

newness of the local taxable bonds would affect their marketability and cause their interest rates to be higher than our experts have assumed—and indeed perhaps to cause a rise in the whole range of market interest rates.

I am not here to weigh these doubts or come to a decision on the differing predictions. Rather, I wish to bring the questions to your attention and to urge their serious consideration. That consideration requires a careful effort to describe with particularity the weaknesses in the use of local taxable bonds, if weaknesses there be. The next step in the process must then be to ask whether other financing techniques could meet those weaknesses. For, if our belief that reliance on the traditional tax-exempt approach to meet the enormous future load on local financing has its own serious problems, to say that the taxable approach may have its weaknesses cannot end the inquiry—so does the tax-exempt approach and its weaknesses seem to be by far the greater.

Possible New Financing Techniques—a Central Financing Institution

Those who have doubts about the local taxable bond approach in large part place their concern on the difficulties of marketing these small novel issues. Would that concern disappear if a central institution took over the financing on a taxable basis? This possibility calls attention to recent Treasury discussion³ of a National Urban Development Bank—a concept suggested by Vice President Humphrey on July 2, 1968 to help solve the problem of financing the needs of American cities.

In brief, as one possible framework, such a Bank would be a non-Federal institution financed initially by an appropriation of Federal funds and then through subscription of non-Federal funds. It would issue its own obligations in the market, and these would be taxable. They would be guaranteed by the Federal Government. The obligations could involve maturities, characteristics and amounts that would make them marketable at competitive interest rates. Congressional control could be assured by requiring regular approval by the Congress of the dollar volume of obligations issued by the Bank.

The Bank, as one of its activities, could then accept obligations of local governments issued to meet their financing requirements for the new social projects. It could utilize affiliated regional banks for this purpose. It could accept such obligations at interest rates that would involve a subsidy so as to provide interest costs to the local governments lower than, or at least comparable to, the interest rates on tax-exempt bonds—the parallel to the subsidized local taxable bond approach. The cost to the Bank of this subsidy could be met by Federal appropriations to the Bank, with these appropriations in turn being financed ultimately (not earmarking necessarily) by the increase in revenue to the Federal Government through having the obligations of the Bank taxable, as compared with the revenue loss if traditional tax-exempt local financing were used.

Federal assistance for the local projects, such as the partial annual debt service grant I described earlier, could of course be a part of the arrangement. The terms of that assistance could be established under the particular substantive Federal legislation governing the social programs involved—anti-pollution, urban development, etc. The mechanics of that assistance could be handled through the Bank, thereby avoiding a proliferation of the channels of assistance. The financing of that assistance could be through Federal appropriations to the Bank. The Bank, of course, could make loans and provide assistance to private groups as well.

Such an Urban Development Bank—Community Development Bank might be a more descriptive term since it could handle rural as well as urban programs—would appear to meet the problems some may see in the local taxable bond approach previously discussed. The Bank, in effect, permits a pooling of the various local government obligations, so that the disadvantages of issue size, of lack of a ready market in which the local taxable bonds could be sold and bought, and of novelty are all eliminated. The bank instead would be raising the funds involved in the private market on a centralized taxable basis, in a volume sufficiently large and with a Federal guarantee so that the rate of its obligations would be as comparable as possible to taxable Treasury bonds. The financing

³ See Remarks of Frederick L. Deming, Under Secretary for Monetary Affairs, Graduate School of Banking, University of Wisconsin, August 27, 1968 (Treasury release F-1339); Remarks of Under Secretary Joseph W. Barr, California Savings & Loan League, Anaheim, California, September 18, 1968 (Treasury release F-1349); Remarks of Frank W. Schiff, Deputy Under Secretary for Monetary Affairs, Municipal Treasurers Association, Washington, D.C., August 21, 1968.