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RECYCLING TRADITION: THE GOLD MONETIZATION SCHEME IN CONTEMPORARY INDIA

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Abstract: India's love for gold is well well-known and recognized. The country shares a unique relationship with gold that is both complex as well as enthralling. Gold in India finds universal acceptance across jewelers, traders and investors offering instant liquidity. It acts as a store of money and is sometimes used to park unaccounted money. The Gold Monetization Scheme was launched on 5th November, 2015 by the Prime Minister of India Mr. Narendra Modi. The scheme is designed to help you earn interest on your unused gold lying idle in bank lockers. The Gold Monetization Scheme is basically a new deposit tool to ensure mobilization of gold possessed by various families and institutions in India. It is expected that the scheme would turn gold into a productive asset in India. This new gold scheme is a modification of the existing Gold Deposit Scheme (GDS) and Gold Metal Loan Scheme (GML), and it would replace the existing Gold Deposit Scheme, 1999.

Keywords: Gold Monetization scheme, Gold Deposit Scheme.

I. Introduction

India: One of the largest consumers of gold since thousands of years, gold has been an integral part of the Indian households. For many people, gold is equally viewed as a safe, protected investment; an exclusive way to preserve their wealth. Investors have considered gold as one of the best sources of value due to its durability, easily movable and universally acceptable, and therefore one of the safest avenues of investments in the world. Additionally, gold is conventionally considered a good inflation hedge and during times of inflation the price is likely to rise. Even with these benefits, gold has not been an exceptional long-term investment and has suffered through many phases of underperformance, which are generally followed by shorter periods of strong gains. Nonetheless, gold may be a suitable holding as part of a diversified portfolio focused on safety. However, it is vital to think that gold does not provide any income and is therefore not appropriate for investors interested in generating cash flows from their portfolios. The preferences of people for gold in India are influenced by many factors such as social, economic and cultural. In India, gold is regarded as a liquid asset and hence widely recognized for intergenerational transfer of wealth as it is considered to be the most efficient store of value. In the last few years, gold imports have also

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been rising significantly. India accounts for more than a quarter of global gold imports despite being the contributor of less than 2 percent in the global trade. India is the largest buyer and consumer of gold in the world, accounting for approximately 26% in the year 2015.

Gold has a great advantage of liquidity, availability and universal acceptability along with no availability of other investment avenues, particularly in rural India, has made gold a favorite investment avenue for Indian retail investors. Indian weddings generate approximately 50% of annual gold demand. India is one of the largest consumers of gold and nearly 95% of its annual gold demand is met through imports. This puts burden on the country's fiscal management. India imports 800-1,000 tons of gold every year. Out of the total imports, around 350 tons of imported gold is in the form of coins and bars. India imported gold worth US\$4050 billion annually between 2010 and 2013. Imports, in US dollar terms, came down to US\$34 billion in 2014 on the back of import restrictions, fall in international gold prices. In the last eight years (2007-14), India imported gold worth about US\$270 billion.

According to World Gold Council, over the next decade, there are likely to be 15 million weddings per year in India, where more than half of the population is under 25 years of age. Along with the above factors, this is likely to keep gold demand buoyant in India.

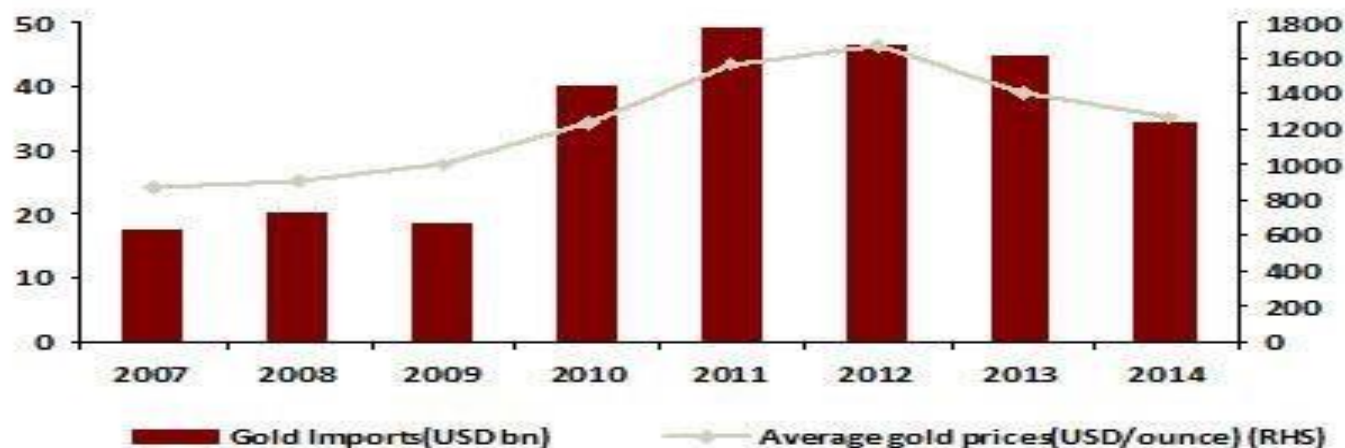


Fig 1: India's annual gold imports have significantly increased in last few years (Source: ICICI Securities)

It has never been an easy task to formulate the policy on gold. Policies around gold (and to some extent business plans and financial innovations related to gold) have all largely been based on a couple of assumptions;

- Demand for gold in India will never fade;
- People in India will not part with their gold easily;
- Women are sentimentally attached to their jewelry and hence will not part with it;
- If given a choice between cash or gold, Indian people will opt for gold. At various points of Indian history, one or all of these assumptions have been true.

Gold makes a valuable contribution to Indian economic growth as well. It is estimated that at least 2.5 million people are employed by the gold industry and, according to consultancy PricewaterhouseCoopers, gold boosts economic output in India by at least \$30 billion per annum.

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Indian government is trying to show how gold can become an asset for the Indian economy, rather than a liability. The purpose of this exercise was simple: to discover why Indian consumers buy gold, why they sell it and how they would respond to initiatives aimed at monetizing gold in India.

II. Objectives

1. To study the gold monetization schemes in India.
2. To study Gold Monetization Scheme, 2015
3. To compare Gold Monetization Scheme, 2015 with Gold Deposit Scheme (GDS) 1999.

III. Literature Review

Gold has been uniquely important to the Indian economic system since very long because of the religious, social, cultural ritualistic and behavioral reasons. Reddy (1997) discussed about the importance of gold in Indian system. Trivedi and Behera (2012) provided a comprehensive review of how gold prices in India are related to macroeconomic variables. Reserve Bank of India (RBI, 2013a) states that demand for gold in India cannot be compared with other parts of the world. The 1.3 billion population of India would continue to generate demand for gold; the demand is from both investors and gold jewelry consumers. The benefit that it offers by way of long-run inflation hedge, high liquidity and the absence of substitutes with similar risk-return profile makes it an attractive asset to store. The convenience of cash based transactions and absence of documentation (no paper trail, tax obligations, etc.) further makes it a preferred channel for money laundering. Hence, attempting to curb gold demand in India would be a difficult and complex task. RBI (2013a) also mentions that “the price of gold is inelastic”. Thus, gold demand is relatively unresponsive to rising prices, and import bans would simply cause the “consumers to take recourse to unauthorized channels to buy gold”. This indicates the complex behavior of Indian consumers with respect to gold price which does not match the typical investor profile.

Balaji and Maheshwari (2014) found that in Indian jewelry market, consumer preferences are expected to lead to a more professional industry while share of family jewelers is expected to decline over the next few years. Anand and Tulin (2014) shows a strong correlation (0.83 for the 2006Q3–2013Q2) between gold imports and inflation expectations of Indian households, indicating that one reason for high gold demand is its use as an inflation hedge. Gallagher and Segara (2011) concluded that classical ETFs in Australia provide investors with returns commensurate with the underlying benchmark with lower tracking error relative to index managed funds. The variation between net asset value (NAV) and traded price for ETFs is small, and does not occur with high frequency.

Snehal Bandivadekar and Saurabh Ghosh (2003), BSE Sensex incorporates only the market effects; the reduction in volatility due to “future’s effect” plays a significant role in the case of S&P CNX Nifty.

Goyal and Joshi (2011) concluded that investors are investing in Gold ETFs for earning fair and sure profits in future. The prices of Gold ETFs have less variation than the index of NSE, hence investment in Gold ETFs is increasing over the time period. The investor confidence in Gold ETFs is increasing and therefore the future of Gold ETFs is bright in India.

Gayathri and Dhanabhakyaam (2014) exhibited the co-integration and casual relationship between the Gold price and the NSE Nifty. There is a uni-dimensional relationship between the selected variables. The change in the gold price also changes the stock market indicator, NSE Nifty.

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Vipin Kumar Aggarwal et al. (2013) demonstrated that the gold ETFs have lesser variability as compared to the physical gold and concluded that the performance of gold ETFs is better than the performance of physical gold.

Shefali Sinha and Mahua Dutta (2013) concluded that the Goldman Sachs Gold exchange traded fund is consistent in generating better performance, which is dependent on its lower tracking error.

Hundal et al. (2013) examined the perception of retail investors towards purchase of gold. The study provides strong evidence that despite hike in taxes and depreciating rupee, unless the consumers get suitable alternatives which meet their respective needs, people don't want to shift away from gold, rather they are treating gold as a safety buffer. Another major advantage for gold being preferred is that it has multiple characteristics which very few other assets have - high liquidity: both in terms of ease of en-cashing it or availing a gold loan from bank but also the resale value (very small deduction while reselling); conventional value and cultural values it holds for the consumers.

Prashanta Athma and Suchitra (2014) enunciated that the demat form of gold investment options viz. Gold Futures, Gold ETFs, Gold FoF and E-gold are better than the physical form of gold. An investor can make investment in any demat form of gold investment options as there is no significant differences in the return of the various demat form of gold investment options.

It is evident from the above literature review that the study hasn't been conducted on the comparison of Gold Monetization Scheme 2015 with Gold Deposit Scheme (GDS) 1999.

IV. Research Methodology

The present research paper is an attempt of descriptive research, based on the secondary data sourced from various research papers, journals, magazines, articles and media reports. The available secondary data was extensively used for the study.

V. Historical Background of Gold Monetization Schemes in India

Efforts to monetize gold stock in India is not a decade-old phenomenon. More than 50 years ago, in November 1962, 15-year gold bonds were allotted having an interest rate of 6.5% per annum. In March 1965, a new series of 1980 gold bonds were allotted at 7.0%, whose interest rate was revised to 6.5% after seven months in October 1965. However, unlike the previous two issue of bonds, the repayment of which were in rupees equivalent of gold, these bonds were redeemed in gold of standard quality on maturity.

The Central government undertook gold auctions in 1978-79 to curb smuggling and contain local prices (proceeds from the auctions were meant for bridging the fiscal deficit gap) after more than a decade. The gold auctions were, however, not continued because of denunciation. Afterwards there were a lot of developments such as review of the gold policy in 1986 and the Reserve Bank of India (RBI) suggesting the setting up of an institutional mechanism called „Gold Management Corporation“ (GMC) to mobilize gold in 1992, and Gold Bond Scheme (GBS) 1993 was launched for a period of three months between March to June 1993. With a minimum offering of 500gms, subscribers could buy five-year gold bonds carrying a fixed lump sum interest payable on maturity. However, the RBI offered to buy back those bonds after three years at lower than market prices.

This scheme replaced gold bonds in 1999. Banks were allowed to float the scheme after the RBI's approval, but banks did not show much of the interest. State Bank of India (SBI) launched the scheme in November 1999,

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discontinued it later and then introduced it again in 2009. The decision of rate of interest was left to the banks discretion. SBI paid 1.0% for three-year gold deposit; 1.25% for four-year gold deposit and 1.50% for five-year gold deposit in 2009, which were changed to 0.75% for three years, and 1.0% for four-five years in 2010. In the early 2013, RBI relaxed the norm, but it still could not take off. In all, GDS failed to achieve the desired objective of monetizing gold stock in India and reduce imports of the yellow metal.

VI. The Recent Gold Monetization Scheme, 2015

With the approval of the Prime Minister, Shri Narendra Modi, Gold Monetization Scheme (GMS), was introduced in the Union Budget 2015-16. This scheme was introduced to replace the existing Gold Deposit Scheme, 1999. The deposits outstanding under the Gold Deposit Scheme will be permitted to run till maturity unless these are withdrawn by the depositors prematurely as per existing instructions.

This scheme can be implemented by all Scheduled Commercial Banks excluding RRBs. A comprehensive policy should be formulated by the banks who intend to participate in the scheme. All designated banks will be eligible to implement the scheme.

Under this scheme the following persons are eligible to make a deposit - Resident Indians (Individuals, HUFs, Proprietorship & Partnership firms, Trusts including Mutual Funds/Exchange Traded Funds registered under SEBI (Mutual Fund) Regulations and Companies). Joint deposits of two or more eligible depositors are also permitted under the scheme and the deposit in such case shall be credited to the joint deposit account opened in the name of such depositors. The current rules regarding joint operation of bank deposit accounts including nominations will be applicable to these gold deposits.

6.1 Deposit allowed under Gold Monetization Scheme 2015

An investor has an option to deposit gold for short, medium and long term under the Gold Monetization Scheme. The scheme would permit an investor to deposit gold in two different deposits i.e. Short Term Bank Deposits (SRBD) and Medium and Long Term Government Deposit (MLTGD). The term of a Short Term Bank Deposit is 1-3 years. The Medium and Long Term Government Deposits can be opened for 5 -7 years and 12-15 years respectively. The Short Term Bank Deposit would be accepted by individual banks on their own account. But the Medium and Long Term Government Deposits would be accepted by banks on behalf of the Government of India based upon announcement issued by the Reserve Bank of India.

6.2 Objective of Gold Monetization Scheme 2015

The very objective behind introducing the modifications in the scheme is to make the existing scheme more operative and to widen the range of the existing schemes from merely mobilizing gold held by households and institutions in the country to putting this gold into productive use. This will also lead to the reduction of country's reliance on the import of gold to meet domestic demand. Talking about its significance, the scheme would benefit the Indian gems and jewelry sector which is a major backer to India's exports. The mobilized gold will also strengthen RBI's gold reserves and will help in reducing the government's borrowings.

6.3 Key features of Gold Monetization Scheme 2015

The Gold Monetization Scheme comes with the following features:

The scheme accepts a minimum deposit of 30gm of raw gold in the form of a bar, coin or jewelry.

There is no maximum limit of investment under this scheme.

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The scheme allows premature withdrawal after a minimum lock-in period. However, it charges penalty for such withdrawals.

All designated commercial banks would be able to implement the Gold Monetization Scheme in India. The scheme would offer interest at 2.50% per year which is higher than previous rates offered on gold investments.

The short term deposits offered by Gold Monetization Scheme can be redeemed in either gold or in rupees at current rates applicable at the time of redemption.

VII. Comparison of Gds with Gms

	Gold Deposit Scheme 1999	Gold Monetization Scheme 2015
Objective	To mobilize a portion of privately held stock of gold and use it for productive purpose.	To mobilize the gold held by households and institutes in the country.
Minimum quantity	500gms	30gms
Tenure	Earlier it was three to seven years. The maturity period was modified and now it ranges from six months to seven years since February 2013.	At least one year with a roll-out in multiples of one year.
Procedure	The obtained gold will undergo preliminary test, after which the depositor will be given an option. If the depositor back off, he pays a nominal fee and leaves. If the depositor agrees,	The obtained gold will undergo preliminary test, after which the depositor will be given an option. If the depositor agrees, gold will be melted using fire assay. The depositor will be
	Gold will be melted using fire assay. The designated bank shall issue (a) Gold certificate or (b) Statement of account or (c) Passbook	Given the option again. If the depositor back off, the melted gold can be taken back by paying a nominal fee. If the depositor does not back off, a certificate will be given by the collection center.
Tax exemption	Exempted from income tax, wealth tax and capital gain tax.	Exempted from income tax, wealth tax and capital gain tax.
Premature redemption	Allowed	Allowed
Redemption	Option to redeem gold certificate either in gold or in cash (equal to the price of gold as on the date of maturity) to be decided at the time of application or once during the tenure.	Option to redeem either in gold or in cash to be decided at the time of making the deposit.
Interest payment	Payable in cash at fixed intervals or at maturity, as decided by the bank.	Interest to be paid will be „valued“ in gold.

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Depositors	Resident Indians (Individuals, Hindu Undivided Family, Trusts, and Companies) Mutual funds/Exchange Traded Funds registered under SEBI (Mutual Funds) Regulations allowed in February 2013.	Resident Indians (Individuals, HUFs, Proprietorship & Partnership firms, Trusts including Mutual Funds/Exchange Traded Funds registered under SEBI (Mutual Fund) Regulations and Companies).
Interest rate	1% for 3 years; 1.25% for 4 years and 1.50% for 5 years in 2009. Revised in 2010 to 0.75% for 3 years and 1% for 45 years.	Interest rates offered to depositors in the range of 0.75-1%. Rate of interest to be offered has been left to the banks to make it competitive.
Utilization/deployment of deposited gold	1. Rupee loans may be given against collateral of gold deposits; 2. Gold loans to domestic jewelers and jewelry exports; 3. Outright sale of gold domestically; 4. Export/import of gold scrap/refined gold and exemption from customs duty	1. Lending to jewelers; 2. Outright sale of gold domestically; 3. Export/import of gold allowed to generate forex reserves; 4. Buy/sell gold on domestic commodity exchanges.
CRR/SLR treatment	CRR: The banks which are exempted from maintaining CRR on liabilities under gold deposits, have to maintain minimum CRR on total net demand and time liabilities (NDTL) SLR: The mobilized gold with the bank will constitute an eligible asset under SLR if the bank holds gold with itself in physical form.	Proposes permission to deposit the mobilized gold as part of the bank's CRR/SLR requirement with RBI. This is under examination.
Expected benefits	1. To provide depositors the opportunity to earn interest on their idle gold holdings; 2. To reduce the country's reliance on gold imports; 3. Free owners from the problems of storage, movement and security of their gold possessions	1. To reduce the reliance on gold imports over time; 2. To provide a fillip to the gems and jewelry sector.

Source - Nirmal Bang Institutional Equities Research, May 2015

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Conclusion

Gold monetization within the nation is essential for macroeconomic stability, and requires a sound scheme for valuing, storing, and tracking the metal. Hence, Gold monetization scheme is considered to be the need of an hour for the country like India. From the given fact that India has surpassed China in gold import per year, it would only be prudent for people to take benefit of this scheme and monetize their idle lying gold.

Considering that India, which has around 20,000 tons of idle gold lying with households, has no reason to be described as a deprived country. The public should take benefit of the golden opportunity to help India march to a golden period since it provides an opportunity to earn additional returns on idle Gold Jewelry.

By studying the various aspects of the scheme, it appears that the various intricacies are involved into the implementation such as the tripartite agreement between refiners, banks and collection centers. Also, investor has the option of either taking the cash or gold at the time of maturity and once exercised cannot be changed.

Also, it would be unwise to expect households to actively participate in any schemes that involve „melting“ the long-preserved jewelry. Similarly, it will be challenging to persuade temple trusts to part with their gold possessions since the gold lying in temple domes are linked to faith and religion. Hence, the government can achieve the target only if the Indian households and temple trusts contribute and actively participate in it. Only, time will tell whether the scheme is successful or not.

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