

Will the gold for cash scheme pay off?

The monetisation plan has been well received but needs additional measures

India sits on a gold mine -literally. The government reckons that Indian households hoard as much as 22,000 tonnes of gold, an estimate that the World Gold Council concurs with. But how useful is all this gold when its monetary utility lies frozen? The government, therefore, has proposed a gold monetisation scheme that will mobilise the idle gold for release into the economic ecosystem.

In the past two years, India imported around 750 tonnes of the yellow metal. Before the government took measures to check the inflow of gold in 2013, more than 1,000 tonnes came in annually, adversely reflecting on the current account deficit. In 2012-13, gold imports cost the country \$56 billion - the second largest item on the import bill after crude oil. The new scheme, the government hopes, will help reduce the imports.

Monetisation of idle gold is not a new idea. An earlier gold deposit scheme, in the 16 years since its inception in 1999, has brought 15 tonnes of gold into the open, almost half of it from temples that get the metal from devotees.

WORLD GOLD COUNCIL SUGGESTIONS

Banks to be allowed to accept gold deposits

Minimum deposit could be 10 grams

Disclosures on ownership may be waived for deposits up to 500 grams

The National Democratic Alliance government's aim is to change the mindset of Indians regarding gold. So, in addition to monetisation, it is planning to launch sovereign gold bonds and India gold coins.

In his Budget speech, Finance Minister Arun Jaitley had said the gold bonds would "carry a fixed rate of interest, and also be redeemable in cash in terms of the face value of the gold, at the time of redemption by the holder of the bond", while the Ashok Chakra-stamped India gold coin would help reduce the demand for coins minted abroad and facilitate recycling of the gold available in the country.

The monetisation scheme entails the holder depositing purity-tested gold that he doesn't need immediately in banks to earn interest in the form of grammage of gold. Banks will lend the deposited gold to jewellers, who otherwise would import their requirements. On maturity, the proceeds will be paid in cash or, if the depositor wants, in gold.

Financial planners as well as jewellers have received the plan well. However, Gaurav Mashruwala, a Mumbai-based financial planner, feels that depositors may not agree to melt their jewellery at the time of making deposits. "If interest and repayment are offered in gold as proposed in the draft scheme, I would suggest depositing idle gold in the form of coins and bars," he says. As far as investing in gold to balance the investment portfolio is concerned, he advises investment through "exchange traded funds which are easy to encash".

Jewellers are optimistic that the scheme will prove advantageous to them. "We estimate that just 1 per cent of the gold reserves invested over the past decade can help bring down imports by 50 per cent in the first year," says Rajiv Popley, director of jewellery house Popley Group that has operations in India and Dubai. "Consumers can invest in this scheme in the form of gold bars and earn returns without liquidating their gold. They can thus meet any future requirements for financial security."

Potential roadblocks

There are, however, two factors that will affect how successful the scheme proves. The first is the tendency of Indians to buy gold with cash, leaving the origins of purchase funds undisclosed. The second relates to the infrastructure for assaying and testing of gold, melting and storing it.

Credit cards are usually not used in buying gold because of both the costs incurred by jewellers (which they pass on to consumers) and the value added tax on finished jewellery. There is an ease in cash transactions for those who would want to park their unaccounted cash in gold.

Thus, many bullion traders suggested to the government that a gold monetisation scheme would succeed only if no questions were asked about the source of funds. The government did not oblige, but as Popley says, "amnesty schemes are different from monetisation programmes. Both have different objectives."

Gold has always been linked with black money. An example of tax leakage can be found in Kerala, a big market. A revenue official says on condition of anonymity that a report of the Kerala Public Expenditure Review Committee 2012-13 declares "the actual tax revenue realised from gold is Rs 394 crore, only 43 per cent of the potential".

Sales tax on jewellery in Kerala is 5 per cent, higher than in other states where it is only 1 or 1.1 per cent. Calculations based on India's gold consumption as published by the World Gold Council, and assuming that 15 per cent of it happens in Kerala, show the turnover from jewellery business should be Rs 30,000 crore in the state. At 5 per cent sales tax, the collection should have been Rs 1,500 crore - the actual collection falls much short of this.

Similarly, Maharashtra, which is a large bullion and jewellery trading hub with sales tax of 1.1 per cent, has seen collection rise from Rs 3,175 crore in 2011-12 to Rs 3,483 crore in 2013-14.

According to the revenue official, the collections should actually have been at least Rs 10,000 crore. Figures from other major gold bullion trading centres like Jaipur, Kolkata and Ahmedabad show similar tax evasion.

Apart from checking black money, the monetisation scheme would also have to consider the expansion of the infrastructure for assaying and testing gold as well as melting it. Existing schemes require banks to carry out these exercises. An official from one such bank says, "Currently, we are not promoting gold deposits because of the (excessive) workload in collecting gold to assaying and getting it refined."

While the new scheme puts the onus of assaying to hallmarking centres, there are only 350 in the country, and more importantly, not all of them have melting facilities. The key to the success of the government's project, says Ketan Shroff, spokesperson for the Indian Bullion and Jewellers Association, is "expanding this infrastructure". That will determine the ultimate success in bringing gold kept in households into the economy.

(Business Standard)