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I. Introduction

Since the end of World War I the world has been periodically rocked by monetary crises. Hundreds of devaluations were carried out during this period and some revaluations. During the inter-war period the worst monetary crisis was the devaluation of the dollar in terms of gold carried out by the Roosevelt Administration in 1934. From 1934 to 1971 the dollar had never been devalued, even though the pound sterling had been devalued three times, in 1940, in 1949 and in 1967. However, since the late 1960's the reserve currencies of the world have been in trouble. Following the November 1967 devaluation of the pound sterling, a pressure against the dollar developed. As a result, the two-tier system of gold price has been established—one price among the Central Bank, and the second the free price of gold for other uses: ornamental, industrial, speculative and hoarding of gold.[1]

From May 1971 until December 18, 1971 an international monetary crisis prevailed,[2] as a result of which, according to the Smithsonian agreement, the dollar was devalued by 8.6 per cent and the Japanese yen, the German mark and several other currencies were revalued. This was the worst monetary crisis that has erupted since 1934. It was the first time since 1934 that the dollar had been devalued.

II. The January and February 1973 Monetary Crisis

A. *The Basic Problems*

Several basic problems influence the present instability of the dollar. The United States balance of payments has been negative for many years as a result of the "super-power" obligations of the United States, namely its military and economic assistance to other free countries

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1. *See* S. Scheps, The Dethronement of Gold (1971).
2. *See* Flanders, *The International Monetary System, an Unsolved Problem,* 1971 Israel Econ. Q. 240; Strange, *The Dollar Crisis 1971,* Int'l Affairs, Apr. 13, 1972, at 197.

and its involvement in Viet Nam. The United States economy has started to lose its competitive position in relation to Japan and Western Europe for two basic reasons. First, the wages standard. The average wages paid to blue collar laborers in the United States are much higher than those prevailing in Japan and Western Europe. The United States had for many years an advantage in productivity, in the quality of its management, and in its technological know-how and capacity. However, the United States has started to lose these advantages. The trend is toward maximization of profits and minimization of expenditure of effort. The first is legitimate under the free enterprise system, the second can be less easily defended and is one of the reasons of present-day inflation, as productivity does not increase proportionally. This tendency toward minimization of expenditure of effort affects both management and labor and is one of the attendant evils of the society of plenty. Second, the United States is much closer to the saturation point in durable consumers goods than Japan and Western Europe. Therefore, there is an outflow of capital. American businessmen believe that better opportunities for investment and future profits prevail elsewhere. During the whole post-World War II period the degree of economic growth was higher in Japan and in Western Europe than in the United States.[3] Therefore there is no outflow of capital from the United States.

American residents enjoying higher standards of prosperity tend to carry out one-sided transfers to residents abroad. The tendency toward travel abroad is stronger in America than elsewhere. Many American tourists tour Europe, but only a few Europeans tour the United States.

All these reasons have contributed toward a huge deficit in the United States balance of payments with the rest of the world; since the beginning of the 1970's the attitude has prevailed that the dollar is an overvalued currency. This attitude influences practical developments. Since the February, 1973, devaluation of the dollar, a certain improvement in the balance of payments has occurred. But, as the result of floating, the value of the American dollar has decreased.

B. *The Sequence of Events*

Many economists believe that the Smithsonian agreement has only effected a truce in the international monetary warfare without solving

3. *See* M. Postan, An Economic History of Western Europe 1945-1964 (1967); S. Scheps, The Dethronement of Gold (1971).

the basic problems.[4] A crisis of confidence has developed in the dollar as a result of the fact that it was devalued for the first time since 1934. A huge amount of Euro-dollars[5] held by private and central foreign banks (de facto inconvertible) has complicated the problem.

In 1972 the international markets showed symptoms of nervousness without causing a serious crisis. These symptoms were the high price of gold on the free market and the problems created by the "floating" of the pound sterling.

In January 1973 the Italian lira on capital account started to "float." As a result, funds were transferred to Switzerland and pressure on the Swiss franc ensued. The Swiss franc started to float and its price appreciated. Hot money (Euro-dollars held by multinational companies and oil producers) and other speculative funds were transferred to Germany and to Japan. For several days the German mark was under enormous pressure as funds of close to two billion dollars a day, on the average, were exchanged into marks.

The United States published the fact that during 1972 there was a deficit in its balance of trade of 6.4 billion dollars;[6] this publication has caused a flight from dollars. President Nixon decided to devalue the dollar. Negotiations with Japan and Germany ensued and the dollar was officially devalued on February 12, 1973 by 11 1/9 per cent.[7]

III. The Problem of Reserves

A. *The Public Policy Approach to Devaluations*

Under the traditional gold standard which prevailed in the developed part of the world during the second part of the Nineteenth Century and until the outbreak of World War I, devaluations were not carried out. They were treated in theory as breach of trust, national and international, and an admission of moral and commercial bankruptcy. Since World War I the attitude to devaluations has changed. Monetary policy operates under different ethical standards than it did.[8] Devaluations are in fact carried out if there is no other

4. See note 2 *supra*.
5. Euro-dollars refers to American dollars held by European banks.
6. *See* Newsweek, Feb. 26, 1973, at 39. The important thing is not the statistical fact, but rather its impact on the speculation which has ensued.
7. This changed the price of gold from $38.00 per fine ounce to $42.22 per fine ounce.
8. Chandler, Monetary Policy, in 10 International Encyclopedia of the Social Sciences 119 (1968).

practicable way to correct balance of payments disequilibria and to achieve other objectives such as growth and full employment.

Technocrats and bureaucrats and even economic writers tend, however, to disregard the psychological effects of devaluation. People are not happy when their rights are interfered with. Devaluation causes a loss in value of money of banknotes, bank deposits, bonds, savings and other rights expressed in terms of money. Legally, the value of money is presumed to be stable notwithstanding inflation and devaluation.[9] Therefore, devaluation undermines economic stability which is organized around the present value of money, to a lesser or a greater degree. Devaluation, therefore, causes nervousness and crises of confidence. It may also have social and political side effects. Devaluation, once inevitable, should be carried out *but only as long as other effective measures to achieve the same result are not devised.* It should be effected rationally, after taking all relevant facts into account. Therefore, once a need for devaluation has arisen it should be carried out *from above* and should be as effective as possible. However, usually devaluations are carried out as a result of pressure *from below* and they are often an admission of failure by monetary authorities to counteract the pressure of speculative funds. This is what happened in the United States in 1968 (when the two tier market price of gold was established), in 1971 and in February, 1973. *Devaluations by installments have a destabilizing influence and undermine the confidence in currency.*

B. *How Can Public Authorities Counteract Speculative Pressure?*

Generally, when a speculative pressure develops against a currency the fact that something is wrong with it is manifest to the public and to their financial and economic advisers. The public authorities should by then have a clear picture of the nature of the problem and of possible effective remedies. For many reasons, public authorities are often surprised by the speculative pressure and its dimensions. *They find themselves in the position that no adequate solution has been prepared in advance.* Therefore, the public authorities should first counteract such speculative pressure and prepare an adequate and effective solution. *The time element is by then exceedingly important.* The amount of gold and foreign currency reserves is usually inadequate as these

9. *See* E. HIRSCHBERG, THE NOMINALISTIC PRINCIPLE (1971).

reserves are treated as a stop-gap measure to cope with routine trade and payments disequilibria and not with flight from currencies. Public authorities are faced with a situation that they may lose all available reserves without restoring confidence.

The British Government fought devaluation for three years (from October, 1964 until November, 1967) and in the end had to admit defeat and carry out a devaluation.

The problem arises as to whether paper gold and paper foreign currency can be created through taking recourse to value clauses. This is a legal problem which is usually not seen by public officials and economists. *The solution therefore should be prepared by lawyers and the problem should be discussed and the initiative undertaken by them.*

IV. Gold Value Clauses

A. *Why Are They Included in Contracts?*

Gold value clauses have been included in contracts, and are still included, in order to protect the parties from changes in value of national currencies in terms of gold. If such clauses had been valid in the summer of 1971, or in January, 1973 in the United States and included in contracts, parties to them in the United States would have been protected from the devaluations of the dollar which were carried out in December, 1971 and February, 1973. Many maintain, however, that the creditors under such clauses make only windfall profits because the domestic value of the dollar did not change in the same measure as its external value. But what happens if the creditors are active in international trade and the proceeds of such contracts are to be so applied? Through the devaluation of the domestic currency they incur a loss, and the relative stability of domestic prices does not recompense them for such a loss. The whole issue of freedom to include gold value clauses is *still controversial all over the world.* Whatever may be said for the abrogation of gold value clauses in the United States, this abrogation has been too sweeping.

B. *The Impact of Gold Value Clauses on the Stability of Domestic Currency*

It is maintained that gold value clauses have a detrimental impact on the stability of the national currency. As long as such currency is relatively stable externally in terms of gold, however, such gold clauses are relatively irrelevant. They do not add anything to the extent of the obligation. The problem arises when a devaluation in terms of gold is in fact carried out. Then a gold value clause becomes operative and affects the extent of the obligation. In such a case the problem is really not one of the stability of the national currency but one of "*equality of sacrifice.*" Gold value creditors receive more nominal dollars than other creditors. Gold clauses become operative and relevant only if the risk against which they protect becomes a practical risk. Devaluation is caused by many factors and the fact that gold clauses are included in contracts is relevant only because they enlarge the extent of certain obligations. Gold value clauses, when included in contracts in the pre-devaluation period, are only a symptom of nervousness or a necessary precaution against a practical risk.

C. *How Gold Value Clauses May Help Alleviate Monetary Crises*

We analyze this problem from the point of view of contemporary problems and attitudes. In our time devaluation is often treated as a necessary evil. The monetary authorities are seldom ready to sacrifice other objectives of public policy like growth and full employment for the preservation of the external stability of the value of the national currency. This fact is now known to the man in the street and his financial advisers. Therefore, when overvaluation of a currency is manifest and a pressure against it develops, practically the only remedy is to carry out a devaluation in fact. Lately a rumor of devaluation, when there is an economic case for it, can bring about a devaluation in fact under pressure from speculative and other funds. Gold value clauses can serve as a *valuable defensive weapon* in the hands of monetary authorities once there is a pressure for devaluation. The amount of liquid funds is so large and rumors of a possible devaluation and of a pressure against the currency spread so quickly through the mass media that monetary authorities are relatively defenseless and have no choice but to give in to the pressure. This fact is known today to the average speculator, and this in turn reinforces the expectations of devaluation. Therefore, once a rumor spreads and a pressure develops, the speculative expectations are directed toward devaluation and tend to influence behavior. *Gold value clauses cannot prevent devaluation once it is necessary and overdue.* But they can, by offsetting speculative pressure, provide a breathing space for the authorities so that the devaluation, if necessary will be carried out rationally. If it is inadvisable to devaluate, the pressure can be counteracted and the flight from currency stopped. Of course, such breathing space is bought at a price. The price is worth it, however, if the devaluation itself is rational.

A very important psychological consideration must be taken into account. When expectations of devaluation prevail, a flight from currency starts. By that time the public does not trust official denials. Recent monetary history has proved that very often official denials of a possibility of a devaluation are not sincere and very often misconceived.

A breathing space may be bought only through countermeasures involving the sale of gold or foreign currency in the market. If the real reserves are inadequate, recourse may and should be made to paper gold or paper foreign currency; specifically, value clauses. This problem will be further discussed.

In conclusion, once the expectation of a devaluation prevails it is difficult, if not impossible, to counteract speculative activity without having recourse to defensive weapons. Such defensive weapons are available and can be easily created through taking recourse to value clauses which can offset "flight from currency." Of course, if devaluation is carried out in the end the monetary authorities which have issued value clauses incur a loss. Such a loss is inconsiderable, however, in comparison with other devaluation losses and gains. For monetary authorities, fighting devaluation or revaluation always entails a risk and a loss; and an irrational devaluation which is carried out hastily and under pressure involves a grave loss for the national economy in the long run. This problem is especially grave when there is a dollar crisis. The dollar until 1968, and perhaps until 1971, was the most important reserve currency of the free world. Its devaluation causes both tangible and intangible losses, such as a loss of confidence which may have an impact on foreign trade and international cooperation.

V. The Gold Value Clauses in the United States

A. *The Traditional Attitude to Gold Clauses*

Since the rapid depreciation of the Continentals, a paper currency issued by the Continental Congress during the Revolutionary War, a relative distrust of paper currency has prevailed in the United States. During the Civil War both North and South issued paper currency which later depreciated in value. In the North the greenbacks were declared to be legal tender, but in practice a disagio prevailed between it and gold coin. Gold value clauses have been declared valid by the courts.[10] In *Willard v. Taylohe,*[11] an order for specific performance was granted on the condition that the purchase price would be paid in gold coin.

After the Civil War, gold value clauses continued to be routinely included in contracts. America has been a rapidly developing country and its economy had shown an inflationary bias. In 1933, when gold value clauses were abrogated in the United States, the total amount of dollar obligations, including gold value clauses, has been estimated to have reached the sum of 100 billion dollars.[12]

B. *The Abrogation of Gold Value Clauses in the United States*

The Joint Resolution of both houses of Congress on June 5, 1933, abrogated gold value clauses in dollar obligations, both in domestic and international contracts. This was a sweeping measure proposed by the Roosevelt Administration to facilitate the 1934 devaluation of the dollar. It was tested and upheld by the Supreme Court,[13] and extensively discussed by legal writers.[14] The main reason behind this enactment was the approach of equality of sacrifice—"if all cannot escape none will be allowed to." It was a step in the direction of the demonitizing of gold. Gold was treated as a barbarous relic from the past and this attitude was extended to gold clauses. Since then gold value clauses have been invalid in the United States in dollar obligations and are not included in such obligations.

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10. Butler v. Horwitz, 74 U.S. (7 Wall.) 149 (1868); Bronson v. Rodes, 74 U.S. (7 Wall.) 229 (1868). *See* Dawson & Cooper, *The Effect of Inflation on Private Contracts U.S.A.*, 33 MICH. L. REV. 852 (1935).
11. U.S. (8 Wall.) 490 (1869).
12. *See* A. NUSSBAUM, MONEY IN THE LAW NATIONAL AND INTERNATIONAL 282 (2d ed. 1950).
13. Perry v. United States, 294 U.S. 330 (1935); Nortz v. United States, 294 U.S. 317 (1935); Norman v. Baltimore & O.R.R., 294 U.S. 240 (1935).
14. *See* Dawson, *Gold Clause Decisions*, 33 MICH. L. REV. 647 (1935); Hart, *The Gold Clause in United States Bonds*, 48 HARV. L. REV. 1057 (1935); Nebolsine, *The Gold Clause in Private Contracts*, 42 YALE L.J. 1051 (1933); Post & Willard, *The Power of Congress to Nullify Gold Clauses*, 46 HARV. L. REV. 1225 (1933).

C. *The Present Situation*

The conditions and circumstances have changed since the passage of the Joint Resolution.[15] *Public policy approaches are necessarily flexible and should change with the times and circumstances.* Gold value clauses are no longer routinely included in obligations.

Many have believed that the psychological attachment to gold is irrational. This psychological attachment inherited by us from our forefathers, however, is continuously reinforced by contemporary phenomena. Nationalizations carried out in many countries, monetary instability, and political, social and economic instability all reinforce the traditional trust in gold. The use of gold for ornamental and industrial purposes is continuously increasing; in fact, supply lags behind the demand and the price of gold has been continuously increasing since 1968. A private party will probably be better off if he trusts gold rather than paper money. Of course, gold carries no interest and the price of it on the free market is volatile and fluctuates according to speculative pressures.

Whatever the justification of the Joint Resolution of Congress on June 5, 1933, its basic approaches should have been reconsidered and revised in the light of the present day reality.

VI. The Present Utility of Gold Value Clauses

A. *Gold Value Clauses and Their Use for Monetary Authorities*

Gold value clauses could perform an eminently useful function in case of a flight from currency. Once a flight from currency starts, a distrust in this currency develops. But in modern conditions this distrust is, except in the case of a very grave political crisis, relative and not absolute. It extends not to paper currency itself but to its value in terms of gold or other currencies. Therefore, the public authorities can in theory issue obligations which include gold value clauses to an unlimited extent in order to counteract speculative pressure. It is worth mentioning that the "special drawing rights" issued by the International Monetary Fund include a gold value guarantee.[16]

15. *See* Hirschberg, *Gold Value Clauses and Public Policy in U.S.A.*, 89 Bank. L.J. 99 (1972).
16. *See* Gold, *A Comparison of Special Drawing Rights and Gold as Reserve Assets*, 2 L. & P. Int'l Bus. 376 (1970); Johnson, *The International Monetary System and the Rule of Law*, 15 J. Law & Econ. 277 (1972).

The British Treasury extended a dollar guarantee to other Central Banks, particularly those in the Sterling Block, after the 1967 devaluation in order to induce them not to convert their sterling balances into other currencies.

It must be kept in mind that the supply of gold metal and the supply of foreign currencies is necessarily limited. The creation of paper gold and foreign currency paper through value clauses is unlimited. The use of value clauses may enable monetary authorities to reduce and even offset speculative pressure to gain time to proceed effectively and rationally on the national and international monetary front.

Value clauses would have been eminently useful for the United States monetary authorities in 1968, 1971 and 1973. Due to the Joint Resolution of June 5, 1933, however, they were barred from taking recourse to value clauses. Outdated approaches continue to govern us even when circumstances have changed.

Value clauses may be useful not only in case of revolutionary developments like a flight from currency, but also in case of evolutionary processes. The confidence in the dollar which has been devalued twice since 1971, has been undermined. Almost 80 billion dollars, however, are held by foreigners and foreign central banks.[17] In the near future they will attempt to convert dollars into francs, marks and yens, all of which are now regarded as stronger than the dollar. This will create a continuous pressure on the dollar; such pressure can be counteracted only through value clauses being included in dollar obligations, *i.e.,* gold or foreign currency guarantees. The International Monetary Fund has tried to find a solution to the monetary crisis, but the solution has not yet been found.

We have dealt here only with the public aspects of value clauses. They may further protect legitimate interests of private parties, but this aspect of the problem has been dealt with elsewhere in this article.[18]

VII. Conclusion

Devaluation, if necessary, should be rational and effective. Very often, even under favorable circumstances, it is only effective after a

17. Estimations vary. Some circles close to the International Monetary Fund estimate the amount at 100 billion dollars. The exact figure is still unavailable from official sources, as it varies from day to day.
18. *See* note 16 *supra.*

certain period of time. Often it affords only a breathing space for monetary authorities to supplement it by other measures. Devaluation carried out under pressure is often ineffective and irrational. Gold value clauses and foreign currency value clauses may be extremely useful to monetary authorities in the event of a flight from currency or the evolutionary developments brought about by the undermining of confidence in a currency. This will require the revision or the partial or total abrogation of the Joint Resolution of Congress of June 5, 1933. This enactment should have been reconsidered long ago, but even now such a reconsideration may be helpful.