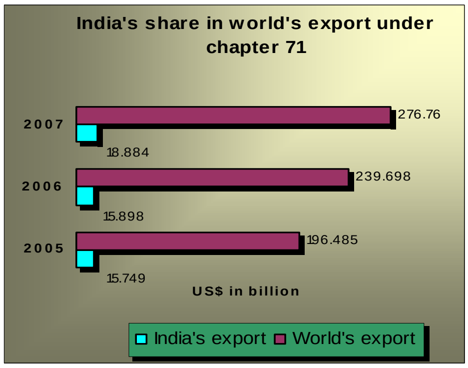
The industry is dominated by family jewellers, who constitute nearly 96 per cent of the market. Organised players such as Tata, with its Tanishq brand and Gitanjali have entered the market with branded jewellery which has a four per cent market share. The Department of Revenue under the Ministry of Finance is responsible for the tax administration of this sector. The Central Board of Excise and Customs, through its field formations spread across the country, is the main executive authority for collection of revenue. The Director General of Foreign Trade under the Ministry of Commerce implements various Export promotion schemes.

The Gems and Jewellery Export Promotion Council (GJEPC) is the apex body of the industry set-up in 1966. It is primarily involved in promoting the Indian gems and jewellery products in the international market. It also acts as trade facilitator, a nodal agency for diamond certification and organises training and research for the industry.

1.3 Major initiatives by the Government to promote the industry

This industry has been identified as a thrust sector in our Foreign Trade Policy (FTP). It falls under chapter 71 of the Customs Tariff Act, 1975 (CTA). The Government set up an Expert Committee on Gems and Jewellery in 2006 to suggest measures for making India a global hub. The committee recommended various measures for providing a competitive edge to the Indian industry which included removal of import duty on cut and polished diamonds and reduction in the import duty on gold, gold items, machinery used in cutting and polishing industry etc.

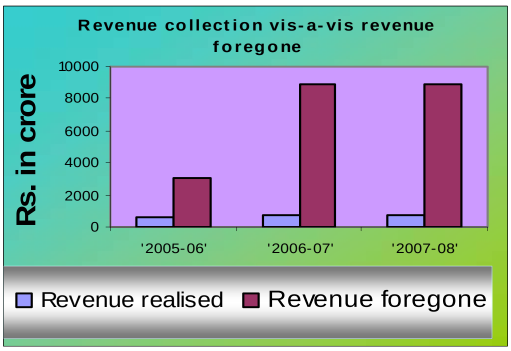




In international trade under chapter 71, India's import for the period 2005-07 was US$ 70.74 billion (equivalent to Rs. 3,18,348 crore), which was ten per cent of the world import and the export share of US$ 50.53 billion (Rs. 2,27,389 crore) was seven per cent of the world export for the same period. Bulk of exports and imports are effected through a specialised customs clearance centre called the Diamond Plaza Customs Clearance Centre (DPCC), Mumbai.

With a view to doubling our percentage share of global exports within five years, the Government, in the Foreign Trade Policy (2004-09), announced (April 2004) special initiatives for the gems and jewellery sector. Import of gold of eight carats and above were allowed under replenishment scheme; duty free import of consumables for semi precious metals other than gold and platinum, commercial samples and re-import of rejected jewellery was allowed; and cutting and polishing of gems and jewellery was treated as manufacturing for the purpose of exemption under section 10A of the Income Tax Act. In the New Annual Supplement to FTP (2004-2009), duty free import of machinery, precious metals and gems was allowed. In the Union Budget for the year 2007-08, import duty on cut and polished diamonds was abolished, import duty on un-worked corals and rough synthetic stones was reduced and all industrial undertakings in the gems and jewellery sector were exempted from obtaining industrial licence for manufacture.

As a result of these exemptions which were given to bolster exports, the estimated duty foregone by the Government on goods of chapter 71 during 2005-06 to 2007-08 amounted to Rs. 68,192 crore.



We found that **the eleven commissionerates audited by us earned revenue of Rs. 2,023 crore from gems and jewellery during 2005-06 to 2007-08, while the duty foregone was Rs. 20,864 crore.** The revenue foregone increased by 191 per cent in the year 2007-08 over the year 2005-06, whereas the revenue earnings increased by only eight per cent during the same period. **Despite foregoing**

substantial revenue on imports and extending various benefits to this sector, the exports have not yet been able to catch up with the imports. While the imports grew by 16 per cent, the growth in exports was only 13 per cent during 2005-07. The details are shown in the table below: -

Table no 1.1
Growth of exports and imports

(Rupees in crore)

Year	Export	Growth% (Base year 2005-06)	Import	Growth% (Base year 2005-06)
2005-06	70209	--	91604	--
2006-07	72784	3.67	102250	11.62
2007-08	79763	13.61	106451	16.21
Total	**222756**		**300305**	

Source: Export Import data bank, Department Of Commerce and Receipt Budget 2007-08 and 2008-09,

According to a strategic report by the consulting firm KPMG on the jewellery industry, commissioned by GJEPC, India's growing importance in the global jewellery market is expected to increase in the future with total estimated jewellery sales of US$ 21 billion by the year 2010 and US$ 37 billion by the year 2015. Diamond jewellery consumption in India is also estimated to jump by 78 per cent in the year 2010. It is evident that the sector has tremendous potential for growth.

1.4 Why we chose the topic

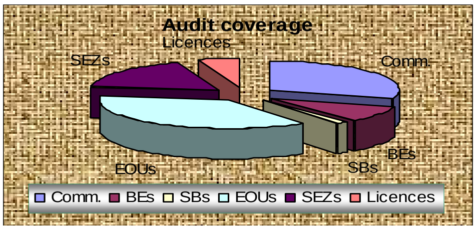
We chose the topic because the industry has a primary position in export and import activities and has tremendous potential for growth. Moreover, the Government has taken many initiatives to promote it, such as concessions, exemption, reduction of duty and has consequently foregone a large quantum of duty. We felt that all these factors made this industry a very important player in the economic activity and was suitable for a detailed study.

1.5 Audit objectives

The objectives of our audit were to ascertain whether:

- the relevant Acts, Rules and instructions issued by the Ministry of Finance/Central Board of Excise and Customs ensure proper assessment and collection of revenues,
- the internal control systems and monitoring mechanisms are effective in ensuring compliance with the provisions of the relevant Acts, rules and instructions,
- the exporter are discharging their obligation after availing of the benefits of various promotional measures and
- the export promotion schemes for this sector are being correctly administered.

1.6 Scope of audit



This performance audit was carried out in the six states of Delhi, Maharashtra, Tamil Nadu, Gujarat, Rajasthan and Karnataka, which showed highest volumes of trade for gems and jewellery. We scrutinised the records relating to imports and exports for 2005-06 to 2007-08 in 11 out of 17 commissionerates in these states. The commissionerates were selected on the basis of high volume of transactions. In these commissionerates, we selected a sample of 26,890 bills of entry (BEs), using statistical sampling technique[1], out of a total population of 1,41,527 BEs. The scrutiny of these BEs involved cross checking with 10,765 shipping bills (SBs) (total population – 4,13,494), records of 43 out of 55 Export Oriented Units (EOUs), 114 out of 292 Special Economic Zone (SEZ) units and records of 777 licences out of 3,519 licences issued under various export promotion schemes by six Regional Licensing Authorities (RLAs). In summary, a total of 19 per cent of BEs, three per cent of SBs, records of 78 per cent EOUs, 39 per cent of SEZ units and 22 per cent of licences were checked by us.

1.7 Acknowledgement

The Indian Audit and Accounts Department acknowledges the cooperation extended by the Ministry of Finance and its field formations in providing the necessary information and records during the conduct of this audit. The objectives, scope and audit methodology for the review was discussed in entry conferences held on 19 November 2008 and 7 January 2009 with Ministry of Finance and Ministry of Commerce and Industries respectively. The draft report was issued to both the ministries in December 2009. The audit findings and recommendations were discussed in an exit conference held on 15 January, 2010 with both the ministries. While the written responses to the draft review from the ministries were awaited (February 2010), the departmental responses, wherever received, have been appropriately incorporated in this report.

[1] The selection was done using the data base of import/export kept by each commissionerate. The assessees in each comissionerate were stratified on total assessable value, in a descending order. The top 25 importers were short listed. The BEs of these top 25 importers were further stratified scheme wise. From this stratified data, samples of BEs were selected using monetary unit sampling. The total number of BEs selected were restricted to one thousand per year in each commissionerate. Wherever the total number of BEs was less than 3000 in three years, the sample size for audit was kept at 50 per cent of the total transactions during three years (2005-06 to 2007-08).