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"GOLD SCHEMES" – Can They Replace The Need To Hold Physical Gold? – Expectations and Realities

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Abstract: **From ages Indian women's love for gold is very famous. The yellow metal which was described as 'barbaric relic' by famous thinkers has always been occupying prime place in the life of Indian woman. However for a long period of time Indian Government failed to consider this fact and capitalize it. They followed US way and considered gold as evil asset. The picture has reversed with the bounce back of the gold in global economy. In spite of much disregard of modern economist about its economic value, to their shock gold now proves its mystic hidden power by bouncing back as a financial asset in the global economy. Realizing the power of gold which is backed by 20,000 tons of gold lying idle with people and temple Modi government accepted gold as a reality of the Indian Economy and launched three gold schemes namely Gold Monetization Scheme, Sovereign Gold Bonds and Gold Coin Scheme. Monetization is the process of converting or establishing something into legal tender. However, still the questions remain about the success of the schemes. GMS aims to alleviate the need to hold physical gold or in more precise finance terms improve the productivity of gold. Will the scheme trio achieve the purpose? If not what modifications are required to be adopted for taking the scheme much more nearer to people knowing the Indian psychology towards gold. The present paper is a discussion paper on these thought provoking issues. Authors attempt to trigger few questions into the minds of the esteemed academicians with a modest attempt to provide few suggestions.**

Key Words**: GMS, Indian women and Gold, Productivity of Gold, Legal tender.**

I.INTRODUCTION

A. *Prologue*

Role of Gold from Ages:

There are evidences of using gold from distant past. Man's love for gold is known from ancient periods. Fossil study experts observed that bits of natural gold were found in Spanish caves used by Paleolithic Man about 40,000 B.C. Though there was usage of gold it was mostly used for adornment but not used as medium of exchange. For the first time it was used as money in 700 B.C by the kingdom of Lydia.

Coming to recent history gold was adopted as bimetallic standard for the nation's currency by the US Congress in 1792. Gold valued at $19.30 per troy ounce. It continued until 1834, when the price of gold was raised to the $20.67 level which held for the next 100 years. It was not until 1934 that President Franklin Delano Roosevelt devalued the dollar by raising the price of gold to $35 per ounce.

A. GOLD AS A MONETARY INSTRUMENT:

Gold was not considered as a good asset in the late 19th and 20th centuries. Economists like John Maynard Keynes considered it as 'barbaric relic'. The anti gold campaign led to US government to outlaw gold as a private asset. US government nationalised it in 1934. As a result gold official reserves in US have gone up to 20,000 tons by 1942. In 1950, when the International Monetary Fund was born, its member world nations accepted the US Dollar as global currency on the US promise to give gold in exchange for US Dollars at one troy ounce gold for $35. As a result US became global financial power. Dollar was fixed to gold and exchange rates of all currencies were fixed to the Dollar from 1950 to 1972. Later, as the maintenance of gold price at $35 per ounce became a tough task for US, it suspended gold dollar convertibility and legalised private gold. Floating exchange rates emerged as the fixed exchange rates faded out. It can be noted as a victory of gold against economists.

Later, in order to keep up the demand for dollars US adopted petrodollar strategy* which helped to maintain the demand for dollars in 1970s and 80s. Since 1990s onwards the growing globalization helped to protect the supremacy of dollar till financial meltdown in 2008. As one of the worst effects of financial meltdown the dollar designated debt reached its peak. It amounts to $49.1 trillion dollars at present.

To the shock of the modern economists who advocated gold as barbaric relic, the Bank of International Settlements (BIS) which serves as a bank of central banks states that gold offers protection against the crises in the financial system when the extreme levels of global debts threaten it. Hence, gold is considered as post modern global economic asset and safety net.

B. GOLD IN INDIAN ECONOMY:

In India gold always occupied an exclusive place. A godly place is given for gold. Irrespective of economic stamina or social status every Indian makes it a point to maintain at least minimum reserves of gold. The Economist magazine (Nov 20, 2013) wrote, "In Hinduism, Gold is sacred almost on par with Gods." Ignoring the fact of Indian's love for gold, Indian government upheld a similar strategy of US and considered gold as an evil asset till 1992. The wrong strategy which was against Indian sentiments helped for nothing except increasing the smuggling activities and growth of people like Dawood Ibrahim and Haji Masthan.

Relation with gold by Indian economic system can be understood as two phases. The first phase can be described as the phase where gold was seen as pretentious. This period continued from 1948 – 1992. It was an unrealistic view. Slowly it was replaced by realistic stage which can be described as ambivalent phase which continued from 1992 - 2015. It was a two minded phase.

A leap change introduced by Modi Government ended the two minded approach towards gold by internalizing the micro gold economy into macro gold economy of India.

C. GOLD DEPOSIT SCHEME – 1999:

Way back in 1999 an attempt was made to draw a part of gold holding from private hands to reduce India's dependence on importation of gold. "Gold Deposit Scheme" was launched by India's largest commercial bank SBI. According to this scheme bank would issue interest bearing certificates against gold collected from households, temples and trusts.

A. Three Gold Schemes – Major step towards making India a gold economy

Three gold schemes announced by Modi government can be regarded as a very important step towards using gold as an instrument to strengthen the economy. It is accepting the reality of the economy. The three gold schemes are featured in the following way.

- ❖ Gold Deposits: Banks accept Gold Deposits from public.
- ❖ Government sells Sovereign Gold Bonds to people who want to buy gold in future. The sovereign gold bonds carry an interest of 2.75%.
- ❖ Government sells Indian Gold Coins to people.

B. Gold Deposit Scheme:

Out of the three schemes gold deposit scheme holds lot of importance. It has the ability to divert the gold from private hands to join financial flow. On one side, it helps to reduce import bill and on the other hand it enables people to earn interest in the place of bearing carrying cost in the form of locker rent etc.

C. Rationale:

Every financial year the increase in the demand for gold is met by imports. In the financial year 2015, it contributes significantly to the current account deficit of 1.4% of GDP. Around 700-900 a tonne of gold is imported every year by India and it accounts for a significant portion of physical demand.

Indians purchase gold either for consumption (in the form of jewellery) or as a capital good (in the hope it may be used in the future). Investors hold gold for a variety of reasons like as a store of value, a hedge against inflation and currency fluctuations, as an insurance against uncertainty and tail risks.

While the rupee has depreciated by 47% against the US dollar over the past five years, gold in rupee terms is up by 28%. There is a positive correlation between consumer price index (CPI) inflation and gold purchases. If gold monetization scheme is implemented successfully, the metal collected under the GMS Scheme can be lent out to the jewellary industry.

D. *Objectives Of Gold Monetization Scheme*:

1. To unlock the estimated 20,000 tonnes of gold lying idle with households, temples, and trusts.
2. To reduce the imports of gold. India imports 800 to 900 tons of gold every year.

3. To reduce the current account deficit. Gold accounts for 15% of the total imports.
4. To make productive use of gold.
5. Banks can account deposited gold as SLR and thus help use its liquidity in productive assets.

D. SCHEMATIC PRESENTATION OF GMS:

After due deliberations and consultations with various stake holders the following draft is prepared. It explains the scheme of GMS (Gold Monetization Scheme).

A. *Purity Verification And Deposit Of Gold*:

There are 350 Hallmark testing Centres spread across various parts of the country. They act as the purity testing centres for GMS. In a Purity Testing Centre, a preliminary XRF machine-test will be conducted to tell the customer the approximate amount of pure gold. If the customer agrees, he will have to fill-up a Bank/KYC form and give his consent for melting the gold. After receiving the customer's consent for melting the gold for conducting a further test of purity, at the same collection centre, the gold ornament will then be cleaned of its dirt, studs, meena etc. The studs will be handed-over to the customer there itself. Net weight of the jewellery will be taken after such removals and told to the customer.Then, right in front of the customer the jewellery will be melted and through a fire assay, its purity will be ascertained.

When the results of the fire assay are told to the customer, he has a choice of either refusing to accept, in which case he can take back the melted gold in the form of gold bars, after paying a nominal fee1to that centre; or he may agree to deposit his gold (in which case the fee will be paid by the bank). If the customer agrees to deposit the gold, then he will be given a certificate by the collection centre certifying the amount and purity of the deposited gold.

B. Opening of gold savings account with the bank:

When the customer produces the certificate of gold deposited at the Purity Testing Centre, the bank will in turn open a 'Gold Savings Account' for the customer and credit the 'quantity' of gold into the customer's account. The bank will commit to paying an interest to the customer which will be payable after 30/60 days of opening of the Gold Savings Account. The amount of interest rate to be given is proposed to be left to the banks to decide. Both principal and interest to be paid to the depositors of gold, will be 'valued' in gold. The tenure of the deposit will be minimum 1 year and with a roll out in multiples of one year. Like a fixed deposit, breaking of lock-in period will be allowed. In the Gold Deposit Scheme (1999), the customers received exemption from Capital Gains Tax, Wealth tax and Income Tax. Similar tax exemptions are likely to be made available to the customers in the GMS after due examination.

C. *Transfer Of Gold To The Refiners*:

Purity Testing Centres will send the gold to the refiners. The refiners will keep the gold in their ware-houses, unless the banks prefer to hold it themselves

D. *Utilization of Deposited Gold*:

Banks are permitted to deposit the mobilized gold as part of their CRR/SLR requirements. They can sell this gold to generate foreign currency. It can be used for onward lending to exporters/importers. Banks can convert the mobilized gold into coins for onward sale to their customers. Lastly, they can also lend it for the jewelers.

E. Lending gold to the jewelers:

The jewelers, on the basis of the terms and conditions of the banks, will get a Gold Loan Account opened at the bank. When a gold loan is sanctioned, the jewelers will receive physical delivery of gold from the refiners. The banks will in turn make the requisite entry in the jewelers' Gold Loan Account. Interest is received by the bank. It is charged to cover the interest rate paid to the depositors of gold, fee paid to the refiners and purity verification centres and profit margin for the banks.

F. MoU between Banks, Refiners and Purity Testing Centres

The banks will enter into a tripartite MoU with refiners and purity testing centres, that are selected by them to be their partners in the scheme. The MoU will clearly lay down the details regarding payment of fee, services to be provided, standards of service and the details of the arrangements between the banks, refiners and purity testing centres.

G. *Benefits of the Gold Monetization Scheme for Investors*:

- The GMS earns interest for gold jewelry lying in the lockers. Broken jewelry can also earn interest.
- Coins and bars earn interest.
- They have appreciation of value
- Redemption is possible in physical gold or rupees hence giving gold purchases opportunity of further earning.
- Earnings are exempt from capital gains tax, wealth tax and income tax.
- If there is potential growth in the economy, injection of real money would increase in the potential GDP and Velocity of Money (Kangan Jain et.al 2015). New employment opportunities are created. New demand for goods and services is created. Virtuous cycle (ibid) is formed.
- ‘Gold Backup’ adds to the business sentiment.

H. Expected Benefits in International Front:

If Indian Rupee can be internationalized and accepted as a reserve currency it renders many benefits for the economy from external sector point of view. A currency can be a reserve currency with surplus current account. Other enabling conditions are Fiscal Discipline, net savings, a big domestic market, a net debtor country, an efficient investor of international capital, home of many MNCs, low domestic tax rates, high levels of privatization. Many currencies which are existing presently in SDR basket do not possess these qualities. Reserve currency is the one in which central banks hold their reserves. The ‘gold’ backup for the banks increases the ‘reserve’ nature of the Indian Rupee.

I. Performance of GMS Scheme:

It is noteworthy to mention that Gold Monetization Scheme has not received a hearty welcome from people in India. Its performance in the beginning was very dull with poor results. Hardly 500 gms of gold was received by the banks in first quarter of the year after the scheme was announced. Analysts started looking for the reasons about why it was not a big hit. Doubts were also raised about its chances of success. The approach of Indian consumers towards gold is very much attributable for the moderate or less success of the scheme.

Most of the Indians link gold with traditions and customs rather than a mere investment asset. According to World Gold Council more than half of India’s demand for gold is for marriage purpose. In that case how can one think that people voluntarily come forward to melt their ornaments?

Indian women consider wearing gold ornaments as prestige symbol. Many ornaments they wear contain the memories of various life events or their elders. It would be difficult for them to see them lose their shape and structure.

Temple trusts in India are known for their gold treasures. They can be deposited with banks compared to households’ gold. But faith and religion play an important role in this case.

Another major challenge for the government will be to check the possible flow of black money into the financial system through this scheme. Those, who have unaccounted wealth stored in the form of gold ornaments and bars, will find this as an excellent opportunity to legitimise their ill-gotten wealth. Also, they can split the gold into tiny instalments and approach banks either by themselves or a benami to escape filters.

Since gold is typically bought in cash in India and there is no documentation required for the purchase, it will be difficult to verify the ownership of the gold deposited under the GMS. There is also a possibility that such transactions might come under the scanner of taxmen.

J. Recent Trends Seen in the Performance of GMS:

Recent trends generate rays of hope towards success of the GMS Scheme. On February 14th Minister of State for Finance Jayant Sinha said in a written reply to Lok Sabha that so far 1,131,kilograms of gold valuing Rs. 3,014 crores have been deposited by 71 depositors. It can, therefore, be concluded that though GMS had not picked up initially, is slowly getting fine tuned.

K. How to make GMS more effective?

If the government could effectively induce the belief into people that there is lot of gold and by monetizing it a good ‘backup’ could be created for the economy, people may work for the store of value property of money. Government can look into the possibilities of making few policy changes with respect to the gold reserves of temples and trusts without disturbing the religion sentiments. Another important factor to deal with is how best the sentiments of the people can be protected about melting of the gold. Is it possible to use the net value of gold for CRR/SLR purposes without disturbing the shape or converting into rods? If these questions are answered then perhaps GMS has chances of working more effectively.

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Draft Gold Monetization Scheme - MyGov: h***ttps://mygov.in/sites/default/.../Draft_****Gold_Monetization_ Scheme****.pdf***