The Gold Clause Muddle

CRITICAL ANALYSIS OF THE SUPREME COURT DECISION

By Raymond V. McNally

THE gold clause cases undoubtedly constituted the climax in the stirring drama that has gripped this country since the Roosevelt administration assumed office. The Constitution of the United States, as the central character, had been subjected to such brutal buffeting in a series of engagements involving AAA and the NRA up to Feb. 18, 1935, when the gold decisions were handed down, that the spectator had been left limp and gasping, hardly daring to take a square look to see whether his hero was up or down. The gold clause controversy entered on the scene at the psychological moment and the Supreme Court's decisions were hopefully expected to throw some light on the question as to whether the Constitution was still alive and whether it had ever been anything more than just a pleasant illusion.

A careful examination of both the majority and minority opinions leaves one with an almost hopeless feeling that the human mind, in the last analysis, when it can produce so much that is contradictory and incoherent, is a pretty dismal failure. One wonders whether Kant was right when he declared, in no uncertain terms in his "Critique of Pure Reason" that the Human Reason deceived itself and that we must depend on another kind of reason, that is, Pure Reason, if we wish to see things as they really are. Of course, the Constitution itself must be held partly responsible. Its connotations are so broad that, while they may have been perfectly clear to those honorable gentlemen who offered them as the fundamental laws of the land, when life was simple and unalloyed, they are quite meaningless to the complex society of today that has achieved a high level of material progress but little or no advance in the social sciences. One thing, however, is clear and that is that the Constitution as originally conceived for a nation of free men, is gradually being whittled away by those whose social philosophy is born and bred in a dearth of the precise definitions of words.

The case involving government obligations was in connection with a suit brought by the plaintiff as owner of a Fourth Liberty Loan 4¼ per cent gold bond of 1933-1938 for $10,000 which provided: "The principal and interest hereof are payable in United States gold coin of the present standard of value." When the bond was issued and when the plaintiff acquired it, a dollar in gold consisted of 25.8 grains of gold, .9 fine. The bond was called for redemption on April 15, 1934 and was presented for payment on May 24, 1934 by the plaintiff. When he was refused payment in coins of 25.8 grains or an equivalent in gold or in gold coins of 15 5-21 grains each, the content of the dollar at the time of redemption, he demanded an equivalent value in legal tender currency, namely, $16,931.25. The refusal of his request by the government was based on the Joint Resolution of Congress of June 5, 1933 (48 Stat. 113). The plaintiff brought suit because he claimed that he had been deprived of his property without due process of law.

The purpose of the gold clause, as the Court conceived it, was to provide a standard of value in order to afford protection against loss through depreciation in the medium of payment. The question was whether the Joint Resolution was a valid enactment so far as it applied to the obligation of the United States.

This resolution declared that provisions requiring "payment in gold or a particular kind of coin or currency" were "against public policy," and provided that "every obligation, heretofore or hereafter incurred, whether or not any such provision is contained therein," shall be discharged "upon payment, dollar for dollar, in any coin or currency which at the time of payment is legal tender for public and private debts."

The Court declared that the Joint Resolution was unconstitutional, because while Congress had been granted power, through the sovereign will of the people, to issue obligations for the payment of money borrowed on the credit of the United States, it had not been given the power to alter or destroy those obligations. However, the plaintiff's claim for damages was denied because no loss had been proved. The Court was perfectly within its rights in drawing a distinction between the "binding quality of the obligation" and the "question of damages." It pointed out that before the change in the weight of the gold dollar on Jan. 31, 1934, gold coin had been withdrawn from circulation and Congress had prohibited the exportation of gold coin and placed restrictions on transactions in foreign exchange. It went on to say that the power to coin money included the power to prevent its outflow from the country and to impose restrictions on transactions in foreign exchange, and that, therefore, the plaintiff was not entitled to obtain gold coin for recourse to foreign markets or to engage in foreign exchange dealings. But it was at this point that the Court seemed to experience some difficulty in reconciling the borrowing power of Congress with its power to control currency, for it finally ruled that as the plaintiff would have to determine his damage only in relation to the internal purchasing power of the dollars he had received, he had actually sustained no loss. Although the Court had declared the Joint Resolution unconstitutional and had carefully explained that Congress did not have the power to destroy the obligations it had incurred, it permitted the power over money to destroy the borrowing power by narrowing the field for determining the amount of damages. In other words, it permitted the Constitution to be violated in spite of its rebuke to the government.

That the Constitution had been violated appears to have been the view held by the minority justices, who, in no uncertain terms, stated that "valid contracts to repay money borrowed cannot be destroyed by exercising power under the coinage provision." These powers of Congress are equal. Neither should be allowed to dominate the other. If the gold clause was to be interpreted as setting up a standard of value and not as prescribing a mode of payment, how could the Court justify its opinion that because the plaintiff had been prohibited from receiving the gold coin promised him, the government could avoid its obligation by restricting the method of determining his damages? Was its decision one of expediency because it feared the consequences, if a reverse ruling had been rendered?

On the other hand, how could the minority justices justify their judgment that the plaintiff was entitled to an additional $6,931.25, representing the amount of dollar devaluation, if the gold clause had not been interpreted by them as providing a mode of payment but as providing a standard of value against a loss and in view of the fact that no actual loss had been proved? Obviously, this would have been an injustice to the government, but the minority justices considered this $6,931.25 to be the amount of the loss that the plaintiff had suffered. In my opinion, such judgment springs from primitive notions of value. Gold seems to be considered as something having a natural value irrespective of the ratio that its supply bears to demand. While it does not have an intrinsic value greater than that of any paper currency, the larger part of this value is due to the demand for it for monetary purposes. The market value of gold varies when new mines are discovered, but it varies more often because of the changes in the demand for it. Monetary history clearly shows that its value has constantly changed and that this has given rise to frequent recoinages and changes of system. We cannot look upon gold, therefore, as a fixed standard of value. Reducing the gold content of money does not necessarily reduce the value of that money. A reduction in the value of money through reducing its gold content could only be brought about by increasing the supply. That this was not done in this country when the dollar was reduced in gold content, is evidenced by the fact that the internal purchasing power of the dollar is greater now than it was at the time the bond was issued and when the dollar had a greater gold content. However, in the matter of determining the creditor's loss, the value of the dollar should also be considered in its relation to foreign currencies. In other words, the external value of the dollar at the time the bond was issued should be compared with its external value at the time the bond was redeemed, through the rate of exchange. In connection with this, it should be kept in mind that all currencies have undergone considerable change since 1918. Since that time, currencies have been depreciated and most countries have been jumping on and off the gold standard. Nor has the internal purchasing power of the various countries remained stable. Furthermore, the internal purchasing power of the various currencies do not always correspond with the external value of those currencies. It was said that when England returned to the gold standard in 1925, the external value of the pound was fixed somewhat above its internal purchasing power and when France stabilized her currency in 1928, she fixed the external value of the franc well below its internal purchasing power. Abandoning the gold standard leads to a distrust in a paper standard and this has caused also an undervaluation of the various paper currencies. In order then to determine the true value of the different paper currencies expressed in terms of the dollar, we would have to estimate their purchasing power parities. And as for the gold currencies, it can hardly be said that the dollar has been placed at a disadvantage with them since 1918 in more than a few cases. But whether we are considering paper or gold currencies, we must keep in mind that the internal purchasing power of these currencies does not necessarily correspond with their value in terms of gold, as quoted on the exchanges.

The point I wish to emphasize is this: That while I do not believe the government is within its constitutional rights in restricting the creditor in his determination of his own damages, we must not lose sight of the fact that a dollar containing 25.8 grains is not necessarily more valuable than a dollar containing 15 5-21 grains. The burden of proof to show the actual loss he sustained is on the plaintiff, and I believe that any fears that might have been disturbing the majority justices as to the consequences were groundless.

In the light of the foregoing facts, it would seem that the gold clause, as a measure of value, is limited by its very nature as a protective device against loss. Assuming that the content of the dollar had not been reduced but that the internal purchasing power of the dollar had fallen, would the bondholder have escaped loss merely because he had received gold coin or its equivalent? To think so is to ascribe some mystic quality to gold. An example of the efficacy of the gold clause that is clear-cut, is a case in which the government issued a large amount of fiat money such as the "greenbacks" during the Civil War period. The bondholder, in such an event, should have no difficulty in proving a loss.

In turning to the case of the gold certificates, we find that the principle involved is practically the same. The plaintiff, holder of the certificates in the amount of $106,306, claimed that when he presented them for redemption on January 17, 1934, an ounce of gold was $33.43 and that because he had been refused gold coin, he had been damaged to the extent of $64,334.07. He arrived at that figure by stating that he was entitled to 5,104.22 ounces of gold, that is, one ounce of gold for each $20.67 of the gold certificates. The Court denied his claim on the ground that these certificates did not call for gold as a commodity; that they called for gold coin, not bullion and that legally he could not have retained the gold coin, even though he had received it, for recourse to world markets. Therefore, he had actually sustained no loss in receiving legal tender currency. The plaintiff had conceded the power of Congress to regulate the currency so the question was simply one of just compensation. Although the Court held that as the certificates were currency and legal tender, they could not be regarded as warehouse receipts, it is significant that the government regarded them as such when they treated them as being superior to all other currency in circulation. Furthermore, a definite amount of gold coin had been deposited in the Treasury and held there for payment on demand of these certificates and was to be "used for no other purpose." Act of March 14, 1900 (31 Stat. 45). However, this act had fixed the content of the dollar at 25.8 grains and when the plaintiff presented his certificates for payment on January 17, 1934, the currency that he received was at a parity with that standard of value, as the content of the dollar was not reduced until January 31. Therefore, as the certificates did not call for gold as a commodity, the currency he received must be considered as an equivalent value and he could not logically ask for more.

The blunt opinion of the minority justices that these certificates were contracts to return gold left on deposit and that the plaintiff was entitled to the value of this gold in currency indicates that they considered them as representing gold as a commodity. This position I believe to be untenable. Furthermore, as the gold dollar had not yet been devalued, he certainly could not claim recourse to the foreign exchanges in order to determine his loss.

In taking up the case of the private bonds, we find that the question was the validity of the Joint Resolution which had abrogated the gold clause in private contracts. This case of course, while involving only private obligations, relates also to State and municipal obligations. The plaintiffs claimed that they had suffered losses because the Joint Resolution had compelled the obligors to pay in depreciated dollars. The Court ruled that the gold clause interfered with the authority of Congress to choose and maintain a uniform currency and that therefore the Joint Resolution was valid. It it difficult to see just how the uniformity of the currency is interfered with, if we are to interpret the gold clause as a measure of value and not as a mode of payment. In connection with this, the minority justices stated that the real purpose of the Joint Resolution was not to assure uniform value to the coins and currencies but "to destroy certain valuable contract rights." They seemed to be on firmer ground than the majority when they said that while the authority exercised by the President and by Congress to regulate the currency was not challenged, there was no authority given under the Constitution to destroy validly acquired property rights. On this point, the majority cited the legal tender cases to support their contention that the "Fifth Amendment forbidding the taking of private property without just compensation or the deprivation of it without due process of law" referred only to a direct appropriation. The minority replied that the Joint Resolution caused a direct loss, but they weakened their opinion when they said that there was no "question here of the indirect effect of lawful exercise of power." But what is the "lawful exercise of power." Surely the Resolution is no less lawful than our tariff and unjust tax laws. It certainly is no more of a direct appropriation than the tariff, but I never heard of the consumer or importer being compensated because the power of Congress to regulate commerce destroyed validly acquired property rights. Nor was the consumer or importer compensated when the President suddenly devalued the dollar. But the minority justices seemed to be in awe of gold. Apparently, when gold is appropriated, that constitutes the taking of property, but when the consumer is deprived of part of his wages through the tariff for the benefit of a few people, that does not constitute the taking of property. This is making a fetish of gold, and it is about time the Supreme Court made an honest effort to define property, so it could find out what property really is. In spite of the difference of opinion over the meaning of the phrase, "due process of law," the majority and the minority, in drawing a distinction between a direct appropriation and an indirect appropriation, seemed to be agreed that an indirect appropriation was not unconstitutional. This vague, undefined and apparently innocent phrase, "due process of law," has much to atone for. It has been invoked innumerable times to plug up the gaps in the invoker's knowledge of the science of economics.

While it would not appear that the minority justices were more logical in ruling that the Joint Resolution was invalid, the plaintiffs certainly were not entitled to any compensation, as they had not shown any actual loss.

ECONOMIC EFFECTS OF GOLD CLAUSE DECISION

The immediate reaction of the stock market was no indication of the real economic effects of the gold clause decisions. The sudden rise of stocks and bonds was more forced than spontaneous. It was based partly on erroneous ideas of what the effects would be on the industrial world and partly on the hysterical efforts of speculators to spread rumors that inflation would be the next step in the political drama. That the Court's decision with respect to government bonds was an encouragement to inflationists, cannot be denied. The rebuke to the government for attempting to repudiate its obligations, sharp in tone though it was, fell flat when the Court finally ruled in effect that the power of Congress to regulate the currency could interfere with its borrowing power. This could be interpreted by irresponsible politicians to mean that the government could be sublimely free in pledging itself to unlimited amounts, because it could always depend on the currency power to pull it out of difficult situations.

The various measures adopted by the government, namely, the Agricultural Adjustment Act of May, 1933, authorizing the President to reduce the gold content of the dollar, the Joint Resolution of June, 1933, abrogating gold clauses in contracts, and the action of the President on Jan. 31, 1934, reducing the gold dollar from 25.8 grains to 15 5-21 grains, were all aimed, beyond question, at reducing the debt level. However, they did not constitute inflation in the economic sense of the word. Inflation means the increasing of the supply of the means of payment in relation to the demand for them, or, in other words, to the volume of goods in the market. Believing that the value of money depends on its metallic content, the administration expected that a cut in the gold content of the dollar would raise prices and permit debtors to pay off their debts. This would have taken place, if the cut in the dollar had led either to an increase in the money in circulation or to an increase in bank deposits. But the purchases of gold at steadily increasing prices which led up to the devaluation, were made by the Reconstruction Finance Corporation, not with cash but with the Corporation's own notes. Even though these notes could have been used as collateral for bank loans which would have resulted in an increase in bank note circulation or in bank deposits, comparatively little gold had been bought and the increase in the money circulation was too slight to affect prices to any noticeable degree. President Roosevelt himself finally admitted that the plan had failed. We might say that the devaluation was inflationary in spirit but not in method.

On the other hand, the Treasury's arbitrary appropriation of the sum of $2,800,000,000 representing "profit" arising from the devaluation of the dollar, was potentially inflationary. With $2,000,000,000 of it remaining in the stabilization fund, it is practically harmless at the present time, but the Secretary of the Treasury on Aug. 28, 1934 was reported to have stated frankly that this "profit" would ultimately be used to reduce the national debt. In that way, it may become actively inflationary. Whether the results will be disastrous or not depends on how and when and under what circumstances it will be used to reduce the debt. In fact, a move to use this "profit" has already been made. On March 11, 1935, an issue of gold certificates based on $675,000,000 of it has been made to retire interest-bearing bonds against which national bank notes are outstanding. This naturally increases the bank reserves, but while it appears to have the elements of inflation in it, the increase in the credit base is practically offset by the necessity of the national banks to retire the notes that had been issued against these bonds. As the gold certificates merely replace these bank notes, there will be no increase in currency circulation, at least, not immediately. However, the government is in a better position to borrow as a result, and if it does through the banks, there will be either an increase in currency circulation or in bank deposits.

When I say that the Court's decision with respect to government bonds might be regarded as unconsciously lending encouragement to the inflationists, I am not referring to the final denial of damages itself but to the reason for it. In fact, I believe that if the final judgment had been unfavorable to the government, the possibility of inflation would have been all the stronger. Federal gold clause securities outstanding have been estimated to be about $14,565,000,000 ($7,000,000,000 had been retired) and would have been increased by about $15,-000,000,000, if the government had been compelled to redeem them in dollars equivalent in amount to their gold value. While the total amount does not fall due at the same time, a substantial part falls due in the next few years. Increasing the public debt at this time, accompanied by an increase in interest charges, would, without question, bring us nearer to the danger of inflation. The result would either be increased taxation, or a greater strain placed on the public credit, or an immediate and possibly disastrous use of the "profit" in the stabilization fund. Recovery would then be still further retarded. Industry has at least been relieved from this uncertainty, but there is no indication that because this obstacle has been removed, it will leap ahead with unbridled optimism. There are too many other factors to be considered and industry is not showing any great eagerness to make long-range commitments.

In connection with the public debt, the $40,000,000,000 of State, county and municipal indebtedness must not be overlooked. An adverse decision would have increased that burden by about $28,000,000,000 and many of the local political subdivisions, almost near bankruptcy as we know, cannot afford to have their debts increased at this time without placing a greater burden on the taxpayers and jeopardizing their facilities for extending unemployment relief. As for the private obligations, which amount to about $150,000,000,000 but which some people say run up to $200,000,000,000, they would be increased by at least $85,000,000,000. While all debts incurred prior to 1917, are now and have been through the depression payable in dollars of less purchasing power than those in which they were incurred, most of them were incurred during the war and the early part of the post-war period when prices were high and are now payable in dollars of greater purchasing power. All of the bonds, of course, do not mature at the same time, so there would scarcely be any general financial disaster, if the decision had been unfavorable. Individual debtors, however, in many cases, would be seriously embarrassed, because not only would they be required to pay larger amounts when their bonds matured, but they would be compelled to pay increased interest charges out of incomes that had not increased. But then it must be pointed out that many of these debtors are also creditors holding gold bonds, and so while they might lose in one direction, they would gain in another. The country would be affected only to the extent that actual producers of wealth, whether they were industrial corporations, public utilities or railroads, were injured. Placing a greater burden on them at this time, which would curtail their credit or force them into receivership or bankruptcy, would definitely tend to retard recovery by curtailing production. But whatever value we may attach to the foregoing speculations should be considered in conjuction with this significant fact: If the stock market is to be taken as a reflection of business sentiment, the fact that the sharp gains, made immediately following the Supreme Court decisions, were soon wiped out and stocks declined to an even lower level, is an indication that business had not been materially checked by the uncertainty prevailing before the decisions were rendered.

Beyond the borders of our own country, the situation appears to be the same. While other nations were almost as vitally interested in the cogitations of our highest court as we were, the reaction was one of relief rather than one of enthusiastic hope or extreme gloom for the future. The uncertainty of the monetary situation has not been eliminated for them, because, as I mentioned previously, the liberal attitude of the Court has expanded the power of Congress to regulate the currency beyond anything that had ever been imagined before in this country. Therefore, from the foreign viewpoint, further devaluation of the dollar is an ever present possibility to stalk any effort at a restoration generally of the gold standard. But at least there was the feeling that there would be no immediate disturbance to the exchanges which would undoubtedly have followed an unfavorable decision.

However, there is no reason to suppose that stabilization of the currencies is any nearer merely because the decisions have averted immediate disaster. To think so is to ignore all other economic factors. Recovery is proceeding so slowly in these other countries that they are practically falling over one another in a greedy attempt to grab all of the foreign trade for themselves. At the same time, although trade is a mutual exchange of goods, they are trying to achieve this goal by shutting out each other's goods. In order to play this one-sided game, they elevate the monetary question to an exaggerated importance. Their aim is to export goods and to receive only gold which they bury in their vaults. Apparently they believe that they can become rich by sending goods out of the country and taking none in. This in itself is sufficient reason why any return to the gold standard at this time or even in the near future is impossible. It tends to pile up gold in those countries that have been more successful than the others in restricting imports. Thus, France, in brutally raising her tariffs and quotas against foreign goods, has been accumulating huge reserves until now she has fully a hundred per cent gold cover for her currency. Such maldistribution of gold nullifies the gold standard as a workable system. It was the maldistribution of gold in connection with the war debts which the various creditor countries, particularly France and the United States, insisted had to be paid with gold and not with goods, that was largely responsible for the breakdown of the gold standard in the first place.

Such a policy is glaringly inconsistent. They want to increase their exports and at the same time to keep their large gold reserve intact. And so imports decline while exports increase, gold flows in and there they are sitting on top of their piles of gold trying to delude themselves into believing that they are prosperous. Then the exchange rate naturally turns in their favor, exports decline, imports increase, gold flows out and then they look with envious eyes at the cheaper currencies of other countries, wondering whether to manipulate their currencies downward or to raise their tariffs. And the impairment of their reserves also makes them tremble and so, in order to protect them and also their export trade, they resort to such devices as buying other currencies such as we are doing with our stabilization fund and England with her equalization fund. And so the silly process goes on and on, all due to the ignorance of fundamental economic principles. Now the recent sharp decline of the English pound has made the gold standard countries exceedingly jittery. This insane greed for gold springs from the superstition that the reserves have the power to infuse value into the currency, and the curious idea that exports are more beneficial than imports is a surviving relic of the English Mercantile Theory, according to which money was the only kind of wealth and the only way to grow rich was to exchange goods for money and not money for goods. The idea current in the world is that foreign trade offers an outlet for the surplus product of a country as though this surplus was made for any other purpose than as the cheapest means of supplying the country with the things it needs, in other words, to pay for imports.

As long as each country tries to obtain an advantage in trade by depressing its currency below its internal value, there will be no stabilization, and any hasty return to the gold standard will produce no permanent good. A necessary condition for real stabilization is more freedom of trade, and this no country is willing to meet. The Supreme Court decisions have left the world as it was, although from the academic standpoint, they have actually deepened the confusion.