Gold Monetization Scheme

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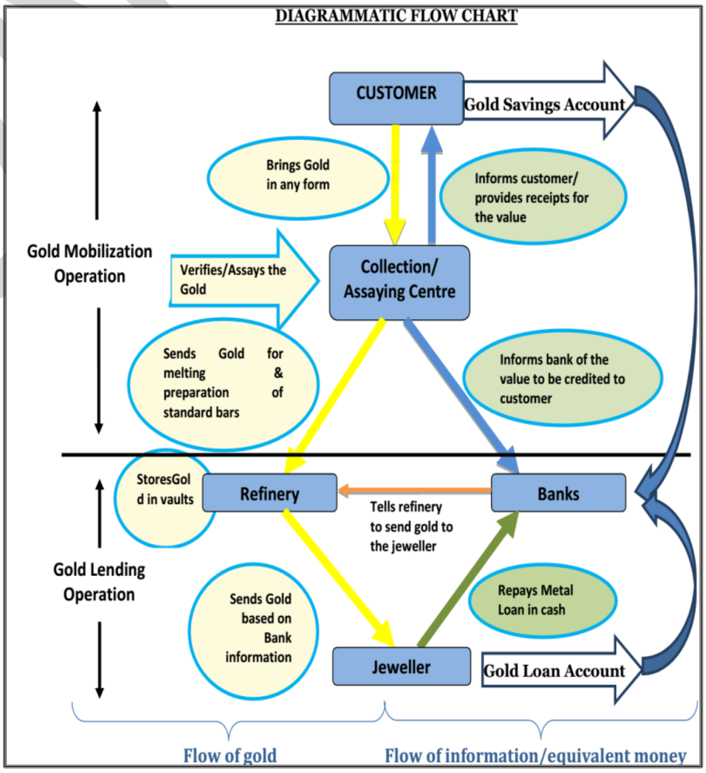
1 Background

- The government has launched, amidst plenty of fanfare, three new schemes to monetize gold in the country — the Gold Monetization Scheme (GSM), the Sovereign gold bond and gold coin.
- The underlying objectives of all three are laudable. Households in India hold a large amount of their savings as physical assets — gold, silver and other precious metals and real estate. Gold especially has for long held a tremendous attraction both as an investment avenue as well as a store of value.
- Indian households and temple trusts may hold as much as 22,000 tonnes of gold. India imported 967 tonnes of gold in 2014-15 and the import bill was $34.4 billion.
- The demand for gold puts serious pressure on the import bill of India. As it impacts the growth and investment, the government has been under pressure for some time to bring down the import bill to fix macroeconomic fundamentals of the economy.
- To reduce physical demand for the yellow metal and to bring into circulation the idle gold lying with households, GSM is right step in that direction.

2 Proposal of the Scheme

- The (GMS) will offer **resident Indians** the option to deposit their precious metal and earn interest of up to 2.5 per cent, while the Sovereign Gold Bond will offer investors an interest rate of 2.75 per cent per annum on the paper bonds issued by the government.
- When a customer brings in gold to the counter of specified agency or bank, the purity of gold is determined and exact quantity of gold is credited in the metal account.
- Customers may be asked to complete KYC (know-your-customer) process.
- The deposited gold will be lent by banks to jewelers at an interest rate little higher than the interest paid to customer.
- Both principal and interest to be paid to the depositors of gold, will be 'valued' in gold. For example if a customer deposits 100 gm of gold and gets one per cent interest, then, on maturity he has a credit of 101 gram.
- Following are the steps in GMS-:
    - Purity Verification and Deposit of Gold.
    - Opening of Gold Savings Account with the banks.
    - Transfer of Gold to the Refiners.
    - Utilization of Deposited Gold.
    - Lending the Gold to the Jewelers.
- The tenure of gold deposits is likely to be for a minimum of one year. The minimum quantity of deposits is pegged at 30 gram to encourage even small deposits. The gold can be in any form, bullion or jewellery.
- Customer will have the choice to take cash or gold on redemption, but the preference has to be stated at the time of deposit.



3 Benefits of the Scheme

- **Consumers-:**
    - Fall in prices of the gold.
    - Consumers earn interest on the gold otherwise lying idle in the households.
    - The Carrying cost for gold is saved.
    - Gold will be securely maintained by the bank.

- It will ascertain the purity of gold held by people.
- Redemption is possible in physical gold or rupees hence giving your gold purchase further earning opportunity.
- Earnings are exempt from capital gains tax, wealth tax and income tax. There will be no capital gains tax on the appreciation in the value of gold deposited, or on the interest you make from it.

- **Government-:**
  - The import bill of India can go down by 10 to 20 per cent even if 1% of the gold lying with people is deposited into banks under the scheme.
  - Strengthening Macroeconomic health of economy by reducing Current Account Deficit (CAD).
  - GSM may lead to greater investment and accelerate the growth.
- **Banks-:**
  - Banks may sell the gold to generate foreign currency. The foreign currency thus generated can then be used for onward lending to exporters / importers.
  - Banks to buy and sell on domestic commodity exchanges, where mobilized gold can be delivered.
  - Lending to jewelers and earn extra cash.
  - Bank may convert mobilized gold into coins for onward sale to their customers.

4 Analysis of the Scheme

The idea to monetize gold is by no means new. In fact, various schemes to tap the gold hoard already exist. Though launched with a lot of fanfare, they have garnered very little subscription. GMS needs to avoid the lacunae in the existing Gold Deposit Scheme (GDS) launched in 1999, which could garner only 15 tonnes.

Hurdles in the success of the scheme-:

- Despite the reduction of the minimum limit, individuals would be worried that if they pledge a significant amount of gold with banks, the income-tax department may want to know the source of that gold. Experts feel that the government should clarify the amount that can be pledged without income-tax scrutiny and possible harassment.
- Other big hindrance will be the tax on conversion of physical gold into the gold deposit scheme. It demoralizes consumers to monetize the gold.
- There is need to build the infrastructure for operationalizing and monetizing to promote efficiency as well as transparency. Currently, on both counts the infrastructure is lacking.
- The gold held as jewelry will be very difficult to be monetized. The point has been made several times before that there would be a sentimental objection to parting with jewelry, which in many households are passed on from one generation to another.

Implementation

- In first two week the scheme attracted only 400gms gold. A shortage of centres to assay the gold being put on deposit is a problem that acted as roadblock.
- The industry has urged the government to allow Bureau of Indian Standards-certified jewellers to act as collection agent for GMS, and the finance ministry has already given in-principle approval to the suggestion.
- The government has also decided to allow gold depositors to give their gold directly to the refiner without involving the collection and purity testing centres, in a bid to encourage bulk depositors.

Suggestions

- For the gold market to enlarge, banks should not only receive but also sell gold in a two-way process involving bid and offer. Simultaneously, efforts must be made to link ordinary bank accounts such as savings bank account and recurring deposit to gold.
- Experts in field urged government to increase the interest rate to 4% to attract more gold.
- There should be perfect liquidity in the GMS accounts where the consumer has chosen equivalent cash as the exit option. It will make this kind of holding more liquid and much safer than physical gold, and at the same time allow the consumer to enjoy a small interest payment in gold.

5 Conclusion

The new norms issued by the Reserve Bank of India (RBI) in consultation with the government are based on suggestions to make the scheme more accessible for potential gold depositors, and allow premature redemptions after three years and five years for medium term and long term deposits, respectively. These suggestions if implemented can go a long way in ensuring that GMS does not go the same way as the GDS, at least as far as the consumer side of the equation is concerned.

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