

The value of gold



Many bloody wars have been fought because of gold, and many precious lives have been lost over it. But what is it? And how valuable is it to us? Those questions are perhaps better answered using an old English saying: “When we have gold we are in fear; when we have none we are in danger” (McCalman, 2001). For starters, gold is a rare, yellow, lustrous metal. Since the beginning of time, man has valued it because of several reasons.

Firstly, gold is important to man because of its aesthetic value. Gold is beautiful, warm and sensual – all at the same time. It is a symbol of richness and immortality. For over six millenniums, “gold has been used extensively in making various adornments such as medallions, crowns, tiaras, rings, cuff links, necklaces, bracelets, brooches and all sorts of jewelry” (McCalman, 2001). That it is generally friendly to the human skin, has endeared gold even more to people. Gold has also been used in artistic works. Notable among them were the golden gods and statues made by biblical figures like Aaron and Roman emperors like Nero.

Secondly, gold is important to man because of its medical value. Being biocompatible, gold has been widely used in the medical arena. For example, gold-coated stents have been used in heart surgeries, where they are inserted into blocked arteries to ease blood flow. “Other medical implants that contain gold include pace makers as well as insulin pumps” (McCalman, 2001). Gold has also been applied in microsurgery of the ear since it has a high degree of protection against bacterial colonization. In pharmaceuticals, gold has aided doctors in administering accurate doses of powerful drugs to the parts of the body where they are needed without either causing harm to the body, or reducing the effectiveness of the drug. This has particularly

proved crucial in the treatment of HIV/AIDS and cancer. Dentistry has also benefitted from the use of gold. Numerous patients have had their cavities filled with gold inlays.

Thirdly, gold is important to man because of its engineering and industrial value. “ Gold is a very reliable and effective conductor of both heat and electricity” (Bernstein, 2004). It is also inert therefore does not react when in contact with other substances. Furthermore, it neither wears away nor discolors. These properties make gold significantly useful in the manufacture of mobile telephones, car airbag systems, computer keyboards and various other things we need today. Fourthly, gold is important to man because of its social value. For thousands of years, people have viewed items of gold as some of the most precious gifts that could be given to family and friends during special occasions like weddings, anniversaries, birthdays, religious holidays, public holidays, graduations and so no.

In addition, the mining of gold has contributed considerably to social development; particularly in the third world. Thanks to gold mining, social necessities such as hospitals, schools, transport and communication networks, power lines and water supply have been made available; thereby making life easier and better for locals. It is safe to assume that were it not for gold mining, “ leading gold exporters like Mali, Tanzania, Ghana, Guyana, Guinea, Papua New Guinea, Peru, Mongolia, Kyrgyzstan, Uzbekistan, Zimbabwe and South Africa would not be where they are today in terms of social development” (Lewis, 2007).

More essentially, gold is important to man because of its economical significance. Gold is not merely a commodity to be used in aesthetics, medicine or engineering. Gold is money. “ Veteran American economist, Allan Greenspan defines money as the common denominator of all economic transactions” (Bernstein, 2004). For any commodity to pass as money, it must first be unanimously suitable to those who would use it as payment for their goods or services. Secondly, it must be durable. Thirdly, it must be divisible, and by extension, portable. Fourthly and importantly, it must be scarce. When a commodity is scarce, it becomes desirable and in high demand; and therefore acceptable. Fifthly, it must be homogenous. Lastly, it must be an efficient store of value. Over the years, “ several commodities have been acceptable as mediums of exchange – for example cattle, seashells, tobacco, salt, grain, silver, gold, and paper money, which is currently predominant” (Sowell, 2011). Some individuals are of the idea that compared with these other commodities, only gold fully satisfies the criteria for money.

Majority of people in various parts of the world consider gold the best option when it comes to saving money. They believe that the safest way to ensure economic security against high inflation levels, unstable currencies or even personal misfortunes is to save money – not in form of US dollars, sterling pounds, Euros, yens or yuans – but in form of gold. Fiat money, they argue, “ can lose value and become worthless overnight (especially as a result of political uncertainty, war, social unrest, increasing national debt, currency failure and so on) and is therefore not a reliable store of value” (Sowell, 2011). Gold in contrast, has a way of keeping its real value over a protracted

period of time. This explains why in countries like Vietnam for instance, home sellers ask to be paid the full value of their homes in gold. As is the case with many other countries, purchasing a home in Vietnam can be a very lengthy process. And because the value of the Vietnamese dong keeps on fluctuating on a daily basis, home sellers often fear that should they be paid in paper currency, they would not get real value for their property.

A considerable number of people in the world also view as gold the most ideal option when it comes to investment, especially during times of economic hardships and high inflation. Gold, they believe, is better than stocks because regardless of the ups and downs on the stock market, gold will never go out of existence or be rendered worthless. This explains why whenever the stock market begins to take a nosedive; some investors quickly turn their investments into gold to protect themselves from inflation. The fact that gold is tangible further endears it to a majority of people.

Many investors appreciate that when they invest in gold, they invest in an actual physically-present product, as opposed to stocks which would just be a mere imaginary representation of their investment in a company. However, it is important to mention that whereas gold may be a secure option for trading as compared with stocks, it may not be the most profitable investment in the long run. Given political and economic stability, stocks and bonds are regarded better than gold when it comes to their return on value. Thomas Sowell in his book, *Basic Economics*, argues that even though gold is a safe way to invest, it in the long-term does not hold its value compared to stocks and bonds. He writes that, “ while a dollar invested in bonds in 1801 would be worth nearly a thousand dollars by 1998, a dollar invested in stocks

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that same year would be worth more than half a million dollars” (Sowell, 2011). “ Meanwhile, a dollar invested in gold in 1801 would by 1998 be worth just 78 cents” (Sowell, 2011).

Some central banks in the world also still consider gold vital when it comes to building their reserves and defending their currency against the all-conquering US dollar. Currently, gold accounts for almost 10% of reserves held by central banks. This is despite the fact that gold no longer plays a pivotal part in the international financial system. What attracts these central banks towards gold is perhaps the fact that gold is the only reserve asset that is no one’s liability. “ This means that unlike other world currencies, the value of gold cannot be affected by the fiscal policies of a country or undercut by inflation in that particular country” (Lewis, 2007). For example, no government can create more gold at will in order to achieve its economic goals. Gold cannot be rejected by any central bank anywhere and owning it is a protection against potential future crises. Gold also injects the much needed diversity to a central bank portfolio because of its low correlation with major currencies and its solid inverse correlation with the American dollar. The central bank of Argentina, for example, when diversifying a portion of its reserves away from total dependence on the US dollar a few years ago, included gold in its purchases. Other countries which have considerable amount of gold reserves include China and India.

Being the valuable commodity that it is, the pricing of gold has been a matter of concern and a subject of greatest mystery to many an economist. Several theories have therefore, been used to try and explain the pricing of gold – ranging from the ritualistic use of voodoo to the ridiculous study of <https://assignbuster.com/the-value-of-gold/>

cow dung manure patterns and finally, to the more reasonable theories that are currently being advanced. One theory that has been put forward to explain gold pricing is called the safe haven hypothesis. This theory postulates that when investors become fearful for their investments as a result of uncertain economic trends, they see gold as a safe haven to preserve their investment.

They therefore buy gold in large quantities and in turn, increase its demand. This consequently revises the gold prices upwards. In simple terms, the safe haven hypothesis claims that gold returns increase as fear among investors increases, and reduce as fear among investors reduces. This theory has been disputed on the basis of the fact that there have been times in history when there was great economic turmoil, yet the prices of gold remained relatively low. Similarly, there have been times when world economy was fairly stable, yet the price of gold skyrocketed. For example, despite the economic stability that prevailed between 1978 and 1980, the price of gold rose significantly. Again, despite the economic difficulties that characterized the period between 1998 and 2003, gold prices fell by a considerable margin. The same is true of the late 1990s when economic uncertainty rose to rather high levels but the gold prices plummeted.

The safe haven hypothesis however, has some elements of fact. For example, the period between 1987 and 1988 was very volatile economically. This was reflected in the prices of gold, which rose significantly. Objective research has however, shown that economic volatility and gold prices are uncorrelated and changes in volatility do not affect the prices of gold to the proportions that the proponents of this theory would have us believe.

Another economic theory behind the pricing of gold is the real interest rate hypothesis. This hypothesis suggests that as real interest rates in the United States increase, investors buy treasuries as these now carry a higher return. “ This reduces the amount of money available for buying gold, thereby reducing its price” (Eichengreen, 2010). In fact, some investors would even sell their gold to buy the treasuries since gold earns no interest. “

Proponents of this theory further suggest that when the US Federal Reserve runs a budget deficit or decreases interest rates, the demand for the dollar decreases” (Eichengreen, 2010). Subsequently, many people convert their dollars into gold as a defense against the loss of purchasing power due to changes in exchange rates that are unfavorable to dollar holders. This increases the price of gold. This theory is credible to a large extent. Gold, as highlighted earlier, is money. It is more of a currency than a commodity. “ As with other currencies therefore, interest rates have a direct bearing on its value” (Lewis, 2007). From 1982 to 1987, the value of the dollar rose as that of gold fell, again suggesting that the yellow metal has a very strong relationship with the dollar.

Another commonly-held theory that has been put forward to explain the economic valuing of is the inflation hedge hypothesis (Eichengreen, 2010). Briefly, this theory postulates the negative connection between anticipated inflation and the return of gold. “ There is also the global required yield theory or RYT, which was developed in 2003 by University of Albany professors Faugere and Van Erlach” (Eichengreen, 2010). This theory suggests that since global assets are valued to generate a global steady real

return and given that gold is a universal store of value, its price will vary directly with the global required yield and the global inflation rate.

Conclusion

In conclusion, it is worth noting that to-date; none of the theories discussed above or elsewhere have been considered convincing enough. Nonetheless, it is commonly agreed that to come up with an acceptable and reliable way of pricing gold, the yellow metal needs to be viewed, not a unique and mysterious commodity that is immune from any economic upheavals; but as a global currency whose value is an indication of the value of the US dollar and other key world currencies.