

Posted 11.01.2010



The Economist: Why gold?

As a 'standard' it's essentially useless

By Tucker Hart Adams

I was in New York City a few weeks ago and had a chance to tour the New York Federal Reserve Bank. One of my graduate fields was in monetary theory, so I was excited to visit the place that is the heart of monetary policy execution.

Decisions made by the Open Market Committee of the Federal Reserve Board to buy and sell treasury securities - the Fed's tool for affecting interest rates - are carried out by the New York Fed.

However, the tour ignored that aspect of the Fed's responsibilities. Everyone but me was there for one purpose - to visit the gold vault five stories underground where hundreds of billions of dollars in gold bars are stored. After a visit to the coin collection and a movie on how cash is handled, we headed down 80 feet to Manhattan bedrock and the gold.

Close to \$300 billion in gold bars belonging to several dozen central banks, foreign governments and official international organizations are stored in 122 cages labeled with a number identifying the owner. Bars weigh 27 pounds and are moved by hand, an arduous task. As I looked at the hoard and watched other tour members stick their finger through the mesh cages to touch a bar, all I could think of was "Why?"

Gold coins were last minted for circulation in the U.S. in 1933, and paper currency has not been backed by gold since 1971. The U.S. dollar is only as good as the full faith and credit of the United States government. Except for the small amount used for jewelry, decorations and filling teeth, gold is essentially useless. You can't eat it, drink it, use it to keep you warm or protect you from the elements. If you were unfortunate enough to become locked in the gold vault, which cannot be opened until the timer allows it, you'd have enough oxygen for 72 hours but nothing else of any use.

I was reminded of the stone money of the Island of Yap. For several centuries the Yapese used giant stone wheels called rai to execute certain exchanges. Rai were made from a special limestone quarried several hundred miles away and shipped to the island.

Although 10 percent of the adult male population was employed in the money-cutting business, the stones had no significance other than as a representation of value. They weren't functional, spiritually significant or ornamental. The largest were too difficult to move when a transaction was executed, so they remained in front of the home of the original owner, although everyone knew the wealth had been transferred elsewhere.

One piece of lore tells of a stone that was lost in a shipwreck. The village council met and concluded that it still represented a portion of its owner's wealth, since he had quarried it and had lost it through no fault of his own. The fact it wasn't where it could be seen was irrelevant.

Stones in front of village homes in Yap or gold in cages 80 feet below the New York Fed. What is the difference? We haven't come very far from Yap, have we?

I serve on several foundation investment committees, and I always refuse to vote for investing our assets in gold. It's not that I don't recognize that gold often increases in value if people are uncertain about the future. It's just that someday a child will point out that the emperor has no clothes and the value of gold will plummet.

If you bought gold in 1980, at a high of \$825.50 an ounce, you may think you'd made money when it reached \$1,300 an ounce. In fact, your asset has declined 41 percent in value. Ignore all of the hype about gold prices setting a new record. Gold today would have to reach \$2,187 an ounce to match its 1980 high after adjusting for inflation. And for 30 years your investment paid no dividends.

I'm not offering investment advice. That's something I never do. But when people argue for a return to the gold standard, remind them that the world had both inflation and deflation then.

Tell them about the Island of Yap.

Tucker Hart Adams, president of the Adams Group, monitored and analyzed the Colorado economy for 30 years. She can be reached via her website, coloradoeconomy.com.

<http://www.cobizmag.com/articles/the-economist-why-gold/>