

cost of the project. The Federal share of the debt service—as respects both principal and interest—would be paid periodically over the life of that bond. I then indicated that instead of having the local bond a tax-exempt obligation, there could be used instead a *local taxable* obligation with two attributes: the Federal Government would fully guarantee the bond and, in addition, would use the tax revenue gained through the taxable status to pay to the local government an interest subsidy that would bring the interest cost to it down to a level lower than, or at least comparable to, the interest rate on a tax-exempt bond. This interest subsidy would be in addition to the share of the annual debt service provided by the Federal Government.

I described this approach as a new type of joint venture by the Federal and State and local governments for these social projects, with a method of financing that would benefit both governments. This was the approach presented earlier this year by the Administration as a way to start an increased number of anti-pollution projects.

The State and local government groups in general responded negatively—in a positive way!—and opposed the Administration's proposal, stating that the local bonds should be of the traditional tax-exempt type. Another suggestion was for a two-bond approach—a *taxable bond* issued by the local government for the Federal share and paid off by Federal funds, and a *tax-exempt bond* issued by the local government for its share.

Our bond experts then went to work to evaluate the comparative costs of the three approaches—single taxable bond, single tax-exempt bond, and two-bond approach. The crucial issue in this comparison is the cost to the local government.²

Here our experts believe that a tax-exempt approach either as a single bond or part of a two-bond suggestion, would cost the local government more than would the single taxable bond. Under their analysis the effect of the enlarged volume of these new tax-exempt issues on the interest rates for tax exempts generally—the point I have discussed earlier—would involve a higher cost to the local government on its overall borrowings than would the issuance of taxable bonds after the interest subsidy. Hence, a Mayor faced with paying for both a new school and a new social project would save his community money by choosing a single taxable bond for the social project rather than using a tax-exempt bond in whole or in part.

There are two questions in this analysis that deserve careful attention. The first is the possible rise in interest rates on tax-exempt securities if that market really faces the enormous increase in load I have earlier described; the second is the rates at which *local taxable bonds* would sell. I have the feeling that knowledgeable persons could reach a consensus on the first of these questions and that such consensus is likely to be along the disturbing lines our experts foresee. There may be a wider range of disagreement on the second question.

Some private analysts may doubt that the market prospects for *local taxable bonds* would be as good as our experts expect. They may believe that interest, especially bank interest, in local small, long-term serial issues would be limited to tax-exempt issues. The taxable local bond would be a new type of obligation—a new animal—and some analysts believe that the new animal would not be readily accepted by the market for a long time to come, if ever. Since the marketability of obligations depends on their ability to be readily sold and bought, this lack of ready acceptability could be an adverse factor. They say a bank that would buy a tax-exempt bond of City A won't buy a taxable bond of that city even if the taxable rate is adequate to cover the absence of tax exemption.

The impact on interest rates of the future pressures on local financing will therefore be less in their judgment if the local governments were to meet these pressures by using obligations of established acceptability rather than breaking new ground. They concede that a full Federal guarantee for the local taxable bonds could go a considerable way to counteract these attitudes since the guarantee would meet concerns as to credit and rating. But still they believe the

² As respects the Federal Government, the cost of a tax-exempt approach, whether it be as a single bond or a part of the two-bond suggestion, is greater in view of the loss of the tax revenue that would come from using a tax-exempt bond. This loss is greater than the interest savings to the local government and therefore greater than the interest subsidy that would have to be paid to equalize the local government's borrowing costs. And we must remember that the cost of the debt-service approach is greater to the Federal Government than the initial capital grant approach, since the interest on taxable local obligations would be greater than the rate at which the Federal Government can borrow directly to cover the capital grant.