

The ratio has never been higher since that time. Comparison of this municipal yield ratio with the tax ratios shows that in the 1920's municipals usually gave corporate taxpayers a small advantage over corporate bonds, but gave top bracket private investors an enormous advantage over corporate bonds. Tax free institutions, nevertheless, continued their established practice of buying municipals.

When tax rates rose in the 1930's, the chart shows that the municipal-corporate ratio tended downward as might be expected. In fact the ratio followed the inverse of the corporate tax rate closely, so that it was usually a matter of indifference to corporate taxpayers whether they bought taxable or tax-exempt bonds. By 1941 both ratios had fallen to about 60%.

During World War II a remarkable distortion developed. Although corporate tax rates rose no higher (except for the excess profits tax), the municipal-corporate yield ratio fell to 41%. This was when municipals had their own special bull market and rose far faster in price than all other types of high grade bonds. Long prime municipal yields then actually fell below 1% and short municipal yields fell to around .25% or lower. Municipals became highly unattractive to many corporate taxpayers and many of them sold out, as did insurance companies and savings banks.

This extraordinary fluctuation occurred, no doubt, because during the war years new municipal financing virtually ceased, maturing bonds were paid off, and total debt actually declined. Nevertheless, some trustees and a few top bracket private investors thought it worthwhile to buy long municipals at 1% instead of long corporates or Governments at around $2\frac{1}{2}\%$ which equated to less than .25% after tax. Also the acute scarcity of new tax-exempt bonds contrasted with a flood of new taxable Treasury bonds. Thus, analysis only of tax rate changes does not explain this extraordinary market episode. Its cause must be sought in a flow of funds analysis similar to that illustrated in Tables I, II, and III.