

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.

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,

(Signed) M. S. Eccles

M. S. Eccles,
Chairman.

Enclosure

ET:mla

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 194⁶₇.

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 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.

6. The form and text of the Executive Order as proposed are satisfactory, but I think it would be a mistake to issue the Order until Congress has enacted an effective tax measure or given assurance of favorable action. 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 on margins.

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.

June 21, 1945

Honorable Harold D. Smith
Director, Bureau of the Budget
Executive Office of the President
Washington 25, D. C.

Attention: Mr. F. J. Bailey, Assistant Director
Legislative Reference

Dear Mr. Smith:

I am enclosing herewith, for clearance in the usual manner, a proposed Executive Order dealing with the regulation of real estate credit. The background and purpose of the order is set forth in the attached memorandum for the President and letter to Judge Vinson, both dated June 19, 1945.

Very sincerely yours,

William H. Davis
Director

Enclosures

TIE:BJD

C O P Y

June 19, 1945

Honorable Fred M. Vinson
Director of War Mobilization
and Reconversion
The White House
Washington 25, D. C.

My dear Judge Vinson:

I am forwarding to the President through you the attached memorandum of a program to check inflation of capital values.

The recommended executive order has been submitted to the Bureau of the Budget for clearance. I enclose a copy herewith.

I assume that the Bureau of the Budget will collect the comments of other agencies as usual. As you know, the proposed four-point program, as stated in the memorandum to the President, has been thoroughly discussed at several meetings of the Economic Stabilization Board and has the unanimous approval of the members of that Board. I attach for your convenience a list of the members of the Board as now constituted.

Sincerely yours,

William H. Davis
Director

Enclosures

WHDAVIS:BD

June 19, 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 bears all the earmarks of speculative inflation. (See attached report.)

The national program of economic stabilization has helped tremendously in achieving full wartime production, and must be carried through to the end. It would be a shame to permit an economic upset at the eleventh hour by irresponsible speculative inflation of the prices of capital goods. The government should be alert and fully armed to prevent it.

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

June 19, 1945

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

The present increase in real estate values is being financed to a smaller extent by credit than comparable rises in the past, but this is no reason why careful control of credit to restrict speculative inflation in the real estate field should not be undertaken. A steady and rapid development of house construction in the reconversion period, so far as the supplies of material and labor will permit, is a basic element of economic stabilization. The control of credit in the real estate field should be so developed as to put a damper on speculative re-sales and should not interfere with the present policies of the Federal Housing Administration or with new construction undertaken with priority assistance.

The present tax law defines a long-term capital gain as any made in a period of six months or more. This 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. With surtax rates at present high levels and a ceiling tax rate of only 25 percent on long-term gains, this definition leaves a serious loophole in the tax laws. Under it the gains from speculation receive tax treatment which is glaringly inconsistent with normal income and with the stabilizing restraints imposed upon wages and prices. The effect is to invite speculation.

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.

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 to discuss with Congressional leaders the relative merits of instituting it by new legislation and by executive order.

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. You may, therefore, wish to discuss the proposal with Congressional leaders.

June 19, 1945

If 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.

Attachment

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
ET:bjd

RECENT DEVELOPMENTS IN THE FARM AND URBAN REAL ESTATE AND STOCK MARKETS

1. Farm land values have risen in the past four years at a rate almost as fast as in 1916-20. Average per-acre values in March, 1945, were 52 percent above the 1935-39 average. Values in some states have almost doubled. In 1944 about 12 percent of all sales were by owners who had held for two years or less, about 8 percent by those who had held for one year or less. While a rise from peacetime levels is justified by the wartime rise of net farm income, some postwar relapse of income is almost certain. If the present 1 percent a month rise of farm land values continues, returning veterans and other buyers will be forced either to pay prices that will later prove excessive or else to stay out of the market. Those who borrow heavily to buy at current or higher prices may later face serious financial difficulties. Prevention of top-heavy land values now will reduce postwar difficulties, including demand for Government assistance.

2. Urban real estate values increased by an average of 30 to 40 percent in larger urban areas between 1940 and 1944, with much greater increases in some areas in the West and South. Lower priced properties in general have increased more than higher priced properties. Much of the buying reflects not speculation or investment but necessitous purchases for occupancy, caused by the fact that, with rents controlled and sales prices uncontrolled, landlords prefer selling to renting. This is shown by the fact that during the 22 months ending December 1944 an average of 15 to 20 percent of all tenant-occupied single-family dwellings in 34 large cities became owner-occupied.

Veterans are already finding it difficult to use their loan privileges without violating the "reasonable normal value" requirements of the G.I. bill of rights.

Wartime construction costs have risen almost as sharply as real estate values, but FHA believes that much of this increase will prove to be temporary. Any further rise in values will merely increase the downward readjustment later, when values approach equality with costs of construction.

3. Stock prices are about 30 percent above the August 1939 level, 90 percent above the 1942 lows, and are the highest since August 1937. Assuming a reasonably high and stable level of prosperity with reduced corporate taxes, prospective profits probably justify present stock prices. The situation nevertheless appears dangerous because of the recent rapidity of the rise and the increasing volume of speculative trading. The attraction of a large speculative element to the market is likely to accentuate the rise and aggravate any subsequent decline. A collapse can best be prevented by preventing the boom from going too far.