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TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE April 7, 1945

TO Mr. Blough and Mr. Haas
FROM E. M. Bernstein
Subject: Letter to Congressman Carlson

On the answer to Question 1, the following points should be brought out more clearly:

- (a) A change in the scale of living can result only from a reduction of production or a change in the distribution of income.
- (b) The national debt can affect the level of production if interest payments require such heavy taxes on business as to diminish the inducement to undertake new investment. It may also act on the level of production by requiring relatively heavy taxes on consumption or on low income groups, thus affecting the level of consumption.
- (c) On the other hand, the national debt may be accompanied by a monetary policy of low interest rates, which will encourage new business investment. It may also encourage an expansion of housing based on lower interest costs.
- (d) The effect of the national debt on the scale of living therefore will depend upon how taxes are raised and on the maintenance of a reasonably low interest rate.

Part of the answer already given is satisfactory, but the analysis in terms of a transfer of funds from saving to spending and the reverse is confusing and is not good economic analysis.

Question 2 and 3:

- (a) If the debt affects adversely the level of business activity it will have a tendency to keep prices low relative to costs of production. With a reasonably good level of business, the annual interest charges should be small in comparison with the national income. The way in which the debt will affect the level of prices will then depend upon how the taxes are raised.
- (b) If all of the additional taxes were raised by taxing the income of individuals there would be no effect on prices unless wage earners in turn were to demand higher wages because of the tax on their income.

- (c) To the extent that taxes are levied on corporate income or corporate transactions, they might affect costs of production which would, of course, manifest themselves in higher wholesale and retail prices.
- (d) Taxes on consumption, various excise taxes, would affect the cost of living, although if levied at the retail level they ought not to affect wholesale prices. Here too, there is the possibility that a rise in the cost of living might cause wage earners to demand higher wages.