

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date February 15, 1945

To Chairman Eccles

Subject: Capital Gains Proposal

From Richard A. Musgrave R.A.M.

The capital gains proposal was discussed at yesterday's meeting of the Interdepartmental Tax Committee. You may be interested in a brief summary of the views expressed.

Mr. Blough primarily emphasized the difficulties involved in convincing Congress that such a measure is necessary. He believes that to have the proposal accepted it would be necessary to present the dangers and likelihood of an imminent drastic inflation in capital values in the strongest terms, and that this scare in itself may have the very effect which the tax is meant to avoid. Also, he is concerned with the implications of the tax for the transition period when some investment will be desirable in the interest of prompt re-conversion. However, this is somewhat less important than the first point.

Mr. Colm (Budget Bureau), after having discussed the matter with the Director of the Budget, indicated that they were much impressed by the equity aspect of the argument and the need for preventing war profiteering in capital values as a matter of maintaining morale at the home front. He indicated that he was little impressed by the economic aspects of the argument either with respect to financing or with respect to the effects upon the general stabilization program. However, he would favor some action on equity grounds although he was non-committal as to whether as drastic a proposal could be justified on equity grounds only.

Mr. Henry Murphy (Treasury) sympathized with the equity aspects of the proposal but was concerned that pressure and publicity necessary to get it through Congress would have a bad effect on the security market. Taking the general position that it does not make very much difference with respect to inflation potential, whether the Treasury borrows from banking or non-banking sources, he appeared to think that the tax proposal might do financing more harm than good.

Mr. Pritchard (close assistant to Judge Vinson) agreed that some action was desirable but thought that this proposal would have no chance of acceptance in Congress and that its publicity effects might be most damaging. If adopted, he felt that it would be difficult to obtain the administrative discretion necessary to taper it off promptly. He believes that the advantage of approaching the problem by way of credit measures is that such policy could, to some extent at least, be undertaken without

Congressional action and similarly could be withdrawn promptly. He is not sure whether credit controls would do the job but thinks that this is where the beginning should be made:

- 1) because it can be done more simply and with less noise, and
- 2) because a credit financed inflation of capital values is particularly damaging to the debtor when values collapse.

Walter Salant (assistant to Richard V. Gilbert, Director of Research at the Office of Price Stabilization) suggested that the tax would not meet what is perhaps the most serious point at which an increase in values may undermine the stabilization program, namely house-owners who by-pass rent ceilings by forcing tenants to buy at exorbitant prices. Since these are mostly people who must have a place to live rather than speculators, they would not be deterred by the tax nor would the sellers who in most cases had possession prior to January 1. Mr. Salant also shared the concern that politically the tax would be a most difficult proposition.

The discussion is to be continued at a second meeting tomorrow.