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Economic Liberty and the Constitution, Part 10

by Jacob G. Hornberger

An analysis of the *Gold Clause Cases*, decided by the U.S. Supreme Court in 1934, necessitates a brief discussion of the *Legal Tender Cases*, which decided the constitutionality of the legal-tender laws enacted by the Lincoln administration during the Civil War.

To finance the war against the Confederacy, Lincoln resorted to the standard method used by rulers throughout history when faced with tax revolts from the citizenry: he began inflating the currency. That meant simply cranking up the printing presses and printing up enormous quantities of paper money and using it to purchase the goods and services needed for the war effort.

At that time, Americans were accustomed to carrying gold and silver coins in their pockets because that was the medium of exchange that our ancestors had established for the American people. Everyone at that time understood that the government's bills and notes were simply evidence of indebtedness — that is, they were promises to pay gold and silver coin. Thus, whenever someone wanted to redeem the note for the coin, the government would honor it.

Once Lincoln resorted to the printing presses to finance the war effort, however, the bills and notes began trading at a discount. For example, let's assume that something is priced at \$100 (in gold coin), and the government has been inflating its notes. When someone attempts to purchase the item, the merchant might require payment of a \$100 note plus a bit more, to take into consideration the possibility that the government could default.

Lincoln's and Congress's response was a legal-tender law, which required people to accept the government's bills and notes at face value, regardless of how many were being depreciated.

In *Hepburn v. Griswold*, the Supreme Court held the legal-tender law to be unconstitutional. The Court pointed out that under the Constitution, while the federal government had the power to borrow money through the issuance of bills and notes, it had not been given the power to issue paper money or to make its bills and notes legal tender.

Within less than a year, however, two new justices were appointed to the Court. In one of the most shameful acts in the Supreme Court history, the new majority voted to overrule *Hepburn v. Griswold*. In *Knox v. Lee* and subsequent decisions, it became the settled law of the land that the U.S. government had the power to issue paper money and enact legal-tender laws.

Justice Stephen J. Field, who had been a fountainhead for constitutional principles dealing with economic liberty (see “[Economic Liberty and the Constitution, Part 5](#),” *Freedom Daily*, October 2002), stated the following in voting against the constitutionality of the legal-tender laws:

The power to commit violence, perpetrate injustice, take private property by force without compensation to the owner, and compel the receipt of promises to pay in place of money, may be exercised, as it often has been, by irresponsible authority, but it cannot be considered as belonging to a government founded upon law

From the decision of the Court I see only evil likely to follow.

Gold owners as criminals

The evil which Field predicted came into full force during the Franklin Roosevelt administration. In the midst of his New Deal, the federal government committed one of the most heinous acts in history when it nationalized gold in the United States and declared it a felony for any American to own gold in the future. Americans were required to turn their gold in to the federal government and receive in return the federal government’s paper money, which the government had recently devalued.

Today, given that many people believe that the federal government should have the omnipotent power to control and regulate people’s economic activities and their possessions, that might not come as such a surprise.

In the early 1930s, however, that the federal government could do what socialist and communist governments were doing in Germany, Italy, and the Soviet Union came as a mighty shock to many people’s understanding of America’s heritage of private property and economic liberty. At that time, many Americans still believed in Americanism — in the principle that a person’s

possessions were his and that the government could not arbitrarily take them away, as governments were doing in Nazi Germany, fascist Italy, and the communist Soviet Union.

Moreover, not only was gold ownership declared illegal, the government went one step further: it nullified all “gold clauses,” both in private and government contracts.

The gold clauses

What were the gold clauses? Their purpose was to protect the parties to a contract from government depreciation of the currency, as Lincoln had done during the Civil War and, for that matter, as governments throughout history had done when given power to control their nation’s economic system.

Keep in mind that there was one big reason that our Founders and ancestors had made gold and silver coin their official medium of exchange — to protect themselves and their successors from government’s plundering and looting them through inflation. And make no mistake about it: unlike many Americans today who honestly believe that inflation is some mysterious disease that afflicts nations from time to time, or that it is caused by greedy businessmen, early Americans had a very clear understanding of the problem; they knew that inflation had one and only one root — government — and specifically the propensity of public officials to secretly and surreptitiously tax the citizenry through the issuance of depreciated currency.

That’s the reason that the Constitution did not give the federal government the power to make paper money legal tender. It’s also the reason that the Constitution expressly prohibited the state governments from making anything but gold and silver coin legal tender.

Thus, creditors, especially the owners of long-term bonds (e.g., 100-year railroad bonds), needed a way to protect themselves from the possibility of inflation, especially after the Supreme Court had upheld what Lincoln had done with his legal-tender laws. For example, suppose someone lends a railroad \$100,000, with interest payable annually and principal payable in 100 years. How does the lender ensure that he (or his heirs) is not paid back in depreciated currency?

The answer: a gold clause in the contract. Gold clauses would provide that since the lender was delivering \$100,000, the borrower would have to repay the loan using the same measure of “dollar” in effect when the loan was entered into. For example, let’s say that when the loan was entered into, a U.S. “dollar” was defined as a gold coin containing two grams of gold. Later, let’s say that the government depreciated the currency by declaring that a U.S. “dollar” now contained

only 1.5 grams of gold. The debtor would have to use the earlier measure when he repaid the loan, rather than the depreciated measure.

FDR and his statist and socialist cronies went much further than that, however. Rather than simply reducing the gold content in the U.S. dollar (as kings had done throughout history) and rather than simply making the federal government's bills and notes legal tender, the federal government went much further down the road that Nazi Germany, fascist Italy, and the communist Soviet Union were traveling.

By confiscating gold, making gold ownership illegal, and making its bills and notes irredeemable (in terms of what they had promised to pay), the federal government was doing its best to ensure that the American people could never protect themselves from the government's ability to plunder and loot them through the Federal Reserve System's inflationary policies.

Thus the federal government would be unshackled in its quest to go on a perpetual spending spree, promising the people unlimited welfare benefits, and all for "free," because as government continually used depreciated currency to pay for all the goodies, the American people would continue to believe that inflation was some mysterious disease whose cause was unknown or one caused by the greed and rapaciousness of private businessmen.

There was only one obstacle standing in their way: the gold clauses that had been inserted into both private and federal loan agreements ... and the U.S. Constitution, which did not give the federal government the power to destroy contracts, either private or public.

The Court's decision

The *Gold Clause Cases* actually involved three separate cases, all of which were decided at the same time: *Norman v. Baltimore & Ohio Railroad Co.*, *Nortz v. United States*, and *Perry v. United States*.

In a 5-4 decision, the Court upheld the nullification of the gold clauses in all private contracts. What was the Court's reasoning? Essentially, it said that since the Constitution gives the federal government the power to establish a monetary system, the exercise of that power in the interests of society trumps the interests of private individuals to protect themselves from depreciated currency.

Where did the majority find such a power in the Constitution? The Court held that by giving the federal government the power to borrow money, along with the power to coin money and regulate the value thereof, it was obvious that the Framers were actually giving the government the power to establish a monetary system, even one entailing the issuance of irredeemable notes, legal-tender laws, gold confiscation, criminalization of gold ownership, and nullification of gold clauses in private contracts.

The majority had somewhat of a more difficult problem justifying the nullification of the gold clauses in instruments of indebtednesses. After all, it would be an odd Constitution that would give the government the power to borrow money and then allow it to default on the contract through repayment in depreciated currency. The majority agreed that the federal government's gold clauses had to be honored but then held that since gold was now illegal to own in the United States, the bondholder hadn't really suffered any damages.

In the dissent were the Four Horsemen — George Sutherland, Willis Van Devanter, Pierce Butler, and James McReynolds — who were clear and direct with respect to what Roosevelt and the Congress were doing:

Just men regard repudiation and spoliation of citizens by their sovereign with abhorrence; but we are asked to affirm that the Constitution has granted power to accomplish both. No definite delegation of such a power exists; and we cannot believe the farseeing framers, who labored with hope of establishing justice and securing the blessings of liberty, intended that the expected government should have authority to annihilate its own obligations and destroy the very rights which they were endeavoring to protect. Not only is there no permission for such actions; they are inhibited. And no plenitude of words can conform them to our charter.

The dissent then proceeded to explain the purpose of gold clauses, a purpose that the majority conceded:

By the so-called gold clause — promise to pay in “United States gold coin of the present standard of value,” or “of or equal to the present standard of weight and fineness” — found in very many private and public obligations, the creditor agrees to accept and the debtor undertakes to return the thing loaned or its equivalent. Thereby each secures protection, one against decrease in value of the currency, the other against an increase.

The clause is not new or obscure or discolored by any sinister purpose. For more than 100 years our citizens have employed a like agreement....

The gold clauses in no substantial way interfered with the power of coining money or regulating its value or providing an uniform currency. Their existence, as with many other circumstances, might have circumscribed the effect of its intended depreciation and disclosed the unwisdom of it. But they did not prevent the exercise of any granted power. They were not inconsistent with any policy theretofore declared. To assert the contrary is not enough. The Court must be able to see the appropriateness of the thing done before it can be permitted to destroy lawful agreements. The purpose of a statute is not determined by mere recitals — certainly they are not conclusive evidence of the facts stated.

... This statute does not “work harm and loss to individuals indirectly,” it destroys directly. Such interference violates the Fifth Amendment; there is no provision for compensation. If the destruction is said to be for the public benefit proper compensation is essential; if for private benefit the due process clause bars the way.

Thus the dissenters pointed out the obvious: not only did FDR and the Congress not have the constitutional power to nullify the gold clauses, the gold clauses themselves did not interfere with any monetary power that the Constitution gave the federal government.

The dissenters also addressed the federal government’s repudiation of its own bonds and gold certificates:

Congress may coin money; also it may borrow money. Neither power may be exercised so as to destroy the other; the two clauses must be so construed as to give effect to each. Valid contracts to repay money borrowed cannot be destroyed by exercising power under the coinage provision.

The dissent also addressed the majority’s point that damages could not be assessed because of the prohibition on owning gold:

Congress brought about the conditions in respect of gold which existed when the obligation matured. Having made payment in this metal impossible the government cannot defend by saying that if the obligation had been met the creditor could not have retained the gold; consequently he suffered no damage because of the nondelivery. Obligations cannot be legally avoided by prohibiting the creditor from receiving the thing promised. The promise was to pay in gold, standard of 1900, otherwise to discharge the debt by paying the value of the thing promised in currency. One of these things was not prohibited. The government may not escape the obligation of making good the loss incident to the repudiation by prohibiting the holding of gold. Payment by fiat of any kind is beyond its recognized power. There would be no serious difficulty in estimating the value of 25.8 grains of gold in the currency now in circulation. These [U.S. government] bonds are held by men and women in many

parts of the world; they have relied upon our honor. Thousands of our own citizens of every degree not doubting the good faith of their sovereign have purchased them....

These words of Alexander Hamilton ought not to be forgotten: “When a government enters into a contract with an individual, it deposes, as to the matter of the contract, its constitutional authority, and exchanges the character of legislator for that of a moral agent, with the same rights and obligations as an individual.”

Finally, the dissent pointed out how the federal government had used its powers to enrich itself:

Under the challenged statutes it is said the United States have realized profits amounting to \$2,800,000,000. But this assumes that gain may be generated by legislative fiat. To such counterfeit profits there would be no limit; with each new debasement of the dollar they would expand. Two billions might be ballooned indefinitely — to twenty, thirty, or what you will.

Loss of reputation for honorable dealing will bring us unending humiliation; the impending legal and moral chaos is appalling.

With the ruling in the *Gold Clause Cases*, the final obstacle in the path of the power of the federal government to plunder and loot the people through debasement of their currency by the central monetary authority known as the Federal Reserve System had been overcome. FDR and his collectivist associates, both in the executive and legislative branches, had won another big one in transforming American society in a revolutionary way.

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