

gradually over a period of years to reflect the proportion of debt under the old and the new rules. A detailed study of corporate debt would help in establishing the new schedule of tax rates.

THE GOVERNMENT BOND MARKET

The two proposals just made clearly will have some influence on the market in Federal bonds, about which there is much concern at the moment. The introduction of index bonds will presumably lead to some amelioration of the Federal Government's difficulties in placing new savings and long-term bonds; unfortunately there is no basis for forecasting the demand for such bonds. A questionnaire survey could yield considerable information on public interest in them.

Recent events indicate the existence of a large demand for conventional bonds at an interest rate around $4\frac{3}{4}$ percent, but if my diagnosis concerning the future course of inflation is at all accurate, the Federal Government would be ill-advised to attempt the placement of long-term bonds at so high a rate, even if Congress could be persuaded to permit this. If inflation ends within the next 5 years bond interest will fall from its present level, which includes an allowance for a decline in the value of money. Index bonds would not reflect this factor, and would consequently present a convenient solution to the immediate problems in Federal finance.

A successful attempt to stimulate new share issues through changes in the tax laws may have an even greater impact on the bond market. It has often been pointed out that the Federal Government is at a disadvantage there compared to two other important classes of borrowers. State and local government bonds are tax exempt and hence carry a lower rate of interest; one curious consequence of this is that these authorities find it more and more profitable to own Federal bonds.²³

Whether anything should be done about this is a problem outside the scope of this paper.

The proposed change in the corporate income tax, on the other hand, will clearly improve the competitive position of the Federal Government, even though that is not its primary purpose.²⁴ The tendency on the part of important investors, notably insurance companies and mutual savings banks, to hold fewer Federal bonds and more corporate bonds, could perhaps be halted or reversed. It should not be forgotten, in this connection, that the rise of corporate bond financing stems only partly from fiscal factors, and reflects also the general decrease in risk resulting from a policy of full employment.

²³ From 1947 to 1958 their holdings increased from \$7.3 billion to \$17.3 billion, in marked contrast to the holdings of most other classes of lenders which declined (source: Federal Reserve Bulletin).

²⁴ There are no good grounds for giving special help to the Federal Government in the bond market, but neither is there any reason why it should continue to be at a disadvantage because of regulations that are harmful in themselves, such as the tax rules concerning corporate interest payments. Because of the many side issues involved I have not gone into the deductibility of interest in the individual income tax; evidently roughly similar considerations apply there, but they may be to some extent offset by the desirability of homeownership from a social point of view.