March 27, 1945.

Mr. Charles Merz, Editor,
The New York Times,
New York City.

Dear Charlie:

For your information, I am enclosing a copy of an explanatory statement that Mr. Eccles issued in connection with the capital gains tax. Today's editorial in the Times, entitled "Punishing the Thermometer", reiterates what he emphasized in this statement under point 6, namely, that having failed to deal with the causes, we have the alternative of trying to deal with the effects of this enormous inflation potential. You might note also that the editorial appears to be in error in implying that Mr. Eccles did not favor deducting capital losses, but his statement specifically mentioned that point.

He has not undertaken at any time to say that prices of real estate or securities were too high or too low, and he has stressed the point that insofar as these values reflect underlying economic conditions and prospects, there can be no objection to their adjusting accordingly. He has, however, contended that, especially in wartime, the speculative distortion of prices in these unprotected sectors of the economy cannot be justified, and I should not imagine that the Times, of all papers, would wish to do so.

The last two arguments in the editorial are the familiar ones emanating from the brokerage community. First, that such a tax would freeze capital holdings. The most that can be said for that contention is that there could be no runaway price development with such a tax, which would deter the speculative buyer from purchasing with a view to a quick turnover, rather than deter the seller.

The second argument, that it would "stem the flow of money into new ventures", is particularly superficial. In wartime, when there are shortages of manpower and materials there is no occasion for stimulating venture capital. To do so after the war is, of course, of the highest importance. And, as the enclosed statement indicates, this tax, like other control expedients, should be rescinded when inflationary forces are no longer a serious threat to the economy. On this point, Mr. Eccles wrote the other day to a Member of Congress, as follows:

"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."

The letter to the editor printed in the same issue is equally mistaken about the 100 per cent margin. If it were put into effect, it certainly would not be made retroactive, requiring liquidation to margin up outstanding accounts. Manifestly, the time to prevent an inflationary development is before it gets out of control, not afterward.

I would not bother you with all this, excepting that I think it quite probable that something like this tax will be put up to the Congress, perhaps in the form of the alternative suggestion to which your editorial alludes; that is, to extend the holding period from the present six months to, say, three years. Capital gains would then be taxed under the progressive rates of the income tax. As you may have occasion to recur to the subject later, I wanted you at least to know the facts so far as Mr. Eccles' position is concerned.

With kind regards,

Sincerely yours,

Enclosure
ET:b

The New York Times
Times Square

New York 18

April 19,1945

Mr. Elliott Thurston
Board of Governors
Federal Reserve System
Washington 25, D.C.

Dear Mr. Thurston:

Your letter of a couple of weeks ago came in when Mr. Merz was away on a vacation, and I am sorry that through inadvertence I did not personally acknowledge it until now. I am not sure that I agree with your arguments, but we will be glad to bear them in mind.

Sincerely,

Henry Hazlitt