

From 1946 through 1954, as Chart II shows, the municipal-corporate ratio again swung violently, this time up from 41% to 79%. Furthermore, during these years corporate tax rates actually increased. Here we see positive proof that tax trends are not enough to explain the municipal-corporate yield ratio. The following flow of funds analysis, however, makes the events understandable.

In these postwar years the volume of net new municipal financing grew from below zero to over \$5 billion a year. As early as 1947 the flood of new municipal issues swamped the new funds of high-bracket private investors. Bond dealers had to seek lower bracket investors and especially institutions. By 1948 the municipal ratio was up from 40% to above 62%, and this equated to the prevailing 38% corporate tax rate, the point of indifference for fire and casualty insurance companies and banks. But this was not enough to attract a large enough volume of such institutional funds into the municipal market and municipal prices continued to plunge much faster than corporate bond prices. By 1954 the ratio had reached 79% and this large differential from the 48% corporate tax residual was enough. Municipals were then (as now) a bonanza for all corporate taxpayers and for many medium bracket private investors. Medium grade municipals were attractive even to low tax bracket life insurance companies.

At the 79% ratio the large volume of new municipals met with excellent demand, and the ratio soon declined to around 75%. It remained close to 75% ever since (July 66 — 75%) which means that municipals since 1955 have fluctuated closely in line with corporates. (Very recently corporate new issue yields have risen faster than new municipal yields.) At these ratios the chart shows that municipals are still a bonanza to corporate taxpayers. As a result commercial banks in recent years, as we saw in Table IV, stepped in and bought most of the available new volume; recently however with money very tight their volume of purchases has declined.