Tutorial : Gold Is Not Money - At Least In Our Current Economy publication date: Dec 19, 2009
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Proverbs 27:17 – “As iron sharpens iron, So a man sharpens the countenance of his friend.”

Introduction

I was recently presented with a great challenge to my economic hypothesis. I have often stated that paying back all debt in our nation would result in all of our money disappearing, since debt is the same as money. Debt represents owing your future labor to somebody else. Money represents being the master over somebody else’s future labor.

I then wrote an Economic Update on December 11, 2009 that stated gold and silver are both debt.

An astute reader challenged my assertions by pointing out that paying back debt and having no money left is only true with “fiat” currency – like our US dollar. People could still go out, find some gold in the hillside somewhere, and dig it up! Doesn’t this prove that gold operates differently than fiat currency within our economy? Doesn’t this also prove that money and debt are not equal – since being equal would require the same amount of each? Doesn’t this further prove that gold is not debt, since digging it out of the hillside yourself does not constitute debt?

As you can see, there is a whole litany of GREAT questions. Quite frankly, it took me quite a while to formulate an answer, since I was trying to make the questions much harder than they really were.

So let’s dig in and figure out what’s going on. The answer is as follows: “Gold and silver are not money in our current economy. They are commodities.”

Gold and silver as commodities

Whoah!!! That goes against the grain of a lot of current thinking! Why do I keep referring to “current” economy? It’s because this debate needs to be very particular with regards to the economic framework that we’re talking about. The term “current” economy will henceforth be used to refer to the macro-economic structure of the United States as it currently stands. I will capitalize it to make it easy to spot. I will then use the term “alternate” economy to refer to other micro-economies in our nation. Likewise, the term “alternate” will be capitalized for easy reference.

Gold and silver are commodities in the CURRENT economy – the same as oil. Precious metals are purchased with money in the form of US dollars, or some other recognized currency. They are also sold in return for the types of currencies that I described. However, gold and silver are not used in the CURRENT economy as money. Transactions are not paid for with gold and/or silver (Some pre-1965 coins have silver content, but only represent their printed face value in our CURRENT economy).

Don’t most industrialized countries have some stockpiles of gold? Yes, but those stockpiles represent commodities. They have worth, but they are not money used in trade in the CURRENT economy.

What does this tell us about gold and silver in the CURRENT economy? It shows that they are both backed by debt (US dollars, or some other foreign currency). Would they disappear if all debt were paid off? No. It's only money that would disappear, not other assets such as commodities. They just would not be backed by anything, since in our CURRENT economy money would cease to exist.

This is where I was wrong with my Economic Update from December 11th. I incorrectly stated that gold and silver were debt. They're not, because they're not money in the CURRENT economy. They are backed by debt, but they are not debt in and of themselves. Please ignore what I wrote in that update. It has incorrect assertions.

So, is all debt in the CURRENT economy equal to all money? Yes.

This leaves us with one last thing to tackle. What if somebody went out and dug up a few ounces of gold? What effect would this have on the CURRENT economy?

Answer: It would have no effect. It would not increase the money supply, since gold is not money in the CURRENT economy – it's a commodity.

Digging for gold

The person that dug up the gold has a few options. They can sell their gold to somebody for US dollars (or some foreign currency). This would make that gold backed by debt since it will have entered the CURRENT economy at the completion of the transaction.

Another option would be for the person to use their gold as money in an ALTERNATE economy. Maybe somebody is willing to give the person a nice camera for an ounce of gold in exchange. This would be considered a barter transaction, unless the ALTERNATE economy was seeking to make gold and silver their official form of money. This has been tried before, but usually ends up with a visit by the US Secret Service and a trip to jail. Why? Because the US government forbids its citizens from seeking to use forms of money that are in direct competition with the US dollar. This is why it would be very difficult to transact business in precious metals given the CURRENT economic framework.

Conclusion

Here are a few other points to ponder:

What value does the person's gold have in the ALTERNATE economy? We can't say that it's worth today's spot gold price, since it's not part of the CURRENT economy. In reality, the value of the gold would be whatever value the buyer and seller agree to.

Lastly, it's interesting to note that the person digging up the gold had to exert completed labor in order to obtain the gold. The gold was not encumbered by any debt (claims of future labor) whatsoever. It is only when that gold gets sold into the CURRENT economy that it ends up being backed by debt. If the person either held onto the gold, or used it in the ALTERNATE economy, then it would still represent completed labor and be true capital (profit) within that framework. The amount of the capital would be determined at the time in which the gold was used in a transaction that both the buyer and seller agreed to.

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