BOOK REVIEW

THE IMPACT OF INFLATION AND DEVALUATION ON PRIVATE LEGAL OBLIGATIONS: By Eilyahu Hirschberg. Bor-Ilan University, Ramat-gan, Israel, 1976. Pp. 380.

Inflation has been an economic problem of some concern in western industrialized countries of late. Its economic impact on private legal obligations is rather obvious. One need only witness the frustrated intentions of creditors such as depositors in financial institutions who find that because of continuing inflation their apparently secure investment has actually resulted in a loss in terms of real purchasing power. The impact of inflation will also be felt by individuals who have entered into long-term building or supply contracts and who find that as a result of a sudden and unanticipated surge of inflation they can only fulfill their contracts at a loss. Likewise the devaluation of a national currency can also wreak havoc on the intentions of contracting parties. In certain countries, such as Israel, currency devaluation (largely caused by inflation) has become quite frequent. The impact of devaluation on private obligations is not as widespread as inflation; its main impact will fall on individuals who are required to purchase foreign goods (which are more expensive than anticipated as a result of devaluation) in order to fulfill contractual obligations entered into before the devaluation took place.

In this book, Eliyahu Hirschberg attempts to accomplish several ends. First, he sets forth the various theoretical legal approaches to the problem: nominalism, metallism, and valorism. Secondly, he states the law of various jurisdictions (primarily England and the United States, with a comparative look at some civil law jurisdictions) to the extent that such law might have a bearing upon the legal problems created by inflation or devaluation in a private law setting. In this context he discusses *inter alia* the law relating to various types of value clauses in contracts, and equitable relief. Thirdly, Mr. Hirschberg proposes reform in the law.

It is important to stress that this book is not a book which proposes an economic solution for the twin problems of inflation and devaluation. The author recognizes or is at least prepared to assume that in a modern industrial state inflation and devaluation sometimes may be a necessary evil of other economic goals are to be met. His concern is with the effects which rampant inflation may have on private obligations within any legal system. His ultimate proposal is one which attempts to mitigate the sometimes unjust side-effects within an economy, while at the same time permitting inflation and/or devaluation to take place.

In Part One of the book, the author sets out quite well the various theoretical approaches to the problem and the rationales behind such approaches. The prevailing approach under Anglo-American law is nominalism. Under nominalism an obligation to pay a certain sum of units in a given currency remains an obligation to pay just that specified number of units. Any decrease in terms of purchasing power is disregarded in the eyes of the law. The main theoretical basis for the

principle is that the parties must have intended the obligation to be defined by the number of units of currency stipulated since the parties could have taken measures to guard against inflation, *e.g.* value clauses, cost escalator clauses. etc.[1] The fact that such terms were not included in the contract must be taken to be indicative of the fact that one of the parties was bearing the risk of inflation. However, this basis of nominalism is a bit fictitious in the best of times and breaks down entirely in periods of hyper-inflation such as existed in Germany following World War I.[2] Besides this theoretical rationale for nominalism there is a practical reason for supporting the nominalistic approach, namely that without it there would be considerable uncertainty in commercial relationships.

A second approach to the problem of inflation is metallism. Under metallism, the units of account of a given 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 only since ". . . modern industrial economies cannot be made dependent on the vagaries of gold production. . . ."[3]

The third approach to the problem is valorism. Valorism is an approach under which the extent of a monetary obligation is defined not, ". . . by nominal sum[s] of units of currency but . . . by the value included in such monetary units. . . ."[4] This approach has not been adopted by any legal system. Despite the practical difficulties involved in implementing such an approach the author ultimately proposes what he calls "qualified valorism". Basically he would adhere to the nominalistic approach as long as changes in the value of money are not considerable. While no practical guidelines as to what is "considerable" are set forth he proposes the following test: "the changes in the value of money must be so considerable that it is obvious to professional opinion, lawyers, and judges, as a collective body, that the nominalistic solution is unjust."[5] He would apply valorism differently, according to the duration of the obligation. Thus he concludes that short-term transactions (under three years), being so widespread, require more stability. Thus a valoristic approach is undesirable. On the other hand, in long-term transactions (more than ten years), the extent of monetary changes are relatively unforeseeable; hence the need for the valoristic solution.[6]

By the use of extreme examples, the author forcefully makes the point that valorism may indeed be a necessary solution if justice is to be done. For example, he cites the case of a life insurance policy made in St. Petersberg in 1887 in which the obligations were defined in German Marks. The premiums were duly paid, and ultimately when the time came in 1922 to pay out the claim under the policy, the amount paid ". . . was barely sufficient for the purchase of a packet of cigarettes. . . ."[7]

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[1] Hirschberg, *The Impact of Inflation and Devaluation on Private Legal Obligations* (1976) at 67, 72-73.

[2] *Id.* at 83-86.

[3] *Id.* at 58.

[4] *Id.* at 59.

[5] *Id.* at 99.

[6] *Id.* at 101.

[7] *Id.*

While the solution of qualified valorism appears to be more just than the present legal approach, there are certain problems inherent in its adoption which I do not think the author adequately considers. I raise just two problems that merit considerably more attention than has been given them in this book. The first is that to a certain extent the risk of inflation in long-term obligations may be reflected in higher interest rates. To the extent that this is true, it is a factor which tends to ameliorate the effects of inflation. An application of the valoristic solution in such circumstances could lead to creditors being doubly compensated in respect of inflation: once, by the higher rate of interest and a second time by the increase in the amount of the indebtedness as a result of the valoristic solution. The author does not fully work out the implications of valorism in this area of long-term interest rates.

A second problem arising as a result of valorism is that conceivably it may fuel inflation even more, thus aggravating the economic problems that lead to the adoption of valorism in the first place. The author, in fact, admits this is his discussion of the effects of value clauses[8] and cost-of-living clauses.[9] To the extent that the cost of production is increased as a result of such clauses, cost-push inflation is stimulated. Yet it seems axiomatic that the adoption of a valoristic approach could only increase such cost-push inflation. Here, too, further analysis of the economic implications of valorism seems warranted.

In short, while Mr. Hirschberg makes a rather forceful theoretical case for a valoristic solution. It could have been made even more forcefully had he concentrated more on showing how this valoristic approach could be practically implemented, and on exploring in more depth the economic ramifications of such an approach.

As well as considering the different theoretical approaches to the problem, the author has explored several substantive areas of existing law insofar as possible relief from the effects of inflation might be attainable. His treatment of the legality of value clauses in contracts[10] (gold value clauses, foreign value clauses, and index value clauses) is well done and enlightening. However, his treatment of the doctrine of frustration of contracts is unsatisfactory. After setting forth the various theoretical bases for the doctrine of frustration, he concludes that the changes in the value of money can be regarded as a frustrating event. Having concluded that mere economic unprofitability does not justify frustration he argues that monetary changes should be regarded as equivalent to "Acts of God" (since they originate in acts of governmental authorities and are thus unforeseeable). The proper test, he maintains, for determining whether monetary change frustrates a contract is, "Did the parties implicitly assume such a risk or not, in given circumstances?"[11] Unfortunately, his discussion of the case law in this area is somewhat misleading in that he cites cases supportive of his argument while omitting others that point towards an opposite conclusion. By way fo example, he cites *Krell* v. *Henry*[12] but not *Herne Bay Steam Boat Company* v. *Hatton*.[13] He cites the one Suez Canal case

[8] *Id.* at 113.
[9] *Id.* at 151.
[10] Chapters 3, 4, 5, 6.
[11] *Id.* at 188.
[12] [1903] 2 K.B. 740.
[13] [1903] 2 K.B. 683.

which tends to lend support to his argument,[14] and does not refer to Suez Canal cases which support the opposite point of view.[15]

While the law relating to value clauses and frustration are the two most relevant areas of substantive law discussed, the author does discuss several other areas of substantive law, Some of the areas of law have at best an only indirect bearing upon the problem. For example, it is difficult to see the relevance of the various equitable principles, except in the most incidental way. Certainly equity as such can provide no relief to a party who is faced with unanticipated increased costs or who will receive payment in a depreciated currency.

Overall, it is this reader's opinion that, in spite of the failure to deal with the economic implications of valorism in more depth, the book does serve a useful purpose in that it takes a legal principle, nominalism, which is rarely questioned, and challenges the traditional legal rationales for its existence. The reader is forced to consider, very carefully, whether that principle is appropriate for all legal systems at all times. (Indeed, one wonders whether the common law is sufficiently flexible so that truly just solutions could be rendered in situations of hyper-inflation which have existed in some countries in the past.) Potential readers are cautioned, however, that those parts of the book analyzing specific areas of existing law are in certain instances misleading, and in others of limited or only peripheral significance, as far as the legal problem presented by inflation and devaluation is concerned. All the areas of substantive law discussed make for difficult reading and demand from the reader a breadth of knowledge of different areas of law in different jurisdictions.

—R. S. NOZICK*

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[14] *Societe Franco Tunisienne d'Armement* v. *Sidemar S.P.A.*, [1960] 3 W.L.R. 701.

[15] *See Tsakiroglou & Co., Ltd.* v. *Noblee Thorl*, [1962] A.C. 93 (H.L.); *Albert D. Gaon & Co.* v. *Societe Inter-Professionale des Oleagineaux Fluides Alimentaires*, [1960] 2 Q.B. 334.

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