

June 2, 1945.

MEMORANDUM FOR THE PRESIDENT

From: William H. Davis, Economic Stabilization Director  
Subject: Program to Check Inflation of Capital Values

The Current Situation.

The continued rise of prices in the farm and urban real estate markets and in the stock market makes Government action to check further speculative increases imperative. (See attached report.)

With the surrender of Germany, new and serious pressures on the hold-the-line program are developing. Even if a higher level of capital values in some cases may reasonably be anticipated in the long-run, continuation of the present rapid rate of increase in values would help inflame inflationary psychology. Adoption and announcement of a program to curb inflation in the real estate and stock markets will indicate in a most effective way the Government's determination to resist inflationary pressures and will thus strengthen the whole economic stabilization program.

Proposed Program.

The following four point program, which has been discussed and approved by the Economic Stabilization Board, is recommended:

1. Limitation on the use of credit in purchasing farm and urban real estate through higher down payments, and possibly more rapid amortization. Guaranteed loans under the G. I. bill of rights and tenant purchase loans by the Farm Security Administration should be exempt from the regulations. Loans in connection with new construction should also be exempt, at least at the outset.
2. Increase the margin requirements for new purchases of securities, putting the market more nearly or completely on a cash basis. This should not be done until the Seventh War Loan Drive is ended.

3. Extend from the present six months to three years the minimum holding period for computing long-term capital gains for the Federal ~~income~~ tax.

4. An information program stressing the need for caution in purchasing farm and urban real estate and securities.

While the present increase in real estate values is being financed to a smaller extent by credit than comparable rises in the past, credit is nevertheless a very important factor. Limitations on its use will restrict demand and so dampen price increases. By preventing shoestring financing, they will also reduce the volume of foreclosures and other financial distress later.

The present tax law defines a long-term capital gain as any made in a period of six months or more. With surtax rates at present high levels and a ceiling tax rate of only 25 percent on long-term gains, this generous definition provides a serious loophole in the tax laws. Under it the gains from speculation receive tax treatment which is glaringly inconsistent with the restraints imposed upon wages, profits and other ordinary income and which invites speculation. The present six month period is much shorter than that used to define a long-term gain in any of our tax laws at least as far back as the Revenue Act of 1921. It represents an overdose of leniency put into the 1942 tax law for the specific purpose of encouraging trading in securities. Increased taxation of capital gains through lengthening of the holding period should serve to dampen speculative ardor.

Action Necessary to Put Proposed Program Into Effect.

1. Institution of credit control in the field of farm and urban real estate will require either new legislation or an executive order under the Trading With the Enemy Act, as amended by the First War Powers Act. A proposed executive order delegating power to regulate such use of credit to the Federal Reserve Board under the general policy direction of the Office of Economic Stabilization has been drafted and submitted to the Bureau of the Budget for clearance. It is substantially similar to the order in force since August 1941, underlying the control of consumer credit.

2. An increase in margin requirements for the purchase of securities is within the present powers of the Federal Reserve Board. The Board is willing to take the necessary action, provided such an increase in margin requirements is part of a comprehensive presidential program.

3. An increase in the minimum holding period for computing long-term capital gains for income tax purposes requires tax legislation. Judge Vinson and I have had preliminary discussions with Mr. Doughton and other members of the Ways and Means Committee. They requested the

staff of the Joint Committee and the Treasury tax staff to study the matter further and prepare a joint report. The Treasury staff favors extension of the holding period (as do experts of other executive agencies which have been consulted). The staff of the Joint Committee, however, is unconvinced of the necessity for immediate action to check the speculative rise of capital values and is cool to an extension of the holding period on this ground. I understand that this is also the attitude of some of the members of the Joint Committee. As a means of closing a loophole in present income taxation, however, the proposal might get their support. You may wish to discuss the proposal with them.

Since institution of real estate credit control would involve extension of Government controls at a time when the public and Congress look for their relaxation, you may wish also to discuss with Congressional leaders the relative merits of instituting it by new legislation and by executive order.

If, after such discussions, it is concluded that an executive order instituting real estate credit controls should be issued, I recommend:

- (1) that the executive order be issued promptly;
- (2) that it be accompanied by a press release explaining
  - (a) that it is part of a comprehensive program comprising both credit and tax action to deal with the problem of the speculative rise in capital values;
  - (b) that new construction undertaken with priority assistance will be exempt from the credit control regulations at the outset and that, if it should later prove desirable to remove this exemption, ample notice of its removal will be given;
  - (c) that the Board of Governors of the Federal Reserve System already has authority to regulate margin requirements in connection with security transactions; and
  - (d) that the President is recommending to Congress that the holding period for long-term capital gains under the tax laws be increased to three years.

Attachment >