

TABLE 2.—VALUE OF TAX EXEMPTION FOR VARIOUS TAXPAYER SITUATIONS BEFORE AND AFTER A RISE IN EXEMPT BOND RATE RELATIVE TO CORPORATE RATE

Marginal tax rate (in percent)	Net advantage of tax exemption on an investment of \$2,300 ¹ when the exempt rate relative to the corporate rate is—		
	70 percent	80 percent	85 percent
70.....	\$57	\$71	\$78
60.....	43	57	64
48.....	26	40	47
30.....	0	14	21
20.....	-14	0	6
15.....	-22	-3	0

¹ An investment of \$2,300 was chosen because it produces exactly \$100 of exempt interest at current rates.

At the same time the tax savings to present buyers of bonds will rapidly pyramid and new groups of buyers will be drawn to these tax benefits. This expansion of the tax preference will be coming at a time when the patience of many with existing tax preferences is becoming exhausted—as is shown by the rapid and widespread rise in sentiment for a minimum income tax to counteract the effect of tax preferences that now permit many taxpayers with high annual incomes to pay little or no Federal income taxes.

State and local governments should look carefully at their “friends” who want to maximize the use of tax-exempt bonds in meeting the costs of new programs. These data would indicate that such maximization is really more likely to help bond buyers and to hurt the bond sellers—who are the State and local governments.

The recent experience with arbitrage bonds and industrial development bonds should cause some moments of quiet reflection for those who up to now have adamantly refused even to talk about these disturbing possibilities or consider solutions for them that would alter the traditional patterns. There were those who saw no abuses or dangers whatsoever when the volume of industrial development bonds suddenly skyrocketed last year and the size of such issues rose to \$100 million and \$150 million figures. When the Treasury Department called attention to this situation and to the severe effects that could occur if larger and larger volumes of private business financing were converted into tax-exempt financing, there were those who sought only to characterize its concern as an attack on the tradition of tax exemption.

The more perceptive—and your organization merits high marks in this regard—recognized however that the Treasury attitude and its subsequent action were designed to prevent a distortion of that tradition that could all too easily cause its erosion or destruction. And now that these large industrial issues have passed from the scene under the recent legislation and the local government bond market will not have to absorb the corporate bond market, even the voices that had called doom and calamity when the Treasury acted are now admitting to “abuses” they had not been able to see before. But in the meantime, that attitude of head in the sands, of see or speak or hear no evil, did not make it any the easier to shape the needed corrective steps. The task—difficult enough in itself—of structuring those steps, of meeting the many technical problems that corrective tax measures inevitably entail, is certainly not made any the lighter if those with knowledge of the operative facts choose to withhold their experience and refuse constructive cooperation in favor of an adamant stance that denies there is anything to worry about.

As a result, one would hope that there can be a calm appraisal of these possible new developments I have described and their consequences. And if they are likely to occur—as many believe—one would hope there can be a calm analysis of possible new financing techniques to avoid those consequences. Let us therefore turn to this phase of the discussion.

Possible New Financing Techniques—Local Taxable Bonds

In a talk on June 13, 1968 before the Municipal Forum of New York I described one possible new financing technique—that of local taxable bonds. I gave the example of a local project—it could be an anti-pollution project, an airport, an urban development project, and so on—as to which Federal assistance would be provided not through the traditional initial capital grant but through a system of paying part of the debt service of a bond issued by the locality to meet the