Monetization of Gold in India

Charan Singh and Sharada Shimpi[1]

To develop gold markets, it is essential to recycle gold within the country. The schemes announced by the government would generate more employment opportunities in fields such as assayers, hallmarking, high security transportation and warehousing.

Gold holds a unique significance in India. For thousands of years, the preference for gold has been influenced by many social, religious, economic and cultural factors. In India, gold, a liquid asset, is widely recognized for intergenerational transfer of wealth as it is considered to be the most efficient and secure store of value.

As the demand for gold in the country is substantial and domestic sources insignificant, India depends heavily on imports. Import of gold was considered to be the prime contributing factor in the widening CAD. Consequently, the Government and the Reserve Bank of India (RBI) took several measures to curtail gold imports and were successful in lowering the CAD to manageable levels from 4.7 per cent of GDP in 2012-13 to 1.7 per cent in 2013-14. The restrictive gold import policies in India have had limited effect on demand but triggered recourse to unauthorized channels like smuggling, causing loss of customs duty to the government.

In the Union Budget 2015-16, Finance Minister stated that India is amongst the largest consumers of gold, importing around 800 - 1000 tonnes annually, and that the stocks of gold are estimated to be over 20,000 tonnes. In view of high demand and attitude of Indians towards gold, the Union Government took the initiative of monetizing gold stocks held within the country. The proposal was announced in the Union Budget of 2015-16, through three schemes: Gold Monetization Scheme (GMS); Sovereign Gold Bond (SGB) and Indian Gold Coin (IGC). IGC would involve developing a coin with the Ashok Chakra on its face, and help in reducing the demand for coins minted outside India and in recycling the gold available within the country. The minting of IGC, mostly used for investment purposes, would also contribute in generating employment and aid in retention of related profits within India.

Among the three proposals introduced in the Union Budget, draft guidelines for two have been issued by the government. While the draft GMS aims to mobilise idle gold within India, the objective of draft outline of the SGB scheme is to divert the demand from physical gold to 'paper gold'. The SGB scheme is mainly an endeavour to divert some of the estimated 300 tonnes of annual demand for gold bars

The restrictive gold import policies in India have had limited effect on demand but triggered recourse to unauthorized channels like smuggling, causing loss of customs duty to the government.

and coins, and cut down demand for physical gold. As these bonds are sovereign backed, SGB would provide a reliable alternative to gold investors in the country. In the first year, if the SGB scheme is subscribed as per the government's estimate of 50 tonnes and given that the maximum bonds an entity can buy is 500 gms per person per year, a maximum of 1,00,000 entities can participate in SGBs, annually.

Select issues and suggestions

The Government through the above schemes is primarily making efforts to encourage recycling of gold within India and reduce the pressure on imports that ultimately impact the CAD. Following are a few issues and suggestions to contribute towards effective implementation of the schemes:

- GMS will need supportive infrastructure to be successfully implemented. This includes the need to have a widespread network of purity testing centres, and storage and distribution services across the country, given that gems and jewellery industry in India is fragmented and about 80 per cent of the overall market consists of local and independent stores.Currently, there are 350 BIS certified hallmarking centres across India. These may not be sufficient to serve a large country with nearly 640 districts. There may be a need to have the purity testing centres in every district and city.
- To address the fear amongst investors that GMS aims to unearth black money, Government could consider a provision that gold monetization of 100 grams or less would not require any identification documents or KYC norms.
- GMS would require extensive financial literacy campaign to spread awareness on hallmarking and providing information about the scheme, such as location of the centres and facilities provided for safe and secure transactions.
- The banks would need to strategize and strike a balance between their payments and receipts of gold and determine appropriate interest rates, in order to make GMS a lucrative scheme, for all parties involved. This may entail the banks to pay 2 per cent to 3 per cent annually as interest in gold.
- Government and the RBI can consider permitting commercial banks holding mobilized gold, to include a part of such holdings as a component of reserve requirements. In view of the experience of Turkish Central Bank, India could attempt implementing this measure soon.
- The price risk of SGBs will have be taken into account by the government. It would be important to have a constant flow of demand for bonds to be

The draft GMS aims to mobilise idle gold within India, the objective of draft outline of the SGB scheme is to divert the demand from physical gold to 'paper gold'

purchased and sold and make this a perpetual annual scheme with several buyers and sellers in the market. Though the government does not intend to hedge against the risks in the first year, implications of rising gold prices would need to be reflected on. As a possible strategy, the government could consider opening a 'Gold Equalisation Fund', essentially to manage such risks over the years.

- IGC will be minted on the basis of gold available in the market. The government would need to build the stock of gold for such purposes in a gradual manner so as not to impact the market price when it enters the market to purchase gold or sell gold coins.
- Responsibility may be assigned to a Designated Corporation (DC) or an institution by the Government and all gold imports should be channelized through that DC, which should be tasked to ensure high quality of gold in the country. Also, progressively, it should be made mandatory that all gold sold in India has to be hallmarked and meet the gold standards set by the DC. India, with a large demand of gold in the country, could consider establishing its own gold standards.

Conclusions

The concerns for a developing country like India should be to conserve foreign exchange for essential commodities like importing capital goods which enhance production and growth, and not on consumption items like gold. To develop gold markets, it is essential to recycle gold within the country. The schemes announced by the government would generate more employment opportunities in fields such as assayers, hallmarking, high security transportation and warehousing. The development of the gold markets could help the country become a regional hub in gold refining and recycling. To discourage smuggling and also improve custom duty collections, the Government could consider reducing import duty on gold. Monetizing gold will aid in unlocking high volume of dormant-money that could strengthen the economy by providing purchasing power to the households and much needed liquidity to the micro-enterprises. If implemented appropriately, gold monetization could prove to be a constructive and growth enhancing initiative for India.

....

[1] Charan Singh is RBI Chair Professor of Economics and Sharada Shimpi is Research Associate, IIM Bangalore.

■■■

Disclaimer: Views are personal and not the views of the publisher.