

their regular securities for the full cost of each project with the Federal Government agreeing to pay a portion of the debt service. This takes advantage of the already proven means of distribution through the regular municipal bond market.

Here is a market that already works well, having distributed over \$14 billion of new bond issues in 1967. Assuming that the volume of municipal industrial aid financing is substantially reduced as a result of pending Federal legislation or regulations, no added pressure should be placed on the municipal market by this program.

The waiver by a participating municipality of its tax exemption is a very serious consideration regardless of the worthiness of the purpose. Its significance strikes the very constitutional foundations and relationships between local government and Federal Government. We are sure Congress is well aware that the significance of State of local government tax exemption extends beyond economic considerations, indeed it involves their very political sovereignty. If the Federal Government is willing to provide assistance to local government, only at the expense of their surrendering tax exemption, we doubt that this proposal can be justified.

This proposal is particularly important when viewed as a precedent for recent bills introduced by Senator Proxmire and Congressman Patman to create a Government corporation to guarantee municipal bonds issued for all purposes. Nevertheless, since the program outlined in H.R. 15906 is voluntary, the ultimate political decision rests with the local government units, not the investment bankers.

Because of the worthwhile purpose of this program, we sincerely hope that this one aspect—that of waiving the tax exemption—will not distract all of the interested parties in water pollution from seeing the benefits of this over-all proposal, particularly, when there may very well be advantages in operating this program on the basis of Federal contracts providing for a portion of the debt service of ordinary municipal bonds.

The first and most obvious advantage, previously mentioned, is using the proven capabilities of the existing municipal market. Well-formed patterns for the distribution of State, county and municipal securities have already been formed for every region throughout the Nation. Tax-exempt securities are mainly purchased by commercial banks, trust departments, casualty insurance companies, and individuals.

On the other hand, taxable securities, such as the proposed municipal bonds guaranteed by the Federal Government, would be of limited appeal to the normal purchaser of municipal bonds. Thus, a whole new market must be created for the proposed securities from among the existing purchasers of taxable debt.

Most of these purchasers lack initial expertise in the area of municipal finance, having had very little occasion to follow this market. Accordingly, the proposed Government-guaranteed taxable municipal securities would no doubt initially sell at higher interest rates, reflecting lack of investor knowledge and acceptability of the new instruments. In addition, these proposed new securities would have to compete with prime corporate issues. Prime corporate issues now are selling in the vicinity of six and three-quarters percent.

Present market conditions raise another potential problem. Most States and local units of Government have statutory or constitutional interest ceilings on that debt. For example, the State of Washington has a constitutional six percent limit for borrowing by cities. In this case, it would require an amendment to the State constitution which would effectively block their participation for some time. These maximum net interest costs are geared for a tax-exempt rate of interest and the issuer would therefore, under present market conditions, be unable to issue securities at the higher taxable rate. This problem can be eliminated by the issuance of tax-exempt municipal bonds.

In addition, the creation of yet another Government-guaranteed taxable security will add further pressure on the already highly competitive market for individual savings. To the extent that such issues would divert flows of savings from savings and loan shares and mutual and commercial bank savings deposits, the ability of these financial intermediaries to make mortgage loans on both new and existing homes would be adversely affected. Thus, the unsettling process of disintermediation (transfer of liquid savings from institutions to the investment market) and the consequent very harmful implications for the home-building