The Constitutional Law of Money
Professor Christine Desan

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Discussion Questions for Class 15

Liberating the Fed:
The Movement towards Discretionary Monetary Policy

Readings:

Norman v. Baltimore & Ohio RR Co., 294 U.S. 240 (1935)

U.S. v. Perry, 294 U.S. 330 (1935)

Nortz v. U.S., 294 U.S. 317 (1935)

Randall S. Kroszner, "Is It Better to Forgive than to Receive? Repudiation of the Gold Indexation Clause in Long-Term Debt During the Great Depression" (1999)

Background:

The Great Depression was an economic downturn of catastrophic proportions. As they worked to respond to the crisis, New Deal legislators along with the Roosevelt administration restructured the monetary architecture. Innovations included a number of steps that expanded the centralized authority of the Federal Reserve. First, the United States loosened the constrictions placed on its money supply by the Gold Standard. Second, the Banking Act of 1935 put control of the federal open-market committee (FOMC) in the Fed's Board of Governors by giving its members a majority relative to Federal Reserve bank presidents. The combination would allow monetary authorities more latitude to expand banking reserves by monetizing public debt, as well as other eligible assets. In fact, a third important innovation of the same legislation was to give the Fed the authority to discount any "sound" asset, not just the specified commercial loans it had had been directed to discount in its founding act. Mehrling 2011, 44-45.

That latitude would only become clear over time, as the place of the United States in the international order changed. In the short-term, the Roosevelt administration likely acted more out of a sense of exigency than with a longer-term plan. A priority in 1933 was to get the economy moving again, a goal that policy makers believed required the stimulating effect of rising commodity prices. First, the administration suspended the convertibility of the dollar into gold coin. In turn, it prepared to devalue the gold content of the dollar, an action that would decrease the value of the dollar and therefore increase prices in it. But the administration strategy ran into a constitutional problem: What about the "gold clauses," those provisions in both public and private contracts ($100 billion worth) that guaranteed creditors that they could be paid in gold coin of the same fineness and weight as had existed when they made their contracts?

Kroszner provides background for the United States' devaluation of the dollar on January 31, 1934. For reference, the drama turned on the following interventions. Those interventions triggered lawsuits by creditors against both private debtors (*Norman*) and the United States as public debtor (*Nortz* and *Perry*). In subsequent cases, foreign debtors also failed to recover amounts secured by gold clauses.

* The Emergency Banking Act of March 9, 1933 authorized the Secretary of the Treasury to require all people holding gold, gold coin, or gold certificates, to pay them into the United States if required at any time to protect the "currency system" of that country. By executive order in early April 1933, President Roosevelt mandated that gold be surrendered to the Treasury and the Federal Reserve Banks. Holders received, in return, the face value of the gold coin in Federal Reserve dollars. The ban on private holding of gold remained in place until 1974.

* The Joint Resolution of June 5, 1933 prohibited any payment in gold as "against public policy" and provided that every obligation should be discharged in coin or currency that remained "legal tender," as gold coin no longer appeared to be.

* On January 31, 1934, the President acted as authorized by Congress to devalue the dollar in terms of gold. Rather than 25.8 grains of gold (9/10s fine), the dollar would now be worth 15.23 grains (9/10s fine).

Discussion Questions:

1. Would you have devalued the dollar in 1934? More generally, in what circumstances might a devaluation be justified, politically or legally?

    a. In this case, would it matter if the devaluation was to protect debtors from devastating deflation?

    b. to protect the money supply from runs on the gold reserve?

    c. to protect the domestic economic from severe dislocation?

2. What do you think of the Court's reasoning in *Norman*? Why not require debtors to compensate creditors for the loss in gold value by making up the difference in the dollar value of that gold?

3. Did the United States effectively default in 1934? Why or why not?
    a. Is your answer informed by an argument about what "money" is?

    b. What precedents, if any, are there for the kind protective action taken by the United States in 1934?

    c. Is there any way for creditors to protect themselves from the possibility of devaluation?

4. What shall we make of the odd blending of formalism and realism in *Perry* and *Nortz*?

    a. What do we learn about public contracts from this case?

    b. What do we learn about “the market”?

    c. If the plaintiffs lacked a remedy against the United States, how does the Court’s condemnation of the United States matter, if at all?