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All That Glitters...Will Not Solve Europe's Debt Woes

European governments have a lot of gold. But that won't be much help.

By LIAM PLEVEN

Fact No. 1: European governments are among the biggest holders of gold on the planet. Fact No. 2: Massive debts owed by some of those governments are fueling a political crisis in Europe and turmoil in markets around the world.

Those two facts lead to an obvious question from a lot of investors: Why don't those governments sell gold to pay off their debts?

If only it were that simple.

For starters, not even the Europeans own that much gold. The borrowing needs, and subsequent debts, of countries like Italy, France and Spain are so huge, analysts say, that liquidating their gold reserves wouldn't go far toward balancing their books for the long term.

"If they sold their gold, I'm not sure it would do anything to their credit rating," says Kenneth Rogoff, an economics professor at Harvard University who has studied official gold reserves. "This is not exactly a game changer."

Market and political realities, too, would make it challenging for Europeans to rely on a golden parachute, experts say. For one thing, there's a risk that trying to sell the gold or use it as collateral for a loan could be seen in the market as a sign of desperation—which could drive up borrowing costs by making lenders even more wary, defeating the purpose.

Awash in Gold

Nevertheless, some investors still need convincing that gold isn't the cure-all that Europe is seeking. After all, governments, central banks and multilateral financial institutions like the International Monetary Fund hold roughly 18% of the world's gold, according to the World Gold Council, a trade group. Italy has more gold than any nation besides the U.S. and Germany, the council says. France ranks fourth and Portugal 12th. Even Greece, the land of King Midas, is in the top 30, well ahead of wealthy nations such as Australia and emerging powers like Brazil.

And with gold prices near a record in nominal terms—up 17% this year alone—the value of those holdings has soared in recent years. Italy's current gold holdings, now valued at $134 billion, would have fetched only $21 billion at the end of 2000.

A Pale Yellow

Official gold holdings and government debt as a share of GDP for selected countries

	Gold holdings	Government debt
Spain	11.2%	60%
Portugal	9.3	93%
Italy	6.7	119%
Germany	5.8	84%
France	5.3	82%
U.S.	3.1	94%
Greece	2.0	143%
China	1.0	34%

Note: Value of gold holdings is based on Dec. 7 gold settle price of $1,740.90. Debt is based on International Monetary Fund definition of general government gross debt.

Sources: World Gold Council; International Monetary Fund

The other side of the coin, however, is that Italy's gold represents only about 6.7% of its gross domestic product. Portugal's supply is proportionally bigger, at more than 9% of its GDP. But cashing in its gold would barely make a dent in Portugal's government debt, which represents 93% of GDP, according to IMF data.

In addition, European Union members accepted restrictions on using their gold reserves when they launched a common currency. The euro treaty prohibits the countries from financing government operations by selling gold held by central banks—which is where most European nations have their reserves—according to Natalie Dempster, the gold council's director of government affairs.

Protecting the Euro

Using gold to finance state operations "is simply not an option," she says. The gold, Ms. Dempster adds, is mainly there to protect the euro.

For euro-zone nations, similar hurdles apply to the idea of using official gold as collateral to borrow at cheaper rates than investors are currently offering. But Europe could in theory transfer some gold held by member states—or the European Central Bank, which has its own bullion—out of reserves and use it to partially back a bond issue, according to Ms. Dempster.

A similar notion was recently raised in a paper issued by the European Commission, she says. In the gold council's view, that would require the ECB to determine that the move supported member states' economic policies and didn't interfere with price stability.

An additional hurdle for governments when it comes to gold markets is an accord known as the Central Bank Gold Agreement, which is signed by many European nations and, like the euro treaty, limits gold sales by governments, according to the gold council.

Even if a nation found a way around such obstacles, officials could face a backlash from voters who believe gold prices will keep rising. Before 2010, many European nations were net sellers of gold, which some of them had come to view as an antiquated asset.

"That," says Harvard's Mr. Rogoff, "turned out to be not such a good idea."

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