Gold Monetization Scheme: Flaws that Prevent Scale

Prof Arvind Sahay, Head, India Gold Policy Centre-IIMA

Over the past 35 years, the government has attempted several times to collect and / or use the stored gold (as ornaments or bullion) in India. Estimates suggest that there is more than 22000 to 25000 tons of stored gold in India in private hands. At current prices in July 2016, that is Rs. 300,000 X 22= Rs. 66,00,000 crores (or $ 990 billion) - that is half of India's GDP and in the same ball park as the bank deposits in the country. The argument is that monetization will release money back in circulation and it will be available for useful economic activity.

The latest Gold Monetization Scheme launched in 2015 is part of this long tradition. And like all other attempts, this one too will fail. Let us look at why.

First, a very large proportion of the gold holdings exists as jewelry with individuals. Temple gold is actually a small proportion - but it is a low hanging fruit. And Indians have tended to have a deep emotional connect with gold jewelry. And are very loath to part with it. They want to keep it in the physical form.

Consider, for example, the following. A top manager of a leading listed firm in India recently asked his wife about her gold holdings weight so he can declare his assets under the new requirements. The wife tells him that what gold she had was hers only and that it was none of her husband's business. And that was that. And across many houses the same story repeats

in many households. Therefore, there has to be a change to this cultural aspect of the attachment to gold. Incidentally, this kind of attachment to gold does not exist in the United States and Western Europe.

Neuroscience suggests that changing these kinds of deep rooted behavior requires interventions that provide the nudge required to get people to change their behavior. That these behaviors related to gold are embedded in the unconscious. And influencing these embedded ideas requires a concerted campaign on the part of the government. Campaigns that are designed with "minimum necessary change" interventions.

We might even argue that the dominant form of attachment to gold is as "Streedhan" for women who were not working and for whom it was a form of security. And carrying the argument further it could be said that the newer generation of women in India are economically independent and not so attached to gold. And that as these women become a larger part of the female gender cohort that the demand for gold jewelry would anyway decline. And that the right "minimum necessary change" campaign would accelerate the move away from gold and increase the chances of success of the gold monetization scheme.

However, the bottom line is that without a concerted campaign directed at individuals that is based on addressing the neurophysiological bases of desire for gold, the amount of gold deposited under the scheme will be limited - is unlikely to go above a very small fraction of the total gold available. And a 2.5% return on a deposit is not that attractive, even if it on gold, a previously non-interest bearing asset class.

Second, there is the issue of assessing the purity of the jewelry that the person is taking to the

jeweler or the CPTC or the refiner before it goes to the bank as a deposit. Because, the bank will only accept certified gold. Who will certify the gold? Where does the credibility come from? How will the gold that is collected at different places be aggregated and transported?

Without this credible certification, the individual is unlikely to deposit the gold even if she wants to. Some reputed jewelers now have karatometers in their showrooms. However, each one of these machines costs more than INR 10 lakhs and not all jewelers may be able to afford them. By and large, preliminary research suggests that people tend to take back the jewelry, if at all, to the jeweler that they had bought the piece from.

So, the second bottom line. How to reassure the depositor of the grade of gold that has been submitted. Should it be the jeweler where the deposits will be made? Or should it be the CPTCs? And what will the banks accept? Because, ultimately the deposit is on the books of the bank.

Third, we are yet to think of a good commercial reason for banks to take gold as deposits. For the large scheduled commercial banks, gold is a very small part of their overall business. Fluctuations in the value of gold do not make gold a reliable deposit. It is not clear as to why banks should devote the kind of resources to make the scheme a success. One possible way is the creation of gold banks that have been mooted but not in their present form - but as separate organisations within existing banks.

So the third bottom line, what is in it for banks?

To sum up, unless the Gold Monetization Scheme addresses the issues above, this scheme like the ones before it will also not garner more than a small fraction of the gold with individuals. Less than 1-2% - which would be under 400 -500 tons.

Surely, not the intention of the scheme?

....

About Author

Arvind Sahay Ph.D. (University of Texas Austin), P.G.D.M. (IIM Ahmedabad), B.Tech. (IIT Kanpur), is Professor of Marketing and International Business, Dean (Alumni&External Relations), Head (India Gold Policy Center). Professor Sahay joined IIMA in June 2004 from London Business School where he had been teaching since his Ph.D. in 1996 from the University of Texas at Austin.

Professor Sahay has been a visiting faculty at the Mason School of at the College of William and Mary (USA), University of Texas at Austin (USA), IIM Lucknow, Asian Institute of Technology, (Vietnam), Gordon Institute of Business Science, University of Pretoria (South Africa), SP Jain Institute of Management Research (Singapore, Dubai), Retail Alliance (Dubai) and Indian School of Business, Hyderabad. Professor Sahay can be contacted at asahay@iima.ac.in or arvin.sahay@gmail.com.

▪▪▪