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The Impact of Inflation and Devaluation on Private Legal Obligations By Eliyahu Hirshberg

Sam Wolf

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SAM WOLF*

THE IMPACT OF INFLATION AND DEVALUATION ON PRIVATE LEGAL OBLIGATIONS: THE WORLD ECONOMIC CRISIS. By ELIYAHU HIRSHBERG. Jerusalem (Israel): "Daf-Chen" Press Ltd., 1976, 384 pp.

The effect of inflation nowadays on private legal obligations is all too apparent. Frustrated depositors in financial institutions have watched supposedly secure investments turn into losses in terms of purchasing power. Individuals who have entered into long-term building or supply contracts have found that because of an unanticipated increase in the rate of inflation they can only fulfill their contracts at a loss. In addition, inflation and the devaluation resulting therefrom have adversely affected the intentions of contracting parties by victimizing individuals who were required to purchase foreign goods (which have become higher priced because of devaluation) in order to fulfill contracts entered into before the devaluation occurred.

The author is concerned with the effects of rampant inflation on private monetary obligations in any legal system. His view is that of the lawyer rather than the economist and he does not propose economic solutions to inflation and devaluation. Instead, he has three purposes: first, to set forth the three legal approaches to the extent of monetary obligations, namely metallism, nominalism, and valorism; second, to set forth the law of several jurisdictions (primarily England and the United States with a comparative look at some civil law countries) to the degree that such law has a bearing on the problems in private law caused by inflation and devaluation; third, to propose measures for law reform.

Under *metallism*, the units of currency are defined in terms of a quantity of metal, such as gold. As long as the metal is sufficiently scarce the ability of governments to devalue the purchasing power of the currency is limited. However, as the author points out, the metallistic approach is largely of historical interest since modern industrial economies cannot be made dependent on the vagaries of gold production.

The prevailing approach throughout the world is *nominalism*. Under nominalism an obligation to pay a certain sum of currency units remains an obligation to pay just that specified number of units regardless of any change in the purchasing power of money.

The book serves a useful function in challenging the traditional legal rationales in support of nominalism. The author questions whether that principle is appropriate for all legal systems at all times.

*Sam Wolf has attended the London School of Economics, the University of Kent at Canterbury and Cambridge University and has contributed to the *Daily Mirror*, *The Times*, and *The Jerusalem Post*.

The major rationale for nominalism is that the parties must have intended the obligation to be defined by the number of monetary units stipulated since the parties could have taken measures to guard against inflation by special clauses. The fact that such terms are not included in a contract is taken to mean that one of the parties accepted the risk of inflation. The author argues, however, that the lack of special clauses in contracts as a basis for nominalism is fictitious in the best of times and breaks down entirely in periods of hyperinflation.

Valorism is an approach under which the extent of a monetary obligation is defined by the value included in a unit of currency. This approach has not been adopted by any legal system.

Despite the practical difficulties involved in implementing it, the author proposes what he calls "qualified valorism." Basically he accepts the nominalist principle so long as changes in the value of money are not considerable. However, he does not make it clear what "considerable" means in this context. What is offered is a vague definition, *i.e.*, that a change in the value of money is considerable when it is obvious to lawyers and judges as a collective body that the nominalist solution is unjust.

But the author also says that the application of valorism depends on the magnitude of the change in the value of money. Since the rationale for valorism is that it prevents inequities which arise when the contracting parties are not able to foresee and take into account changes in the value of money, the simple magnitude of the change by itself is not a relevant criterion. Changes in currency values are so common nowadays that contracting parties can and do foresee such changes. What they cannot readily foresee are large movements in the *rate* of change, over periods of time which have not traditionally witnessed such change.

The author justifies valorism in part by saying that because the only value of money to the holder is the extent of its command over goods and services, a person contracting to receive money at a later date should be entitled to money having this same external value. The author would apply valorism differently according to the length of obligations. He concludes that the valoristic principle should not apply to obligations for less than three years, but that valorism should be mandatory for obligations longer than ten years.

There is a major objection to valorism which needs careful legal examination. This is that it would set a dangerous precedent for other commodities and reduce the certainty and reliability of contracts in general. It would have been a great improvement to the book if the author had provided such an examination.

There are certain problems inherent in the adoption of qualified valorism which the author has not adequately considered. There are, in particular, two problems that require more attention than the book gives them. The first is that the risk of inflation in long term obligations may be reflected in the in-

terest rates. The application of the valoristic solution may then cause creditors to be doubly compensated for inflation, *i. e.*, once by a higher rate of interest, and secondly by the increase in indebtedness due to the valoristic solution.

A second problem is that valorism might itself increase inflation and thereby aggravate the economic difficulties which lead to its adoption. This is recognized by the author in his discussion of the effect of value and cost of living clauses. To the extent that the cost of production is increased by such clauses, cost-push inflation is stimulated. Therefore, it seems axiomatic that the adoption of a valoristic approach would increase such cost-push inflation. Further analysis of the economic implications of valorism is needed.

While the author makes a forceful case for valorism, the case would have been stronger if he had both concentrated more on showing how valorism could be implemented practically and conducted a deeper examination of the economic results of valorism.

The author explores several areas of existing law to see what relief from the effects of inflation they might provide. There is a full and very useful examination of the concept of value clauses (gold, foreign currency, and cost of living) intended to protect creditors from changes in the value of money.

One of the most fascinating parts of the book is chapter four which discusses gold value clauses with regard to their creation, operation, validity and abrogation by judicial and legislative actions in the U.S.A. and England.

There is a very interesting discussion of the doctrine of frustration of contracts. After setting forth the various theoretical bases for the doctrine the author concludes that changes in the value of money may be regarded as frustrating events. He maintains that the proper test for determining if a change in the value of money frustrates a contract is whether the parties implicitly assumed such a risk in given circumstances.

The author goes on to suggest that the doctrine of frustration be applied when rapid changes in the currency values alter the commercial sense of a contract. He argues that such a step could complete a logical progression of the doctrine away from the very rigid position taken by the English courts in the nineteenth century. However, it may be argued that the author's suggestion takes the doctrine a step too far and would destroy the fundamental distinction between a contract frustrated by events beyond the parties' contemplation and a contract which foreseeable events have merely made uneconomic.

The overall merit of this work is that it stimulates much necessary thought on a complex subject of great contemporary importance.