

Gold Monetization in India: A Paradigm Shift in Regulation

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Abstract: On November 5th, 2015, three gold related schemes namely Gold Monetization scheme (GMS), Gold Sovereign Bond (GSB) and India Gold Coins was introduced in an effort to monetize the idle gold held by Indian households and to mobilize it for growth of Indian economy. The schemes introduced though are reincarnation of the old schemes, are found to revisit the ground realities from the point of view of the Indian sentimental values towards gold and scheme viability from banks perspective. The guidelines proposed seems to revisit the failures of the past schemes introduced in 1999 and 2013. Efforts have been made to address the concern mainly with respect to taxation, returns on investment and mode of redemption. With the introduction of these schemes, there is also a perception that Exchange Trade Funds (ETFs) would lose their luster. World Gold Council reports and FICCI reports emphasize that, in the recent years the sentimental value attached to gold may have diminished with time and if the aspect of standardization of gold in terms of quality and price is addressed, there may be huge potential for success of these schemes. So, will these schemes find solace in the dark as previous schemes or find success is the question of time to come.

Keywords: Gold Monetization Scheme, Gold Sovereign Bond, Gold schemes, ETFs,

I. Introduction

From time infinite, not abound by restrictions, gold has been part of the tradition and reflects rich attachment with cultural and sentimental values for Indians. Thus, being part of the ethos of every Indian household irrespective of the socio-economic conditions. Gold remains an integral and important part of the investment portfolio of every member of this country and is often bought but neverre-invested (only in case of dire needs of the family in difficult times it is considered as safety net). Thus, it remains the best investment choice but never re-investment choice for many, which has retained its shine through the rough cycles of booms and busts in the markets. The financial re-engineering by institutions in India with gold as the underlying instrument has often been considered not a viable option over the years, until now. The financial instruments were either rejected or seen with discontent, as the perception among consumers and big bourses, was that, gold is not an investment instrument but a safety vault and any policy reforms around gold was considered unworthy. So recently on November 5th, 2015, there was an effort by the government for monetizing this asset and for drawing a policy around this asset in the form of Gold Monetization Scheme and Sovereign Gold Bond¹. Would Indian households accept these schemes?. Is there a motivation for Indian households to get enticed by these schemes is the most important topic which needs to be questioned and researched. It is estimated that, Gold over the years has helped review the economic growth of the country by employing around 2.5 million people in the industry and boosts of economic output in India by atleast \$30 billion per annum². The glimpse into the demand and supply of gold shows no waning of people's perception of gold atleast in the next few years. According to the PWC report, 2003, around 4477 tonnes of gold was supplied with two-thirds coming from mining and one-third from recycling of gold. But, the former stats about recycling of gold looks promising and if conceptualized from Indian perspective; it can turn tables for Indian capital markets and for the economy. Indian households are estimated to be sitting on 20,000 tonnes of gold (with consumption of around 850-900 tonnes of gold every year) and if we can monetize atleast 5 percent of this idle asset, it can rejuvenate Indian thirst in other investment options and help in boosting economy³. Thus, perception of consumers towards gold as a re-investment instrument needs to strengthen.

¹ PM LAUNCHES THREE GOLD SCHEMES, www.thehindubusinessline.com, November 5th, 2015

² According to PriceWaterCoopers report entitled "The direct economic impact of gold", October, 2013

³ Golden Diwali, Business Line, November 9th, 2015

II. Insight into the Gold Schemes

Prime Minister Narendra Modi on November 5th, 2015 launched three schemes considering gold as the underlying instrument. The schemes are - The Gold Monetization Scheme, The Sovereign Gold bond Scheme and Indian Gold Coins. The launch was portrayed to further strengthen and transform the Indian economy.

Gold Monetization Scheme is conceptualized around monetizing idle gold kept with households in vaults. This scheme is a deposit scheme of the banks, where deposits are made based on the weight and quality of the gold. For the deposits, the depositors will be paid with interest by the banks depending on the deposit horizon. The minimum weight for deposit under this scheme is 30gms (995 fineness). Once gold is certified (purity certificate) in centres certified by the Banks, the gold deposit account is opened. The government has currently proposed around 125 of 350 hallmarking centers to be collection centers as well as assaying centers in only 14 cities of the country, while, according to analysts, the need is in over 300 cities. Once gold is deposited, the banks enter into agreement with the refiners for vaulting. Thus, one can visualize that, the scheme is a model conceptualized around being a tripartite agreement between certified centers, Banks and the refiners. In order to motivate households, the scheme (depending on the time of investment) is embedded with different payment structure and redemption methods. The key motivator is the tax benefits associated with each of the schemes, as these schemes are tax-free and exempt from capital gains tax (on appreciation of gold prices). The wealth tax also stands abolished for these schemes. This deposit scheme is characterized into three types depending on the time horizon opted for investment namely;

Short-term gold scheme: In this scheme, the gold is deposited for a period of one to three years. The terms and conditions and the rate of interest is decided by the respective banks. For these schemes, strict KYC requirement (PAN details) is to be followed like any other scheme of the bank. The gold deposited is often melted before accepting as deposits and would be redeemed towards the end of the investment period. There exists also an option of getting the deposit redeemed in the form of cash, where the gold prices on the date of redemption would be considered for payments. In case of these short-term deposits, the principle of fixed deposit schemes is followed i.e., a minimum lock-in period of one year is often specified, after which, withdrawal is permissible with some additional fees associated with it. The other advantage of the scheme, is that, the deposited gold can be used as a collateral for taking a loan. The loan-to-value being allowed on the scheme is around 70 percent. The interest rate associated with this scheme can be considered as a hurdle to motivate investors as the rate paid is very less. According to secondary sources, leading PSU banks are paying only 0.5 percent, 0.55 percent and 0.6 percent interest for one, two and three-year schemes respectively on the weight of the gold. Thus, the interest obtained and if compounded for three-year better would be better-off compared to the idle gold kept in homes.

Medium and Long-term gold schemes: The deposit schemes accept a lock-in period of five to fifteen years. In case of medium deposit schemes, the lock-in period is from five to seven years and for long-term deposits, it is from 12-15 years. Except in case of short-term schemes, the terms and conditions of rate of interest and redemption will be decided by the central government and is found often better. In case of medium to long-term deposits, the government offers an interest rate of 2.25 percent and 2.5 percent respectively. Though, not an advantage, the redemption method can be questionable in case of long-term schemes. According to the scheme, in case of medium to long term schemes, the redemption of the scheme is only made in cash and not in gold. The redemption of gold in cash, is done at the prevailing market price which might be unacceptable in case of many households as cash may lose its luster with inflation. For these schemes also, stricter KYC norms are to be followed and they enjoy the benefit of income tax exemption.

Though these schemes consider gold as a re-investment, melting and fire assaying of the ornaments can be a hurdle, as one often find sentimental attachments with the ornaments. If gold is purchased in the form of gold coins or bars and re-invested into the deposit schemes, then these schemes would look practical according to many industry experts. The second scheme launched by the government recently was the Sovereign Gold Bond Scheme. This scheme was mainly launched on the pretext that, almost a third of the country's demand for gold arises from investors who buy gold for investment purposes (capital appreciation). Majority of these investors buy gold bars or coins to sell it in the future to earn returns from the fluctuations in the gold prices. Thus, an instrument/scheme was devised to take into consideration the two critical aspects in investments i.e., the capital appreciation and interest returns. Thus, Sovereign Gold Bond Scheme was conceptualized around principles of fixed debt instruments mainly bonds. This scheme considers issue of bonds by Reserve Bank of India (RBI) on behalf of the government. The scheme often dictates better interest returns than Gold

Monetization Scheme with 2.75 percent interest per annum with a minimum investment of two grams for a lock-in period of 8 years. After the term of the scheme, the redemption will be done in cash at the market value of gold on the existing date.

III. Old Wine in a New Bottle

In order to address the growing inclination towards gold by Indian citizens and its impact on the current account deficit and the economy, the Gold Deposit scheme was introduced on September 14th, 1999 by the then central government. With the official circular, RBI on 5th October, 1999 issued guidelines for the banks authorized to have their own gold deposit schemes. The reasons for introduction of the scheme then, also reiterates in the recent period too with the launch of 2015 schemes. Considering the viability and profitability in the schemes, only few banks introduced the schemes, one being State Bank of India (SBI). Similar to the gold monetization scheme, 2015, the Gold Deposit Scheme (1999) allowed deposits for period of three to seven years with interest rates on the deposit to be decided by respective banks. But, compared to the 2015 schemes, the interest rates charged did not exceed one percent on long-term investments (SBI fixed interest rate of 0.75 percent for short period of 3 years and interest rate of one percent for medium (4 years) and long term (5 years) deposits respectively. This is one of the reasons most often attributed to non-acceptance/ rejection of the schemes among individuals and households. The other characteristics of the 1999 scheme is retained in 2015 schemes, such as exemption of deposits from income tax, wealth tax and corporate tax, and fulfillment of KYC norms. The change one observes in the present schemes when compared to 1999 schemes is mainly in redemption and premature payments. In 1999 scheme, premature payment of the deposits could be done either in cash or gold with lock-in period of 1 year, but changes are made to the GMS with payment to be made only in gold is case of short-duration schemes and not with medium and long-term schemes respectively.

Co-Existence of Exchange Trade Funds and the Schemes

When compared to Gold Exchange traded funds (ETFs) these investments are better because of their additional coupon payments which will remain fixed (based on the price of investment on purchase date) irrespective of the movement of the gold prices (considering Federal Reserve's intentions of rate hikes in December, 2015). These instruments compared to ETFs offer no charges as it is borne by the government (In case of ETFs, one needs to pay transaction charges, management charges etc.. and in case of purchase of physical gold, one has to pay for making charges), which makes it even easier to hold these electronically with demat account (with minimal charges). So, like any other stock, these can be traded on the exchanges and with a lock-in period of minimum five-year period, it would be easier to liquidate the assets. But, ETFs are believed to co-exist as they offer different benefits to investors. The ETFs do not have any specific tenure and no limits compared to gold bonds schemes (500 gms per person per year). ETFs since traded electronically, investors often would not need to worry about quality and price as markets would decide the efficient price based on demand-supply.

Revisioning The Future Prospectus

Some of issues which need to be revisited in ensuring success of the schemes are:

Standardization in price and quality

The key findings of the research survey (Dec, 2014) conducted by FICCI (The Federation of Indian Chambers of Commerce and Industry)⁴, consisting of 5000 respondents across 33 cities, was as follows;

- Sentimental attachment to gold jewellery has been observed to be diminishing with time, and would face other investment alternatives parting away from gold as compared to their parents and peers. And,
- There is a need for standardization in the physical markets with respect to quality and price.

The research findings fall parallel with the views of the industry too, according to which BIS authorized hallmarking centers which are extended arms of BIS are not reliable in terms of the quality, as close to 70 percent of the hallmarked jewellery fails to confirm to their marking standards⁵.

⁴ Why India Needs A Gold Policy, FICCI-World Gold Council report, December-2014

⁵ Gold Monetization Scheme can bring Idle gold to industry use, www.economicstimes.indiatimes.com, Nov 6, 2015

Attractiveness of the schemes for individuals and banks

Indian households though have been assumed to be sitting on 20,000 tonnes of gold, they would not invest in any scheme if the return is not attractive. The Gold Deposit Scheme, 1999 was unacceptable to the investors mainly due to the reason that, the interest rate charged on the deposits did not exceed more than one percent. Thus, the lessons learnt from the past has been revisited in the present schemes by increasing the deposit rates between 2.25 -2.5 percent (for medium and long-term GMS schemes) to encourage investors. The other characteristic, which remains unaltered, is the exemption of the deposit schemes from income tax, wealth tax and capital gains tax.

So the important questions which needs to be asked are, whether

- Indian Banks consider these guidelines provided, sufficient and financial viable to participate by offering these schemes at lucrative interest rates. And,
- Indian investors would change their preference to mobilize idle gold, to be put for more productive use.
- Indian government and Central Bank of India would further consider taking steps in line with measures taken in Turkey and China in rebuilding infrastructure around gold such as gold exchange and world class London Bullion Market Association certified refineries that produce gold bars and coins which would facilitate in developing domestic market.

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