

The chart shows that early in the century prime municipals and prime corporates usually yielded about the same. This was before the income tax. As tax rates grew the municipal index pulled away from the corporate index and when tax rates became very high a huge yield gap developed.

However, we cannot explain the changing differential between these two markets entirely in terms of tax rates. For example, from 1946 to 1952 the differential narrowed strikingly, but during those years tax rates did not come down. The explanation of these large shifts in municipal yields relative to taxable yields requires an examination of the money flows into the bond market according to tax bracket in a manner similar to that discussed under Table II.

### *The History of the Ratio Between Municipal Bond Yields and Taxable Bond Yields*

Chart II on page 13 shows the ratio of the prime long municipal bond yields to the yields of prime long seasoned corporate bonds annually since 1900.\* The data are from Appendix B. The chart also shows the history of two important income tax rates. These are inverted so that the line traces the per cent of the corporate bond yields retained by two taxpayer groups: full corporate taxpayers and top bracket private investors.

The heavy ratio line shows that early in the century, when there was little or no income tax, the municipal yields were about the same as the corporate yields and for a spell around 1913 rose to be slightly higher than the corporate yields. During World War I, when corporate income tax rates rose to 12% and individual top bracket rates to 75%, a spread developed in favor of corporate yields and by 1930 the municipal-corporate yield ratio had declined to 90%.

(\* Note that Chart II and Appendix B are based on a comparison of seasoned corporate bond yields with new municipal bond yields and thus the yields and ratios are slightly different from those in Table I, which compares new issues with new issues.)