

March 13, 1945.

The Editor,
The Washington Post,
Washington, D. C.

Dear Sir:

In your editorial of March 7, headed "Capital Gains Tax", you briefly but inaccurately referred to my suggestion for a special wartime capital gains tax and then repeated the familiar but fallacious Wall Street argument (1) that instead of curbing, it would "aggravate inflationary developments", and (2) that it would have a "deterrent effect upon the flow of capital into enterprise involving risk".

In a public statement which you apparently had not seen before writing the editorial, I described the proposal as follows:

"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."

Your editorial failed to give these facts and said that the levy would be reduced only two (instead of ten or more) percentage points for each year.

However, with regard to what I proposed, which was far less drastic than you represented, you ignored all of the vital reasons for this or a similar curb to protect the prices of farms, homes, securities, and other capital assets from the destructive effects of speculative

operations that are not only permitted but encouraged by the glaring loophole in the wartime tax structure. While wartime surtaxes on individual incomes are as high as 91 per cent and excess profits taxes on corporations as high as 95 per cent, the capital gains tax has remained at prewar levels, with a 25 per cent maximum, even though such gains are just as much war profits as are high individual or corporate incomes resulting from war expenditures. The inequity and inconsistency of this situation is the more indefensible because the benefit of this tax differential accrues only to those in the higher income brackets.

Large operators, that is, so-called smart money, are taking more and more advantage of the opening and this is a principal factor at present in bidding up the prices of real estate, stocks and other capital assets. It is not the bona fide investor or the small tax payer who is applying this upward leverage to these prices. This is speculation, not investment. And it is speculation in basic essentials, such as homes and farms. It adds nothing to national wealth.

You offered no alternative suggestion for preventing these prices from being bid up to higher and higher levels until the speculative bubble bursts, with the inevitable ruinous consequences for the vast majority of the people of this country -- and that includes millions of war veterans.

As to your first point: The outcry from certain financial quarters against closing the loophole indicates that speculators who are profiting so heavily because of it do not agree with you that the proposed tax would aggravate inflationary developments. They complain bitterly because they believe the tax would be all too effective in arresting instead of accelerating a further upward trend of prices.

You say that as a result of the lesson learned in the collapse of the 1919-20 postwar speculative boom, the law was revised severely limiting the maximum tax on capital gains. If, as you argue, a high capital gains tax will accelerate inflation, how did it happen that this low tax in the 20's produced just the opposite effect? This so-called "free market" failed entirely to keep stock market prices from going ever higher until the collapse of 1929. You are strangely silent about the failure of the low capital gains tax to dampen the stock market inflation then. You can't have it both ways.

If the proposed tax were to deter selling, as you contend, the volume of buying would also decline, since there must be a buyer for every seller. The record is all against you, however, in your conclusion that reduced volume would increase prices. In all past swings in the stock market, volume and prices have invariably gone up and down together. I contend that the tax will deter buying rather than selling because the proposed maximum

rate of 90 per cent would certainly put a damper on the speculative buyer after January 1, 1945, while the low rates of the existing capital gains tax would continue to apply to the selling of all capital assets acquired prior to that date. The most that can be said for your contention is that if there were very little buying and selling, the market might be uncertain. But, in any event, no dangerous inflationary upswing could take place -- and that is exactly what the proposed tax is intended to prevent.

As to your second point: The low capital gains tax was of dubious benefit to small business and new enterprise in the 20's. Instead of making money the hard way by investing in new plants which, in turn, would give employment and produce real wealth, investors were more and more lured into making money the easy way by stock market operations that added neither to employment nor to production. That was the heyday of corporate mergers, combinations and consolidations, of monopolistic growth, of the holding company and the investment trust. Over 1200 mergers, involving 4000 companies, took place in the 20's. Holding companies flourished in industry, trade, transportation and in most every other line from chain groceries to utilities. While it lasted, it was wonderful for the Insulls, but small business enterprise was all but forgotten. It has been estimated that of more than \$40 billions of domestic corporate issues floated on the booming stock market in the 20's, some \$10 billions were the offerings of investment trusts, holding companies and financial institutions. Those \$10 billions, together with about \$6 billions more of corporate refunding issues, were reinvested in existing securities, not in new and productive enterprise. The remaining \$24 billions of flotations did not by any means represent investment in new plant and production. Relatively high interest rates could not dampen the speculative fever. Low rates on fixed interest-bearing obligations today make potential stock yields look all the more tempting to the investor, as well as the speculator.

I took care to emphasize, though you neglected to mention it, that the wartime capital gains tax should be discontinued, like any other inflation control measure, when inflationary dangers no longer threaten the economy. Virtually all tax measures have some effect on the flow of risk capital, but this particular objection to the capital gains tax has been badly overworked by those who profit from speculative and not genuine investment activities. As I have previously pointed out, 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,

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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. 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.

Finally, I know of nothing that would be worse from the standpoint of reconversion and new investment after the war than failure to hold the line against inflationary forces that are now unchecked in these important sectors of the economy represented by capital assets. It will become increasingly difficult, if not impossible, to prevent inflationary price and wage increases unless the values of homes, farms and other capital assets are also curbed. My proposal is frankly an expedient to deal with an effect, not with the cause of these inflationary forces, which are due to the huge deficit-financing of the war. The home front -- the stay-at-homes -- 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.

Very truly yours,

M. S. Eccles,
Chairman.

ET:b

The Washington Post

OFFICE OF THE EDITOR

Dear Sir,

Dear Mr. Earle:

I will try to find
a place for your letter as soon
as possible. I imagine the
opportunity of going over the
ground was not exactly
unwelcoming! I am not particular
with the background, time I
was away in Mexico City
when the matter came up, but I
now have an opportunity to
inform myself

Yours truly

Herbert Einstein

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ready, not
ed - but
fine, thank

March 17, 1945.

Dear Mr. Elliston:

This is to thank you for your thoughtful note in regard to the letter to the editor which I wrote on the capital gains tax. I wanted you to know that I appreciated the excellent treatment of this letter on the opposite editorial page. It was another example of admirable fairplay.

Incidentally, I thought the editorials of that same day on foreign trade and on Government officials who take pay for articles and speeches were absolutely first-rate, possibly because I agreed as thoroughly with both of them as I disagreed with the one on the capital gains tax. Some years ago a prominent magazine sent me a check for a thousand dollars for an article I had prepared. I returned the check with a request that they donate it anonymously to a school of finance for scholarship purposes. They did.

Sincerely yours,

Mr. Herbert Elliston,
Associate Editor,
The Washington Post,
Washington, D. C.

ET:b