

Conceivably, each of the projections developed in supplement D may be unduly optimistic as to likely municipal security investments by the respective investor groups. Accordingly, the projections for commercial banks, personal trust funds and "individuals and others" (three of the largest) have been revised on the basis of less optimistic assumptions.²⁸ Under these revised projections, outstanding State and local government debt is projected at \$201.5 billion in 1975 and the annual net demand rises from \$7.2 billion in 1966 to \$13 billion in 1975 (shown in col. 3 table 3). Comparison of the revised annual projected demands with the projected annual net supplies of municipal securities finds that over the 10-year period the demand will still be slightly greater than the supply, but not during 1966-70. Under the revised projections commercial banks would account for \$61.3 billion of the net expansion, or 60 percent of the total, and personal trust funds would account for \$14.8 billion, or almost 15 percent.

From these projections it would seem that long-term borrowing by State and local governments for public facilities during 1966-75 can be successfully financed by capital market resources, if commercial banks continue to acquire most of the municipal securities generated. However, if for any reason²⁹ there is a slowdown in commercial bank asset expansion or if commercial banks find alternative investments more attractive,³⁰ then a shortage of credit resources for State and local government debt financing seems likely to develop. As detailed in chapter 17, such a shortage could be alleviated by increasing the yield on tax-exempt municipal securities to a ratio higher than the current 75 percent of the yield on taxable securities, say, to 80-90 percent.

4. *Tax Exemption and Federal Guarantees*

Municipal securities differ from all other credit instruments in one major respect in that the interest income arising from municipal debt is exempt from the Federal income tax. Much has been written or said on whether this tax exoneration is constitutional or statutory, the value of tax exemption to borrowing State and local governments and the revenue losses to the Federal Treasury,³¹ the equity effects of such exemptions upon the Federal income tax, and the debilitating effects upon State and local governments, if such exemptions were to be terminated. Each side in the long-continued debate on tax exemption for municipal securities has marshaled an imposing array of arguments, statistics, and related analysis in support of its views; and little purpose would be served in reexamining them in this volume.

Nonetheless, there appears to be one aspect of the tax exemption accorded to municipal securities that has not been thoroughly explored before; namely, the effects of Federal guarantees upon such tax exemption. To shed some light on this subject, the committee questionnaire that served as the outline for chapters 21 to 30 included several questions on the relationships of Federal guarantees to tax exemption for municipal securities. The questions inquired as to the effects of a

²⁸ For commercial banks the 1975 municipal security holdings are projected at \$100 billion, instead of \$107.5 billion (the lower projection in ch. 21) and for personal trust funds the 1975 holdings are projected at \$28 billion, instead of \$33 billion (the lower projection in ch. 28). In light of the revised statistics presented in supp. C, the annual net expansion of municipal security holdings of "Households" are projected at 0.375 of 1 percent of annual personal income (instead of the 0.4 percent employed in ch. 30).

²⁹ Such as restrictive credit policies that affect bank reserves or money supply or curtailed expansion of time deposits reflecting changed patterns of savings flows.

³⁰ Business loans, consumer loans, or mortgage loans.

³¹ Current estimates of such benefits and costs are presented in ch. 20.