

### *The Cost of Borrowing*

One reason why the volume of municipal debt expansion has lagged economic growth is probably that municipal borrowing is not cheap and painless. The fact that the gross interest rate usually paid on tax exempts is well below other interest rates is often misinterpreted as an inducement to borrow large sums. However, when municipalities or states borrow they often have to find additional revenues to meet debt service — immediately, not 30 years hence. And they cannot deduct their interest payments as corporations can so that Uncle Sam pays half. They pay it all.

Table V below shows the net cost of borrowing after tax deductions to issuers of a variety of credit instruments. Looked at in this peculiar way it seems that Uncle Sam is the highest cost borrower on the list, and states and municipalities are the second highest cost borrowers.

TABLE V  
The Net Cost of Borrowing After Tax Credits, February 1966

|                                         | Gross | Tax Rate | Net Cost After Tax |
|-----------------------------------------|-------|----------|--------------------|
| U. S. Treasury Notes .....              | 5.00% | 0        | 5.00%              |
| Prime Long Municipal Bonds .....        | 3.60  | 0        | 3.60               |
| Medium Quality Municipal Bonds ....     | 4.00  | 0        | 4.00               |
| Prime Long Corporate Bonds .....        | 5.00  | 48%      | 2.60               |
| Medium Quality Corporate Bonds ....     | 5.50  | 48       | 2.86               |
| Savings Banks .....                     | 4.50  | 20       | 3.60               |
| Commercial Bank c/d's .....             | 5.00  | 48       | 2.60               |
| Conventional Mortgages to Individuals } | 5.75  | 32       | 3.90               |
|                                         |       | 70       | 1.72               |

Neither Table I (net after-tax yield to investors) nor Table V (net cost of borrowing to borrowers) tells a full story. I would not want to press these comparisons too far. For example, it can be argued that Uncle Sam recaptures some part of his interest expenditures in tax receipts while other borrowers do not. It can be argued that corporations not only deduct interest, but also wage payments and all other expenses and, therefore, to the extent that they operate as though labor is costing, say, \$3 an hour, money is