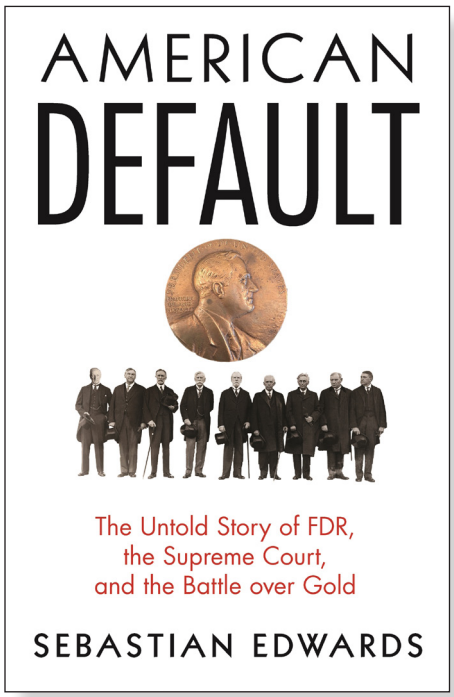
THE FALL OF GOLD
& THE RISE OF THE AMERICAN ECONOMY

Review by Richard Dean



Book cover, courtesy of Princeton University Press

American Default: The Untold Story of FDR, the Supreme Court, and the Battle over Gold by Sebastian Edwards explores a 1935 U.S. Supreme Court decision addressing whether the deviation from the gold standard was constitutional given widely used contractual clauses calling for loan repayment in gold.

A treasure trove for the economic historian, the book tells us how the United States got out of the Great Depression, how the long-running national debate over gold versus silver was resolved, and how the monetary policy put in place in the 1930s remains in effect today. *American Default* also provides great insight into the legal arguments of an important yet long-forgotten Supreme Court case that has not been given such an in-depth analysis until now.

In 1933 the country was in economic crisis, so Congress gave President Franklin D. Roosevelt authority to stimulate the economy by devaluing the dollar in relation to gold. However, FDR's initial efforts led to immediate legal complications. Government debt and most private loans had a "gold clause." Debts were "payable in U.S. gold coin at the present standard of value." But when debts became due, were they to be paid in devalued dollars or in the value of gold? Billions of dollars were at stake.

This was a public issue before it inevitably became a legal one. FDR directly addressed it in his second Fireside Chat. He argued that the total gold in the world amounted to only about 11 billion dollars — far less than what was owed in all the debt contracts. As a result, there was no way all creditors could expect payment in gold.

When the gold standard was abandoned, debtholders lost up to one-half the value of their "assets." After a handful of lower court decisions, the Supreme Court agreed to address the key issues. Oral arguments were held in January 1935 and lasted three days. The arguments were simple and straightforward. The government declared that (1) there was an economic crisis that required devaluation and (2) Congress had a strong basis to believe that the clauses were contrary to public policy. The opposing arguments were keyed to the sanctity of the contract — the government cannot annul contracts retroactively. To do so amounted to taking property without compensation.

Financial markets held their collective breath for the answer. In a 5–4 decision, the Court found that the abrogation of the gold clauses in private contracts was constitutional. Eight justices concluded that it was unconstitutional to annul public debt contracts, but by a 5–4 majority the Court held that such abrogation had not caused any damage to public bondholders. The majority reasoned that if bondholders had received gold for their bonds, they would have been forced to sell it to the Treasury for the devalued price since they could not export gold at market price.

Most of the justices in the majority — Charles Evans Hughes, Harlan Fiske Stone, Oliver Wendell Holmes Jr., and Benjamin Cardozo — gained notoriety over time. The four in the minority (The Four Horsemen) faded into obscurity as individuals, but they were a cohesive and powerful group in the 1930s. Likewise, the lawyers are not well known today, so recording their efforts provides a valuable service to legal historians. This is a well-told story of how economics, public policy, legislation, and the law intersected in the real world to bring the country back from the abyss.

Richard Dean is a partner at Tucker Ellis LLP in Cleveland. He has been a D.C. Bar member for more than 25 years.