CARMINE
COMMUNICATIONS

Client: IGPC	Date: 8th July, 20
Publication: Financial Express	Page No: 9

All that glitters is indeed gold

ARVIND SAHAY & SUDHEESH NAMBIATH

Sahay is chairperson and Nambiath is head, India Gold Policy Centre, IIMA. Views are personal

The relevance of gold to the Indian economy is more than apparent

THE 1992 RBI discussion paper *'Gold Mobilisation as an Instrument of External Adjustment'* noted that "gold reserves are as good as foreign currency reserves and could be deployed for purposes of meeting short-term external payment gaps and more importantly for undertaking a comprehensive programme for sustained and stable economic growth." This perspective holds strong even today.

An individual or a firm willing to sell gold, who is otherwise constrained by taxes and regulations, could see this as a route to get cash in hand. An efficient mechanism can be created to route the proceeds to invest in assets that are just as liquid, or a new venture that can increase investment in the economy or towards consumption spending. In India, people would pledge their gold to buy a car, but are willing to sell if they have to buy a house or invest in business or take a fresh plunge in equities. If one can consider incentivising routing the proceeds to G-Secs, it can also help both ways. Since the gold is being sold, there is little direct negative wealth effect on the citizens that are selling gold, as the seller is getting cash, ruling out negative wealth effect. It puts money in the hands of people, enabling both consumption and investment. Equally important, it allows the government to create more money backed by collateral in the form of gold to finance new expenditure.

The mobilised gold that is unhedged held by RBI can be used for borrowing or doing a swap transaction for dollar or any other reserve currency at a rate lower than in the market. Also a debt issued against gold or tying the money supply to the mobilised gold helps improve the sovereign position. This is built on the premise that fiscal deficit will increase but at a higher rate with an accelerated growth in GDP, but this growth in fiscal deficit will not negatively impact credit ratings.

To remind one of the numbers, if 1,000 tonnes of gold got mobilised, i.e. ₹4,50,000 crore, it is equal to 20% of revenue receipts

South Korea mobilised over 200 tonnes in three months at the peak of the Asian crisis; post World War 2, nations who succeeded in mobilising gold from its public and managed it well, have prospered. So, it is a myth that nations haven't flourished. Swapping only the idle gold with a more liquid and interest bearing asset with a LTV much higher than gold will be useful for the nation. We need to keep in mind that while some gold does get re-circulated through gold NBFCs and other financial institutions, more than 70% of the estimated private gold holdings in the country doesn't get circulated. To remind ourselves of the numbers, if 1,000 tonnes of gold were mobilised, i.e. ₹4,50,000 crore, it is equal to 20% of revenue receipts.

Most nations adopt conventional methods of issuing long-dated bonds, perpetuity bonds and other such instruments, but time and again these have proven to get nations into a vicious cycle of debt and ultimately credit rating downgrades through defaulting on loans and bankruptcy. Brazil and Argentina come to mind. Also, they do not have a choice because these are not the countries where households sit on so much wealth that it amounts to almost half of the country's GDP.

Coming to Korean example, although volumes mobilised in Korea were not enough, they stopped the mobilisation due to an overwhelming response; the signal that had been sent to the markets was strong enough. What it achieved was the willingness amongst citizens to participate actively to get the economy back on track. The Indian economy has been slowing for the past few years and needs a catalyst to regain its momentum. Of course, a lot of regulatory reforms are also required—for any purported mobilisation of gold to work efficiently and effectively—but that is another story.