

ciations and life insurance companies have little incentive to acquire or hold tax-exempt municipal securities. No tax benefit is derived from investments in municipal securities by such groups as State and local public retirement funds, State and local governments and qualified noninsured pension funds because they are exempt from Federal income taxation.

(d) *Comparison of the Interest Cost Saving and Revenue Loss on Tax-Exempt Securities*

Based on the techniques developed by Ott and Meltzer,¹¹ it is estimated that for early 1966 the yield differential between the yields on tax-exempt securities and taxable securities of comparable maturity and credit quality ranges between 133 and 186 basis points (one basis point equals one one-hundredth of 1 percent). For gross issues of State and local government securities sold in 1965 the aggregate total interest payments over the life of the debt issued during the year are estimated at \$5 billion. If net interest cost for each issue were to be increased by a minimum of 133 and a maximum of 186 basis points, the aggregate interest payments by State and local governments over the life of the debt would have risen by an estimated range of 37.8 to 52.8 percent, or between \$1.9 and \$2.6 billion.

The aggregate average marginal tax rate (based on the approximate average marginal tax rate for each investor group, weighted by the 1965 distribution of holdings of municipal securities) is estimated at 42 percent. This rate suggests that over the life of the municipal debt issued in 1965 the increase in Federal revenue (if the securities were not tax exempt) would have been \$2.9 billion (if the relevant yield differential were 133 basis points) and interest payments would rise by \$1.9 billion because the interest were taxable. The additional revenue would have been \$3.2 billion (if the relevant yield differential were 186 basis points) and the increase in interest payments would have been \$2.6 billion.¹² These revenue consequences are based on an assumption that the present distribution of holdings would remain unchanged. If tax exemption were to be removed from new municipal securities, accompanied by a rise in yields on such securities, investor groups that now refrain from buying municipals because they find tax exemption of little value, might instead step up their purchases (owing to the higher yields), while some investor groups might withdraw from municipal securities, unless they too find the yields attractive.

C. SOURCES OF FUNDS

To develop the requisite information on the availability of credit resources for the financing of State and local public facility needs, specific chapters have been prepared for each of the major pools of investment funds or significant investor groups. These include: commercial banks, mutual savings banks, life insurance companies, fire and casualty insurance companies, State and local public retirement funds, State and local governments, nonfinancial corporations, municipal bond investment funds, personal trust funds, and individuals. The only major

¹¹ David J. Ott and Allen H. Meltzer "Federal Tax Treatment of State and Local Securities" (Washington: Brookings Institution, 1963).

¹² See ch. 20.