

It is quite clear that this is a highly prized and highly valued indirect subsidy that the State and local governments enjoy. And there are also, as you know, constitutional questions, and things of that type.

Representative WIDNALL. May I interrupt you?

Mr. WALKER. Yes.

Representative WIDNALL. And a considerable tax saving for a lot of people.

Mr. WALKER. That is correct, too. There are buyers and sellers, and all sorts of interests and all sorts of people involved here.

Now, I think the great preponderance of professional opinion is that the Federal Government loses more in taxes than the State and local governments get back through the tax-free subsidy. This is a very difficult thing to lay out in lay terms. But basically, it results from the fact that more and more State and local bonds are being issued. The tax brackets were reduced in 1964 although somewhat raised with the surcharge, and with the combination of an increase in volume, and fewer individuals who are interested in getting the tax exemption, you are tending more and more toward a saturation of the market.

Under the economic analysis, when you sell a block of bonds as an underwriter, you have to price those at a sufficiently high level in terms of interest rate, or low level in terms of price, to sell all of those bonds. This means you have got to make them attractive enough to pull in that last marginal buyer that the economists talk about.

Now, in this process it would be quite clear that if you had an alternative such as the Urban Development Bank that was proposed by the last administration and which we are studying at the present time—it is quite clear that there would be a theoretical possibility of the Federal Government or the Urban Development Bank borrowing through taxable issues and loaning funds to the State government at lower rates than they could have obtained through nontaxable issues.

But there is a great question as to whether you would want to substitute that approach for the tax exempt approach.

What has been discussed are alternatives to permit municipalities to take either approach, tax exemption if they like that, or the Urban Development Bank approach.

The question, as you well know, is not entirely an economic question. You get into major considerations with respect to the points that Senator Jordan raised as to relationships between State and local governments. Perhaps, Mr. Volcker in his—incidentally, you spoke of him as No. 2. We look upon ourselves as equal; at least we get paid the same amount of money and we work, more or less, the same amount of hours in the Treasury Department.

Mr. Volcker, both as an economist and in his responsibility as to debt management, might want to enlarge upon this point.

Mr. VOLCKER. I think you have covered it all.

Representative WIDNALL. Thank you.

My time is up.

Chairman PATMAN. Senator Proxmire?

Senator PROXMIRE. I want to congratulate you on that last answer, which is very helpful.