

Federal guarantee in addition to the tax exemption or in lieu of tax exemption. Six³² of the ten chapters contain commentary that respond to the questions raised.

Each of the six chapters concluded that a Federal guarantee added to tax exemption would increase the credit quality of municipal securities and reduce the yield on the securities. According to the chapter on commercial banks, Federal guarantees might lower municipal interest rates by about 0.25 percent (ranging from 0.11 percent for AAA rated municipal bonds to 0.42 percent for BAA rated bonds). Most of the respondents advised that a reduction of municipal security yields due to a Federal guarantee would make municipal securities less attractive as investments. Confronted with such lower yields many of the surveyed institutions intimated that they would probably turn to alternative investments in taxable securities.

Interestingly, each of the investor groups to whom tax exemption has a value³³ expressed a preference for continuation of the present arrangements without a Federal guarantee so that investors can make their own judgments regarding credit risks and thereby obtain the necessary yield differentials to compensate for such risks. Some responding institutions even contended that a Federal guarantee "would do more harm than good."

With respect to substitution of a Federal guarantee in lieu of tax exemption, each of the responding private investor groups expressed opposition to such an exchange, with the greatest hostility voiced by the commercial banks. According to the canvass of investor reactions (detailed in the respective chapters), if municipal securities were to be guaranteed by the Federal Government, and the interest income were to be taxable, the resultant yield on municipal securities would be around the yield of Federal agency securities or perhaps somewhat higher. Investor groups such as fire and casualty insurance companies and life insurance companies would find yields at these levels unattractive, causing them to turn to alternative investments. On the other hand, public retirement funds would find the higher yields (on "taxable" municipal securities) more attractive, as might mutual savings banks.³⁴ However, commercial banks and personal trusts, the major sources of municipal credit in the current market, would turn to alternative investments where yields are more attractive.

As might be expected, the investor groups that benefit most from the tax exemption accorded to municipal securities voiced the strongest objections to any intimation of possible removal of such exemption.

The committee questionnaire also inquired as to how municipal securities could be made more attractive to investors. The most emphatic responses called for retention of tax exemption of interest income as the most important attraction. Other suggestions include State guarantees of municipal obligations, more complete economic and financial information to be furnished by borrowing State and local public agencies, uniform municipal accounting and reporting and codification of State laws governing the issuance of municipal securities.

³² Chapters on commercial banks, mutual savings banks, life insurance companies, fire and casualty insurance companies, public retirement funds, and personal trusts.

³³ All of the investor groups responding, except public retirement funds.

³⁴ By analogy, one might infer a similar reaction on the part of noninsured pension funds and savings and loan associations, the remaining major pools of loan funds.