March 2, 1945.

Dear Dan:

I am attaching a copy of a statement I have given out in an effort to clear up the very widespread misunderstanding of what I proposed when members of the Senate Banking and Currency Committee questioned me the other day on what could be done about checking the inflationary rise of homes, farms and other capital values.

While I had not intended to send up any trial balloon, my recommendation of the wartime capital gains tax seems to have stirred up a good deal of discussion, much of it based on complete misunderstanding, which I hope this statement will remove.

Sincerely yours,

Honorable D. W. Bell,
Under Secretary of the Treasury,
Washington, D. C.

Enclosure

ET:b

March 2, 1945.

Dear Fred:

Enclosed is a copy of the clarifying statement on my suggestions in regard to a capital gains tax. As I said to you over the phone the other day, it has been so greatly misunderstood that I felt it particularly important to put out a statement that would say just what I had suggested when I was questioned on this subject by members of the Senate Banking and Currency Committee and the reasons why I favor this tax.

If, as I hope, this statement helps clear the air and remove some of the opposition, so much the better.

Sincerely yours,

Honorable Fred M. Vinson,
Director,
Office of Economic Stabilization,
Washington 25, D. C.

Enclosure

ET:b

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

FOR THE PRESS

For release in morning newspapers of
Saturday, March 3, 1945

March 2, 1945

STATEMENT BY MARRINER S. ECCLES ON A CAPITAL GAINS TAX

TO CURB RISING PRICES OF CAPITAL VALUES

When questioned by members of the Senate Banking and Currency Committee last week as to what could be done to prevent further inflation of capital values, I reiterated my opinion that the most effective single instrument would be a wartime penalty rate on capital gains. Since the proposal, which was only briefly discussed before the Committee, has been widely misunderstood and misrepresented in some quarters, I feel that I should outline what I advocated and why.

I did not propose any change in the present capital gains tax. My proposal would apply only to the sale of capital assets (as defined under the present law) acquired during a period to be fixed by Congress. My suggestion was that this period be from January 1, 1945 until such time as inflationary dangers have passed, which might be two, or possibly three years after the war. This special wartime capital gains tax would not be superimposed upon the existing tax, but would apply only to assets purchased during this period. It would not apply to real estate, stocks or other assets acquired at any time prior to January 1, 1945. These assets, if sold, would continue to be subject to the existing capital gains tax. The special tax I have in mind would impose a 90 per cent rate on capital gains derived from the sale, within two years, of capital assets acquired during the specified period; thereafter it would diminish by 10 per cent, or more, annually until equal to the existing rate. Capital losses incurred on transactions subject to the special rate would be deductible against profits.

The special tax, like any other anti-inflation control, should be discontinued when the need for it no longer exists. Since the purpose of the special tax is anti-inflationary, revenue is not the objective and the more effective the tax, the less it would yield. However, such yield as resulted would be based on rates in line with those imposed under the wartime individual and corporate income tax structure.

The reasons for such a special capital gains tax may be summarized as follows:

1. Capital values, as reflected in current prices of homes, farms, business properties and stocks, have increased sharply since this country entered the war, and are still increasing. If unchecked, this trend would undermine the entire price and wage stabilization program, with grave consequences to postwar reconversion. It would make war-financing problems more difficult and increase the cost of the war. It would make a mirage of the hopes of millions of war veterans who are counting on being able to obtain a home, or a farm, or to get started in business when they return from the front. Congress has encouraged this hope in the so-called G. I. Bill of Rights, and by providing dismissal pay and otherwise. Those on the home front have an inescapable obligation to take whatever steps may be necessary to protect the values of homes, farms and other necessities so that they will not be hopelessly out of reach of the veteran's purse. There are no war profits in that purse.

2. While other sectors on the home front have been protected by direct measures, such as rationing, allocations, price and wage controls, no effective controls have been applied to curb rising prices of homes, farms, stocks and other capital assets. The wartime expansion of liquid assets presents a vast and growing danger to these unprotected sectors. Currency, demand deposits and Government securities held principally by individuals and corporations are rapidly approaching 200 billion dollars and have nearly tripled since we entered the war. This huge inflation potential will continue to grow as long as deficit-financing continues. Unless effective action is taken to prevent these liquid funds from increasingly inflating capital values, it will become more and more difficult, if not impossible, to hold the line against inflationary price and wage increases. Veterans of the last war, especially farmers, have not forgotten the inflation and the consequent ruinous deflation resulting from failure to control a relatively small volume of liquid funds in the last war. The present volume of such funds is already four times as great as it was in 1920. The national debt is nearly ten times larger today and is still growing.

3. The most serious gap in the line of defense against inflationary forces is the capital gains loophole in the wartime tax structure. While Congress has provided sharply progressive surtax rates, rising to a high of 91 per cent on individual incomes, and a maximum excess profits tax of 95 per cent levied upon operating profits of corporations, no corresponding curb has been put upon capital gains, which continue to be subject to prewar rates, with a 25 per cent maximum. This huge differential in favor of the capital gains tax benefits only the larger taxpayers. The bigger they are, the greater the inducement today to dispose of or refuse to put money into fixed interest-bearing obligations that return only a small yield and have little chance for a capital gain, and to put money instead into capital assets, which, when sold on a rising market, yield profits subject only to a capital gains tax of 25 per cent, or less.

Yet these profits are just as much a result of war expenditures as are high individual and corporate incomes which are subjected to high wartime tax rates. The inequity of this situation is the more pronounced because the benefit of the tax differential accrues only to those in the higher income brackets. The smaller income taxpayers can derive no tax benefits from it. Large operators, however, -- so-called smart money -- are taking more and more advantage of the opening, and this is a principal factor at present in bidding up real estate, stocks and other capital values. It is not the bona fide investor or the small taxpayer who is applying this upward leverage to prices of capital assets. This is speculation -- not investment. It is speculation in basic essentials such as homes, or farms, or in stocks representing business investments. It adds nothing to national wealth. Such forms of gambling as betting on horse races or playing slot machines do little economic damage. But speculating in the things that people need and use, speculation that leads to disruption of production and employment, is the worst form of gambling.

4. The proposal I have in mind would simultaneously reach and discourage all such speculative transactions, whether in homes, farms, stocks or commodities, and whether based upon credit or cash -- and would do so without interference with normal, nonspeculative transactions, whereas, if credit restrictions alone were applied, they would fail entirely to reach cash transactions for speculative purposes and would interfere with legitimate, nonspeculative credit transactions. The bona fide investor would not be deterred either now or in the reconversion period by the proposed tax, for he puts his money into a farm, or into stocks of existing or of new enterprise for the purpose of obtaining current income and for long-range appreciation of values. It is the speculator, not the investor, who puts money into capital assets in anticipation of a quick rise in price from which a speculative profit can be realized through selling before the price breaks. However, should the investor be obliged or desire to sell while the wartime rate is still in effect, he would not be injured, since he had not purchased in anticipation of selling in order to make a speculative profit. In any event, under the proposed tax, he would be permitted to retain a profit of 10 per cent, or more, depending on how long he held the asset.

5. To the extent that the proposed tax would discourage surplus funds from going into speculative fields, to which they will be attracted so long as prices are rising, there will be that much more available to go into Government securities where they should go to help finance this war. It would appear from criticisms expressed by some of the financial press and market operators that they fear the tax would be effective in greatly reducing buying activity that might otherwise develop. That is the purpose of the tax. According to these critics, the proposed tax would dry up the market because it would deter holders of capital assets from selling. But it need not deter holders of assets acquired prior to the effective date of the tax from selling, because it would not apply to them. It would deter the buying and hence the bidding up of capital assets while the tax is in effect, and that is exactly the result desired. It is the only way to

keep the prices of these assets from being bid higher and higher until the bubble bursts. Nothing would be a greater deterrent to postwar reconversion than such an inflationary rise in prices, which would inevitably be followed by a deflationary collapse. Hence nothing would do more to wreck postwar programs for full employment and economic stability on which a lasting peace depends.

6. The proposed tax is an essential wartime expedient, like price, wage and other direct measures of control that deal with the effects, not with the causes, of inflationary forces resulting from huge deficit-financing of the war. Had the public and hence the Congress been willing to deal with inflationary causes, deficit-financing would have been held to a minimum by far higher taxes and by far greater economy and efficiency in war expenditures. Some of us urged that course from the outset, but since it has not been followed, the only alternative is to deal with inflationary effects by such expedients as are necessary to hold the line so long as inflationary dangers exist. After reconversion, demand, which has so vastly exceeded supply in wartime, should be met by fully employing our manpower and material resources in peacetime production, and creation of further inflationary forces should be ended by greatly reducing public expenditures and by maintaining such taxes as are necessary to bring about a balanced budget.

I have received a few letters from civilians who fail to see why we should have either such disagreeable things as taxes sufficient to deal with inflationary causes or, alternatively, direct control measures necessary to deal with inflationary effects. On the other hand, I have also received a number of letters from men in the armed forces who hope, if their lives are spared, to buy a home or a farm. They do see, with a clarity that should be a warning, why those on the home front should do whatever is necessary to make this country's economic future secure, with all that portends for the peace of the world.