

an unfavorable effect on the municipal bond market that has recently been dependent on banks for about three-fourths of its new funds. If bank purchases were drastically reduced, it would be difficult to find other buyers, resulting in efforts to sell more municipals to investors in the 20-percent tax bracket. This would raise the municipal-corporate yield ratio—now 75 percent—to perhaps 85 or 90 percent. A rise in this ratio would increase the bonanza of after tax income to investors—institutional, corporate business, or individuals—in the higher income tax brackets.

Historically, rising prime bond yields have coincided roughly with major wars and commodity price inflations. For the next decade, assumptions of no major war, diminution of the Vietnam conflict and related peace efforts, and an end to the superboom of the last 6 years, could lead to a termination of the present bear bond market and a secular trend toward more moderate yields could set in.

(b) *Effect of Credit Conditions on State and Local Bond Sales and Capital Outlays*

Some analysts have concluded that interest rates paid on State and local bonds affect the timing of gross new issues and may have an impact on the amount of issues placed, in the long run. But the latter effect is probably of moderate size, relative to total issues; and after initial impact on borrowing, the States and municipalities tend to adjust their revenue resources to provide for changing interest costs, rather than adjust the volume of their intended borrowing.

A regression model (detailed in ch. 18) explains up to four-fifths of fluctuations in aggregate State and local bond issues around a trend. The interest rate coefficients are interpreted to the effect that State and local borrowers do form and act upon expectations of future interest rates, while buyers of new issues are more influenced by current changes in the spread between yields on municipal bonds and yields on taxable securities.

Also influencing municipal borrowing are Federal grants-in-aid, which have a positive effect, and an index of needs for new construction. The regression study found that the supply of credit funds is positively affected by deviations in the wealth of individuals in the high tax brackets (measured by the ratio of the Standard & Poor's stock price index to total wealth) and increases in the share of total wealth held in the form of time deposits at commercial banks.

(c) *Relative Tax Advantages to Different Investor Groups in Acquiring or Holding Municipal Securities*

The exemption from the Federal income tax accorded to the interest income on obligations of State and local public bodies is of value to investors in such obligations only where their marginal tax rates are higher than one minus the ratio of tax exempt yields to taxable yields of comparable securities. Six of the twelve investor groups reviewed in part 4 frequently find tax exempt securities attractive. They are: commercial banks, fire and casualty insurance companies, nonfinancial corporations, personal trust funds, municipal bond investment funds (which can "pass through" the tax exemption accorded to the interest income) and individuals. Because their effective tax rates are appreciably lower than one minus the ratio of tax-exempt to taxable yields, such investor groups as mutual savings banks, savings and loan asso-