

Why Gold?

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During the last couple of years, there has been a rising interest in gold. Why is that? Are there any good explanations for it? Isn't gold after all a 'barbarous relic', as Keynes put it?

Why the rising interest?

One of the more common explanations for the rising interest in gold is that it acts as a hedge against volatility. By adding yet another asset class, and this being an asset class that is to some extent uncorrelated to the others, one can expect lower overall portfolio volatility (or higher return at the same volatility). Gold could thus stabilize the portfolio.

Another explanation is that gold is seen as a safe haven for those that are concerned about inflation (or deflation) and all the bad effects that might follow from it. No fiat paper currency is known to have lasted forever, something the dollar bugs easy forget. Gold is something different.

A third explanation for the rising interest is of course that the gold price has risen a lot against almost all currencies. With a stock market not performing as dictated *von oben*, people start looking for alternatives. As I write this, gold trades at around USD1,350 per troy ounce and at all time high. Even if the gold price has risen a lot lately, comparing a graph with known past bubbles, it is evident that there's still a long way to go before it reaches real bubble levels. The gold price is still way below the inflation adjusted price from the last gold boom of the 1970's and early 1980's.

A fourth explanation, not so common perhaps but still valid, is that gold can serve as a kind of life insurance. Owning and possessing physical gold might be very important if something goes really bad. I have friends that have escaped from civil war and they tell me gold paid their way and saved them. Even though not so drastic, as fiat paper money becomes worth less and less, get less and less accepted, or even completely worthless, it could prove extremely important to have gold to pay for basic necessities like food and shelter. It's not good enough to keep a gold bar in a Swiss vault, but you need then to possess well-known gold coins and small bars at home. I know many have at least a full year's income at home in gold and silver coins and small bars.

Why is gold so special?

Taken this background, what it is that makes gold so interesting in all these ways. Why not silver, copper or platinum? Why not diamonds or something else?

There are a number of reasons that makes gold special and it turns out that most of them are quite natural.

Firstly, gold is a noble metal and thus is prone neither to rust nor tarnish and does not oxidize. This means that gold can be stored for a long time without being ruined. Hence, most of the gold ever found is still around and available today.

Another purely physical characteristic of gold is that it's divisible. You can divide it into smaller and completely identical parts and then re-unite them again through melting. You can repeat this as many times as you wish and as long as you can secure the fineness of the gold, one ounce is just as good as the other.

These first two purely physical characteristics also result in a third, namely that it's easy to transport. It isn't ruined during the time it's transported, it won't be ruined by dents etc, and can even be made into shapes suitable for transportation.

Characteristics like these in turn open up for a world market price in gold. The only difference between gold from one place to another is the fineness, something relatively easy to take into account. This is quite different from many other goods where there isn't any world market price. Take for example eggs; they aren't very durable, divisible or easy to transport and the market naturally becomes very local.

Gold has many different industrial uses. It is a great conductor of electricity and pure gold is very soft, malleable and elastic. For example, one ounce of gold could be beaten into a sheet covering 100 square feet and an ounce of gold can be drawn into a wire 60 miles long.

Gold is available on all seven continents and has had some importance everywhere, for example as jewelry. Nowadays the jewelry business has a great impact on the gold price, like often seen during the Indian wedding season.

Gold as a unit-of-account

But gold is important also because of other reasons, reasons that follow directly from the purely physical characteristics. One is that it is suitable as a unit-of-account as it shows great stability. For example, a secretary in 1st century Rome earned 15 denarii per month, which translates into about USD2,200 per annum (One silver denarius was 4.5 gram silver and 1 gold aureus was worth 25 denarii. Since one troy ounce is 31,1 gram and with gold at USD 1250 per troy ounce, we get these numbers.). A secretary today earns about USD33,000, i.e. 15 times as much. This translates into a yearly nominal salary inflation of about 0.1%. Compare that to a modern-day nominal salary inflation of say 2% measured in USD as unit-of-account (a bit low perhaps). To see the difference over a period of 2,000 years, the compounded effect would have been those 15 for gold and a massive 158,614,732,760,369,000 for the USD. So do we have high or low inflation today, dear reader?

Thus, compared to any paper fiat currency, the stability of gold as a unit-of-account is rather startling. This is the case even taken into account the huge changes that came about by the European discovery of the gold of the so-called new world. After all, the USD has lost more than 95% of its value since the Fed was established.

This also explodes the usual belief that we all become richer by earning higher salary, while the truth is that the higher purchasing power comes from the ability to produce things cheaper and

in smarter ways, as well as inventing completely new things. This is often obscured by the high inflation of modern-day paper fiat currencies.

But why is a stable unit-of-account so important? [Ludwig von Mises](#) described almost 100 years ago that no advanced society could exist without sound accounting. By calculating revenue, costs, profits and losses, people can plan their lives and businesses. They can figure out, indirectly, what complete strangers want and thus assist others in fulfilling their plans, coordinated through freely adjusted market prices. The amount of planning that takes place through this kind of decentralized planning far surpasses the amount of planning involved in any central planning ever attempt at. Literally billions of people are now doing this on a daily basis. But a poor and unstable unit-of-account can make things much harder and create many of the social problems we see around us today. Mises was right, something not only proven in practice, but also by the leading theoretical socialist of his time.

The availability of gold – a surprise?

But how come gold is so stable as a unit-of-account? One might believe it's because gold is so rare. Gold is after all ranked as the 58th rarest substance on this planet. All the gold ever found is possible to fit into a 20x20x20 meter cube. And you might also have heard people saying that gold is so rare that there isn't enough for all the people and goods around today.

Taking this into account, I think that most people are surprised to learn that gold is so suitable as unit-of-account because of its availability. In fact, gold is one of the most available things on this planet. This is because if you put the available gold in relation to the annual use of gold you end up with a ratio of around 60. This "stocks-to-flow-ratio" indicates that the existing stocks of gold available today would last about 60 years if no new gold was supplied.

The metal next in line is silver, with a ratio of about 1.5. The same ratio for copper is 1/3, i.e. all existing silver and copper would be used up within about 1.5 year and 4 months, respectively. Similarly, even if more steel is produced per hour than the gold that ever has been found, the steel is soon used up and the gold not. In this way, gold has a very high degree of availability, much higher than most other things produced.

Most people are aware of the fact that the more we have of a thing the less we value it on average, i.e. most things have a declining marginal utility (Carl Menger's [Principles](#) is still one of the best texts around explaining this, despite being published in 1871). Gold is probably the thing that to the least extent has a declining marginal utility. We might even go as far as saying that it seems almost to be constant. This might explain why people put so much energy into finding new gold when gold already is one of the most available things. If people would have economized a little, smaller stocks might have sufficed, one might think. But throughout the ages, millions or billions of people have reckoned otherwise.

Thus, it's the availability of gold and the almost constant marginal utility that combine with all the purely physical characteristics to make gold suitable as a unit-of-account.

Extinguisher of debt

One last and highly relevant characteristic for gold is that it's suitable for extinguishing debt. All over the world, private persons, companies and governments have added debt to astronomical

levels, although mainly in the West. Not only minor countries like the so-called PIIGS countries but also major countries and economies like Japan, the UK and the US are in big trouble.

But how can these people repay their debt? Is it possible at all? I'd say no, because they don't have the means to do it. Are they going to use Fed notes, etc? But these in turn are debt on the Fed's balance sheet and so on, so the debt is only transferred, it doesn't disappear. How then could debt be distinguished?

The only way to repay a debt is by repaying with something that isn't at the same time a debt (no surprise). In practice, this often means that it has to be a tangible thing. But you can't expect others to accept a payment just because it's tangible, you can't expect people to accept your sofa or TV. Neither your old car nor your house. No, it has to be something you easily can add up and compare, to value, to store, to transport, that have many uses, that is readily available in most places, still has a stable value and that is a pure asset and not a debt in any way.

Any candidates?

Well, we have just read about one serious candidate, i.e. gold. Gold is probably the only asset that could eliminate the mountains of debt we see today. And the folks in the governments of China, Russia, Nepal, etc, have already realized this. Hundreds of millions of people around the planet has also already realized this. Or rather, they haven't forgotten, or they haven't been brainwashed into believing gold is simply a 'barbarous relic'. They are accumulating gold. For example, in China the government is running TV ads (available at youtube) encouraging people to have at least 5% of their assets in physical gold and you can get gold coins and bars at any decent shopping mall, at banks and at airports. I know it's the same in Russia, and I wouldn't be surprised if it's the same in India.

Meanwhile, in the West and Japan the debts are rising, central banks sell gold and the big players are trying to keep the gold price down, despite sitting on large gold reserves that could be their best chance to survive the debt crisis. Amazingly stupid people, one might think if it wasn't so sad to think badly of other people.

An objective conclusion

The mountain of debt started to rise dramatically that day in 1971 when Nixon made the US default and the government dropped the connection between gold and the USD. The debt will continue to rise until the day gold is [remobilized](#), because it's the only thing that really can reduce the level of debt in a decent way, short of default.

We have now asked ourselves why there's a rising interest in gold, why gold is so special, why it's suitable as a unit-of-account, why it's so stable and how gold can help in the current debt crisis. If you summarize all these findings, I believe there's only one objective conclusion – there is nothing like gold on this planet.

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