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The Role of Gold in the International Monetary System and Gold Based Financial Instruments

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Extensive Summary

Introduction

Gold has been existed in each period of the finance history, it is directly used as an exchange tool and a substantial reserve for the financial system. Besides it has been a saving and investment tool amongst the investors. Today gold still remains on the agenda within various financial tools. The reason of preparing this study is the development achieved in Turkey recently, relating the Gold Bonds/Gold Certificates which is one of the gold based financial instruments contributing to the economic growth via "gold under mattress" belonged to the individual investors.

Though gold no longer functions as coin; it still remains as a substantial tool to reserve for central banks, decrease the probable risks, provide liquidity and inspire confidence within the international financial system by these institutions. In this regard the most important feature of gold is its purpose of usage: Gold is both used in jewelry due to the fact that it is a precious metal and it has been used as a financial instrument throughout the history. Because gold is used to make jewelry, it is considered to be an important status indicator of households. The public authorities have been tried various ways to bring in this metal to the economy and minded gold to be remained in the economy directly, which is used both saving, investment and status.

As it is seen from the economic reports; the demand for gold is quite high in Turkey, but the supply is limited unlikely. Before 1980 gold has been brought to inland illegally, however; the demand is almost met via liberalization transactions and import of gold.

Although the gold is used as an exchange tool throughout the history, it exists within the financial structure systematically. While "Golden Coin Standard" underlied the basis of monetary system between 1873 and 1914, Bretton Woods system fixed the dollar to the gold in 1944-1973 period (Seyidoğlu, 2003).

According to Aslan (1999: 3); gold is a kind of metal easy to shape, chemically resistant, non-corrosive, resistant to oxidation, having high electrical and thermal conductivity, reflective and used in the industrial field extensively. Its atomic number is 79, atomic mass is 197, specific weight 19,3 gr/cm^3, melting point of gold is 1.064,43 ^{o}C, boiling point is 2.807 ^{o}C and stability of gold is 119 kg/m^2, technically (Aslan, 1999, p. 3).

Gold has the property of being a continuously valued mine. According to the reports on gold reserves around the world; while 1-ounce (1-ounce gold= 31,10 gr. pure gold) gold price was 695,39 USD in 2007, it is 1.259 USD for 2017. So that the price of gold has increased about 81% rate in a 10-years period (O'Connell et al., 2017: p. 11).

It is evaluated that Turkey's gold production is few also the top 5 countries ranking (China, Australia, Russia, USA, Indonesia) to produce gold worldwide by 2015 and 2016 has not changed (O'Connell, 2017: p. 27). According to the updated data of Turkey's Energy and Natural Resources Ministry; the weight of gold produced in Turkey is 27,80 tons by 2015 (http://www.enerji.gov.tr, Accession Date: 21.10.2017).

Before evaluating the role of gold within monetary system, it is known that gold is utilized as an exchange tool for a long period. However, the former researches have revealed that there is not a current date on which a complete consensus has been reached, about the first usage of gold. There are 3 significant probabilities detected, regarding the first use of gold, as follows:

(1) There are several significant references in Turkish language claiming that gold is first used in Egypt about 3200 BC (Sağlam, 1993: p. 4),

(2) There are references in English claiming that gold is first used in China about 1090 BC (http://www.jewelleryytt.com),

(3) There are references claiming that coins being made of gold and silver mix are used in Egypt about 700s BC (http://www.goldankauf-pro24.de).

Though it is not clear about which one of the probabilities is correct; their mutual view means that the first use of gold was in ancient history period. So it is detected that gold has been an indispensable value for centuries.

The gold is traded in various markets mostly in (a) spot, (b) futures and (c) loan markets around the world. A continuous and reciprocal interaction is existed between each of the mentioned markets (Rodoplu, 2002, p. 106).

Due to the emerging of gold based financial tools; golden savings especially belonged to households can be brought in monetary markets to be traded.

1. Gold Backed Securities

Gold backed securities is not traded in Turkey yet. It is a financial tool based on paying the credits offered by banks especially to jewelry industry on "gold" or "Turkish Lira convertible to gold". So that, it is suggested to have an "asset backed securities" form (Rodoplu, 2002, p. 110-111).

2. Gold Accumulation Plans

The mentioned investment tool is not applied in Turkey yet, due to the lack of correct application field. Gold Accumulation Plan means reserving a specific amount of money by the investors to buy gold continuously. Though the Gold Accumulation Plans are not existed theoretically in Turkey as we mentioned here; Gold Backed Bank Accounts have been operated and it is mentioned in other subtitle. (Gold Backed Bank Account is another investment tool by which investors deliver their -generally 22 or 24 crats- golden savings to the banks and have "golden saving accounts". Hence, the investors acquire interest/profit shares at the end of the period as gold or Turkish Lira.)

3. Gold Backed Bank Account

As it is mentioned above; these accounts are similar to deposit accounts in the banks. All kinds of gold (unrefined, refined, etc) are accepted by the bank so that the investor may have a "time account" or "checking account". The delivered gold is appraised in pure gold scale by the bank to have a uniform size, its value is recorded within the bank account and the interest rate is detected. The mentioned interest relating the period and the capital invested in the bank can be paid as gold, Turkish Lira or foreign currencies at the end of the period (Rodoplu, 2002, p. 111-112).

4. Gold Backed Credits

Commodity credits are not defined by our regulations yet. According to the notification of Turkish Treasury (No: 2008-32/35); the commodity credits can be defined as delivering the precious metals (gold, silver, platinum) over its pure amount, to an individual or an institution for a certain time and value (Fidan, 2016, p. 109).

Any individual or institution to pay the commodity credit back (the gold backed credit) at the end of the period should pay "the current value of gold in Turkish Lira" or "hand in the gold physically".

5. Gold Mutual Funds

A notification is published in the Official Gazette of Turkey on 19th December 1996 to benefit the investors by a new financial tool, then. It allows the investors, who bought "the gold funds" by the "gold mutual funds", to act as they have a specific weight of physical gold they paid. The probable losses or revenues are varied due to changes in gold prices.

6. Gold Futures and Options

The basic reason for future and option transactions is suggested to be the uncertainty and protection of the individuals and institution themselves against the risks. So; future and option contracts do not include a far too different working principle for gold. They are the contracts to allow the gold, having standard features in certain amount, to be traded on a specific period and price detected before (Rodoplu, 2002, p. 113).

7. Gold Certificates and Gold Participation Certificates

While the bonds issued by conventional banks are called as "gold certificates" or "gold backed bonds" in practice, similar tools are named as "gold participation certificates" if they are issued by a participation bank. No matter they are called as gold certificates, gold backed bonds or gold participation certificates; their working principles are the same. The process is briefly as the following: Gold is delivered, in exchange for the certificates, to the issuer institution or mediator so that the certificate holders earn interest or profit share in a certain period. The mentioned certificates can be issued to the bearer or they may be registered type securities.

Consequently; all the regulations are made in order to have the gold to be earned by the economy via removing them from the places where they are kept by individual investors. So to say; the gold acquire convertibility little less than coins and these arrangements are to encourage individual investors to reveal their golden savings and contribute to the economy by creating a diversity in the economy.