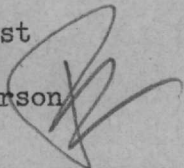


*File* **Office Memorandum • UNITED STATES GOVERNMENT**

TO : Mr. George Vest

FROM : Thomas I. Emerson 

SUBJECT:

DATE: June 21, 1945

I am attaching a copy of the final draft of the Executive Order on Real Estate Credit, as submitted to the Bureau of the Budget today. I am also attaching copies of the final draft of the memorandum sent by Mr. Davis to the President together with a letter of transmittal to Judge Vinson.

Encls. 3

June 23, 1945  
CEP

First Draft of Proposed Memorandum from  
Chairman Eccles to William H. Davis

*the Stabilization Division's*

For the reasons stated below, it is the considered view of the Board of Governors that to exempt new construction from the proposed real-estate credit control, as advocated in ~~your~~ memorandum of June 19 to the President, would be a serious and perhaps even fatal mistake.

*nullifying*  
This control, ~~as you know~~, is relatively weak at best, and to weaken it still further through the proposed exemption would come close to ~~stultifying~~ the whole action. Instead of dampening the over-all demand for homes, as the action would be intended to do, it would merely push a large part of that demand into the new-house sector. If home-buyers must make a large down payment on a house bought from anybody but the builder, but not on one bought from him, they will certainly flock in his direction, with the consequence that the difficulty of "holding the price-level line" in the new-house sector will be made more difficult than it already is.

In addition, the Board is advised by its staff that, for two principal reasons, the proposed discrimination might actually destroy the administrative feasibility of the control. In the first place, the clean-cut moral basis of the regulation, essential to the necessary educational program, would be impaired; in view of the large loophole, we could no longer say that the objective is to dampen demand and that the regulation is a reasonable means to that end. In the second place, the discrimination would give interested parties additional incentives to evasion and avoidance, thus making more difficult administrative and enforcement problems which are bound to be very difficult at best.

A counterargument -- that to include credits for buying new houses would curtail the supply of new houses -- seems to us, in present circumstances, to be quite unrealistic. For all the new houses that can be built during the next year, considering the natural limitation imposed by shortages of materials and labor, there will be abundant demand, counting both the cash demand and the credit demand. In fact, the staggering size of the demand for new houses is a matter of common knowledge and frequent mention in the press. It is worth noting also that the pressure groups which are advancing the counterargument are at the same time advocating higher prices and also framing their proposal so that it would play into the hands of so-called speculative builders as against people wanting to build houses for their own occupancy.

In view of the position taken by the Board on this issue, it would be most unfortunate for the President, in his negotiations with members of Congress or any statement to the press, to say (as ~~the~~ memorandum advises) "new construction will be exempted, at least at the outset." The most that he should say is something in general terms -- e.g., "Due and careful consideration will be given to the importance of new construction in order that the control shall not be so administered as to restrict new construction."

June 26, 1945.

Honorable Fred M. Vinson, Director,  
Office of War Mobilization and Reconversion,  
Washington, D. C.

Dear Judge Vinson:

The Office of the Economic Stabilization Director, Mr. Davis, has transmitted to me a copy of his letter of June 21 submitting to the Director of the Budget for clearance in the usual manner the proposed Executive Order dealing with the regulation of real estate credit together with a letter to you of June 19 to which is attached a memorandum of the same date for transmittal to the President.

I have no question to raise with regard to the form and text of the Executive Order if it is to be issued, but I cannot support the program in the form in which it is submitted in the accompanying memorandum, for standing alone and unexplained I think the President might get an impression which would not be correct. I know that neither you nor Mr. Davis has any such intention and that you are both eager to do what is necessary and most effective on this now unprotected sector of the economic front.

You and Mr. Davis certainly must be familiar with my viewpoint, and I cannot help but feel very strongly that it should be passed on to the President for whatever value it may have to him in judging whether he should sign the Executive Order after consulting the leaders of Congress and in determining the sort of explanatory public statement that should be given out if the Order is to be issued. I had hoped to have an opportunity to accompany you and Mr. Davis to the White House if it is your intention to have a discussion in person with the President about this matter, but if that course is not to be followed, then at the very least I wish you would present to him on my behalf the enclosed memorandum. In it I have tried to state as briefly as possible the reasons why I am so strongly convinced that effective action turns on whether Congress can be persuaded to take action on the capital gains front. This sector cannot be protected merely by dealing with credit, which is the minor, while cash transactions are the major factor, not only in the stock market but also in the buying of farms and homes. If the credit control itself is to be weakened by exempting new construction, as the memorandum proposes, its unimportance would be decidedly accentuated. In this connection I enclose a memorandum which brings out forcibly the reasons why new construction should not be exempted as Mr. Davis proposes. It is undesirable, incidentally, that the memorandum should give the impression that the Board is willing to perform its statutory duty with respect to margin requirements only on condition that this is part of a Presidential program.

DATE FILE



If the Congress, after having considered the matter, refuses to act in the only way I know of to reach the cash speculative element, then doing something on the credit side may be preferable to doing nothing at all. Certainly the public should not be led to suppose that credit curbs by themselves, unless preceded and fortified by an attack on the root of the problem, will be effective. I do not want to take the responsibility of failing to press so far as I can for the effective curb on cash operations as the first and most important thing. Then, if we are driven back to nothing more than the credit controls, it seems to me very important from the standpoint of the Government and the President that there be no illusions about how limited this approach alone would be--the more so, because of the changed mood of the country and the increasing impatience with existing, let alone new, controls.

In conclusion, let me emphasize two points: first, that because of its responsibilities in the credit field, the Federal Reserve System is the appropriate agency to administer the Order, and secondly, that if the responsibility for carrying out the Order, in case it is issued, and for issuing regulations is placed upon the Reserve Board we would wholeheartedly and to the best of our ability strive to make its administration as successful as possible.

Sincerely yours,

H. S. Eccles,  
Chairman.

Enclosure

ET:mla

DATE FILE

June 26, 1945.

Honorable William H. Davis, Director,  
Office of Economic Stabilization,  
Federal Reserve Building,  
Washington 25, D. C.

Dear Mr. Davis:

Enclosed is a copy of a self-explanatory memorandum which I have sent to Judge Vinson today with the request that it be passed along to the President in connection with your proposed program for dealing with the inflation problem as it affects, particularly, homes, farms and stocks. I am also enclosing a separate memorandum to emphasize why the Board feels that if the Executive Order on mortgage credit is to be issued, it should not be accompanied by an announcement exempting new construction. In response to the request I received from the Budget Bureau for my views on the proposed Executive Order, I have also sent copies of both of these memorandums to the Budget Director's office.

I know how greatly concerned you are to meet this problem effectively, and I think you appreciate my feeling and my reasons for pressing as vigorously as possible for what seems to me an adequate tax approach first and foremost.

Sincerely yours,

(Signed) M. S. Eccles

M. S. Eccles,  
Chairman.

Enclosures  
ET:bjd

DATE FILE

June 26, 1945.

Mr. F. J. Bailey,  
Assistant Director,  
Bureau of the Budget,  
Washington 25, D. C.

Dear Mr. Bailey:

Mr. Morrill reported to me your telephone conversation with him in regard to the proposed Executive Order, dealing with mortgage credit, which has been submitted to the Bureau of the Budget for clearance. For your information and guidance, I am enclosing a copy of the memorandum I sent today to Judge Vinson explaining why I cannot support the anti-inflation program, directed specifically to capital assets, in the form in which it is proposed in the memorandum to the President from the Stabilization Director. Also enclosed is a separate memorandum emphasizing why the Board feels that the Executive Order, if it is to be issued, should not be accompanied by an announcement, as proposed by Mr. Davis, exempting new construction. As you will note, I have no objection to the Executive Order textually, but strongly object to its issuance unless Congress has first acted or at least given assurance of favorable action on the tax proposal to deal with the major inflationary dangers on this front. The Executive Order relates only to the credit side of the picture which is the least important. While I have requested Judge Vinson to transmit my memorandum to the President, I would appreciate it if you could see that it goes forward to the White House with such report as you make on the Executive Order.

Sincerely yours,

(Signed) M. S. Eccles

M. S. Eccles,  
Chairman.

Enclosures  
BT:bjd

DATE FILE



Memorandum from Chairman Eccles to William H. Davis

For the reasons stated below, it is the considered view of the Board of Governors that to exempt new construction from the proposed real-estate credit control, as advocated in the Stabilization Director's memorandum of June 19 to the President, would be a serious and perhaps even fatal mistake.

This control is relatively weak at best, and to weaken it still further through the proposed exemption would come close to nullifying the whole action. Instead of dampening the over-all demand for homes, as the action would be intended to do, it would merely push a large part of that demand into the new-house sector. If home-buyers must make a large down payment on a house bought from anybody but the builder, but not on one bought from him, they will certainly flock in his direction, with the consequence that the difficulty of "holding the price-level line" in the new-house section will be made more difficult than it already is.

In addition, the Board is advised by its staff that, for two principal reasons, the proposed discrimination might actually destroy the administrative feasibility of the control. In the first place, the clean-cut moral basis of the regulation, essential to the necessary educational program, would be impaired; in view of the large loophole, we could no longer say that the objective is to dampen demand and that the regulation is a reasonable means to that end. In the second place, the discrimination would give interested parties additional incentives to evasion and avoidance, thus making more difficult administrative and enforcement problems which are bound to be very difficult at best.

A counterargument -- that to include credits for buying new houses would curtail the supply of new houses -- seems to us, in the present circumstances, to be quite unrealistic. For all the new houses that can be built during the next year, considering the natural limitation imposed by shortages of materials and labor, there will be abundant demand, counting both the cash demand and the credit demand. In fact, the staggering size of the demand for new houses is a matter of common knowledge and frequent mention in the press. It is worth noting also that the pressure groups which are advancing the counterargument are at the same time advocating higher prices and also framing their proposal so that it would play into the hands of so-called speculative builders as against people wanting to build houses for their own occupancy.

In view of the position taken by the Board on this issue, it would be most unfortunate for the President, in his negotiations with members of Congress or any statement to the press, to say (as the memorandum advises) "new construction will be exempted, at least at the outset." The most that he should say is something in general terms -- e.g., "Due and careful consideration will be given to the importance of new construction in order that the control shall not be so administered as to restrict new construction."

MEMORANDUM

TO - The President

FROM - M. S. Eccles

Strongly as I favor an effective program to curb rising prices of capital assets, particularly homes and farms as well as stocks, I can not favor the program in the form in which it is presented in Mr. Davis' memorandum.

1. It gives first place to what I think is a secondary, subordinate step, namely regulation of mortgage credit. It puts in third place what I regard as by far the most effective weapon covering the entire field of capital assets, that is, tax action which would curb all speculative transactions, whether based on cash or credit.

2. Private credit is not the principal source of danger. The great threat overhanging the economy arises from the enormous, still growing volume of cash or its equivalent in the possession of the public as a result of war expenditures. Private credit has continued to shrink, on balance, and according to present estimates will contract still more in the next fiscal year, without any further restraints. Public holdings of cash or its equivalent, however, will increase by at least \$33 billions by June 1946.

3. The following comparison strikingly illustrates how vital it is to act on the tax front if this problem is to be effectively met and how relatively unimportant it is to act on the credit front, except possibly as a supplemental step: Private credit, i.e., the sum total of all private debt in the country, dropped from \$161 billions in 1929, to \$127 billions in 1940, and to \$125 billions at present. On the other hand, cash or its equivalent



held by the public--the real inflation potential--increased from \$64 billions in 1929 to \$77 billions in 1940, and has now reached the alarming total of nearly \$250 billions. Accordingly I feel that the program should be aimed first at what is the far greater source of danger.

4. To put curbs on mortgage credit without first curbing speculative cash as well as credit transactions by an adequate capital gains tax would be entirely ineffective, and effective tax action may even make the proposed Executive Order on mortgage credit unnecessary.

5. Extension of the holding period from the present 6 months to 3 years, as proposed in the memorandum, would be effective, provided, however, the present 25% rate is increased to 40 or 50%, *and the tax is also made* ~~the tax should also be~~ applicable to the large number of aliens who do not pay any capital gains tax now because of loopholes in the law and regulations but who are making fortunes by speculation in capital assets.

*An effective tax measure or*  
6. ~~I have no objection to~~ *not satisfactory* the form and text of the Executive Order as proposed, but I think it would be a mistake to issue the Order until ~~assured~~ *has elicited sufficient assurance of favorable action* ~~that Congress will enact the tax program.~~ Similarly I feel that at such time as the Order may be issued exemptions from the Order should not be announced in any accompanying public statement, but that these matters should be left to the discretion, after consultation, of the agency charged with responsibility for carrying out the Order and issuing regulations. I am advised by my technical staff that to exempt new construction, for example, as proposed in the memorandum, would be a serious and perhaps fatal mistake because the effect would be to shift the already huge public demand from existing properties, which would be subject to high cash payments, to the new construction requiring relatively small down payments, thus intensifying inflationary pressures. Neither the general public

nor the returning veterans should be thus encouraged to go heavily into debt for homes built in wartime at high costs and with inferior materials.

7. While I think it would be preferable for the Reserve Board to take action on margin requirements for stocks as a part of a comprehensive program, the Board is prepared to act at any time when it is felt that the situation requires it.

*The situation in the market at present is such that I think it may be inadvisable to delay action*

I agree that it is very desirable to discuss both the proposed Executive Order as well as the tax proposal with Congressional leaders, letting them know that a credit control program would be entirely inadequate unless they are willing to take action on the tax front.

*margin*