

March 23, 1945.

Honorable Jennings Randolph,
House of Representatives,
Washington 25, D. C.

Dear Mr. Randolph:

Mr. Parry, Director of our Division of Security Loans, referred to me your letter of March 20, and I am venturing to reply inasmuch as both points you raise came up as a result of questions which were asked of me when I testified before the Banking and Currency Committees of the Senate and House on the gold reserve requirement bill. In both instances I was expressing a personal and not necessarily a Board viewpoint.

There is no justification for concern with regard to the first point. If the stock market were on a cash basis as, incidentally, it is in London, the banks would not be prohibited from lending on listed securities for purposes other than stock market trading; that is, you could borrow on securities to buy a house, pay taxes, or any other purpose except margin trading on the security exchanges. I agree with you that the point is important and if any action were to be taken, it should be made as clear as possible that this hardship would not be involved.

With regard to my own suggestion for a penalty rate on speculative capital gains, I am taking the liberty of enclosing a copy of an explanatory statement on this subject which I issued after appearing before the Senate Committee. Senator Taft and others unexpectedly asked me what I felt could be done to curb rising prices of farms, homes, etc., and naturally I replied by expressing my own best judgment, which is that such a tax would be the most effective expedient, much as I dislike direct controls that deal with effects now that we have failed as a Nation to deal adequately with the causes of the huge inflation potential confronting us.

The more I look at this question, the more I am convinced that the brokerage community has succeeded rather well in pulling the wool over the eyes of the people generally about the deterrent effects of a capital gains tax on venture capital. Here again, I agree with you thoroughly that everything within reason should be done to stimulate postwar investment that will furnish production and employment, and I would oppose any tax or other needless impediment. In wartime,

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of course, when we have a scarcity of manpower and materials, there is no reason to encourage venture capital. What I am suggesting is a wartime capital gains tax, for there is every reason in wartime to discourage the speculative activity not merely in the stock market, but particularly in homes and farms. People don't have to buy stocks. They do have to live in houses, and to let the prices of these essentials be driven out of reach, particularly of the veteran's purse, by speculators taking advantage of the capital gains loophole cannot be justified.

In the postwar, however, what would really give encouragement to investments that result in production and employment would be to put a tax premium on productive investment and a penalty on mere speculation that furnishes neither production nor employment, but results only in economic instability. In order to induce venture capital to take risks in enterprise that furnishes production and employment, I would reduce the excess profits tax from the present 95 per cent maximum to, say, 70 per cent, and make the normal corporation tax 25 per cent without the corporate surtax. I would then exempt from the normal 25 per cent tax profits paid out in dividends, since they would be taxed in the hands of the recipients. This would avoid the double taxation that is a real deterrent to the investor in productive enterprise. At the same time, I would grant an exemption of \$25,000 to all corporations under the excess profits tax. This would not matter so much so far as the large corporation is concerned, but it would be a tremendous boon to the smaller and medium-sized concerns.

With such positive inducement to real investment, the capital gains tax would be insignificant and, in fact, there is much to be said for retaining a capital gains tax that would penalize the speculator looking for a quick turnover and hence further encourage the bona fide investor seeking income or longer-range appreciation. The low capital gains tax of the late 20's, far from encouraging venture capital to go into new production, was a positive incentive for luring capital into stock market speculation to make money the easy way.

I have not undertaken to say whether stocks or other capital values were too high or too low. So long as they reflect underlying conditions and prospects, there can be no objection to these prices adjusting accordingly. I am, however, opposed to the unproductive, unstabilizing activity in any of these markets, and that is what the penalty rate I suggested would effectively curb.

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I know of your interest in this broad subject, and should the matter of such a tax come before the Congress, I am sure you would want to weigh all the pros and cons before coming to any conclusion.

Sincerely yours,

M. S. Eccles,
Chairman.

Enclosure

 ET:b