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MONETARY POLICY, INTEREST RATE CEILINGS, AND THE  
ACCESS OF STATE AND LOCAL GOVERNMENTS TO THE  
CAPITAL MARKETS

Remarks

By

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MONETARY POLICY, INTEREST RATE CEILINGS, AND THE ACCESS OF  
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In 1969, for the first time in a decade, a significant decline occurred in the volume of long-term borrowing by State and local governments. On the basis of preliminary data, such borrowing may have totaled just under \$12 billion last year. This level represents a drop of \$4-1/2 billion from the \$16.4 billion recorded in 1968. In 1960, about \$7.2 billion of long-term municipal bonds were sold; and in all except one year of the decade, the volume rose steadily. While an interruption in the uptrend occurred in 1966, the decrease in that year was only 5 per cent -- compared with a drop of over one-quarter last year.

The relative decline in the participation of State and local governments in the capital market last year can also be traced in the Federal Reserve Board's flow of funds statistics. According to our preliminary estimates, the net volume of funds raised by all nonfinancial sectors in 1969 amounted to about \$85.6 billion, a decrease of \$11.8 billion

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(or 12 per cent) from the level in the previous year. However, this decline in the total was more than accounted for by the change in the position of the Federal Government. In calendar year 1969, the latter made net repayments of \$5.4 billion -- compared with net borrowings of \$13.4 billion in the previous year. So the year-to-year change was a decrease of \$18.8 billion.

Allowing for the experience of the Federal Government, total funds raised by other nonfinancial sectors in 1969 amounted to \$91.0 billion, representing an expansion of \$6.9 billion (or 8 per cent) over the level raised in 1968. However, the net amount of funds raised by State and local governments in 1969 shrank by \$1.1 billion, (or by 11 per cent). In contrast, net funds raised by them rose by \$2.2 billion (or by 28 per cent) in 1968. Moreover, the decrease of \$1.1 billion in net funds raised by State and local units last year represented more than four-fifths of the decline of \$1.3 billion in net debt financing in the capital markets. In fact, State and local government securities were the only issues among the three principal types of capital market instruments to register a significant decline in 1969. Despite the extreme tightness in the mortgage market, total mortgage debt showed a small gain (of \$200 million) to \$27.2 billion. Mortgages on residential properties rose by \$1.2 billion (to \$19.9 billion), with the gain divided between \$300 million on one-to-four family homes and \$900 million on other types of residences. Net funds raised through sales of corporate and

foreign bonds showed a modest decline of \$100 million in 1969. However, this decline centered entirely in the issues of domestic corporations, where net funds raised through corporate bonds alone declined by \$200 million to \$12.7 billion.

In terms of the relative access to credit facilities, the share of State and local governments in net funds raised by all non-financial sectors (excluding the Federal Government) declined to about 10 per cent in 1969 from about 12 per cent in the previous year. Their relative position in the capital markets, however, was not sustained quite as well; their share of net funds raised through capital market instruments shrank from just under 20 per cent in 1968 to just over 16 per cent last year.

Thus, whether measured by flow of funds data or by the volume of long-term bond sales, the access of State and local governments to the capital markets weakened considerably in 1969. This weakening can be attributed to a number of factors. Undoubtedly, the decrease (to 38 per cent) in the proportion of borrowing proposals approved by voters and the record level of borrowing costs were both contributing developments. However, statutory interest rate ceilings appear to have been of particular importance. As municipal bond yields rose to an average of 5.72 per cent last year -- from an average of 4.45 per cent in 1968 -- these rate limitations became operative for the first time in many widely scattered areas of the country. Although a number of these jurisdictions took steps to modify applicable ceilings, the moves

generally came too late to have much impact on their ability to borrow.

Of course, the experience of State and local governments in the capital markets last year is not at all surprising. Given the need on the part of the Federal Reserve System to pursue a policy of substantial restraint as part of the fight against inflation, a shrinkage in the general availability of credit -- in the face of a continuing strong demand for credit -- would obviously lead to a significant rise in the level of market interest rates. Under these circumstances, it was to be expected that State and local governments, along with other borrowers, would encounter difficulties in their efforts to raise funds. But these difficulties were clearly aggravated because of the rigidities imposed by statutory limitations on the rates of interest many of them could pay on long-term debt.

The detrimental effects of these rate ceilings can be traced in several ways:

- The leading commercial banks (which normally provide a major outlet) turned away to a significant degree from the municipal bond market last year. This was especially true in those States with the lowest ceilings.

The displacement of State and local issues reached a record level, and here also the impact was proportionately greater among States under the strongest rate limitations.

State and local governments had to search vigorously for alternative sources of funds: short-term borrowing jumped sharply and a number of

borrowers relied more heavily on revenue bonds or other sources where rate ceilings did not apply in particular cases.

In some instances, special steps (or special persuasion) were undertaken to induce buyers (particularly commercial banks) to purchase newly issued obligations.

But, despite these diverse efforts, it appears that some jurisdictions may have curtailed current expenditures, and total capital spending by State and local units seems to have moderated in 1969.

In light of these developments -- and given the prospect of a continued strong demand for funds by State and local governments -- the need to eliminate the existing statutory ceiling on interest rates remains as pressing as ever. This need assumes even greater urgency when the expanding demand for funds is set against the decline in the relative attractiveness of tax-exempt securities to commercial banks.

Before examining more closely the behavior of State and local governments in the capital market last year, it would be helpful to analyze the configuration of interest rate ceilings.

#### Structure of Statutory Interest Rate Ceilings

At the beginning of this year, the 50 States were almost evenly divided with respect to the presence or absence of statutory limitations on the rates of interest they could pay on long-term debt. However, the situation was quite different a year ago: not only did a sizable majority of States have such ceilings but the average level of maximum rates payable was also considerably lower. During the

course of 1969, about a dozen States either removed, suspended or raised the existing ceilings, and at the end of last month another half-dozen States had legislation pending or were planning steps to relax these constraints. In a number of instances, changes were also made last year in the ceilings applicable to obligations of local government units.

To obtain a better appreciation of the structure of interest rate ceilings and their effects on borrowing at the local level, the Federal Reserve Banks were asked in January to make an informal survey of the situation in their Districts. The results of that canvass, when combined with information published by the Daily Bond Buyer, provide a fairly good description of the status of statutory interest rate ceilings at the beginning of this year. The information is shown in some detail in Table 1, attached. The Table distinguishes between ceilings applicable to State governments and those applicable to local units; it also distinguishes among general obligations, revenue bonds and agency issues. The States are listed according to the level of the ceiling applicable to the State's general obligations. As a rule, the local ceilings prevail throughout the State, but in some cases large cities have special ceilings. A few of these are also shown separately.

For convenient reference, the details in Table 1 can be summarized as follows:

Level of Ceiling (January, 1970)	State Governments			Local Governments		
	General Obligations	Revenue Bonds	State Agency	General Obligations	Revenue Bonds	Local Agency
No Ceiling	24	23	22	19	21	19
7 per cent and over	9	7	7	14	13	14
6 to 7 per cent	11	11	11	15	13	11
Under 6 per cent	4	4	3	2	0	1
Varies	1	1	3	0	1	1
Not issued	1	4	3	0	1	2
Not authorized	0	0	1	0	1	2
Total	50	50	50	50	50	50

This summary points up several striking features: While almost half the States have no ceilings on general obligations, almost one-third of them have ceilings below 7 per cent -- and in four of the latter the limit is below 6 per cent. As far as States are concerned, the situation appears to be approximately the same with respect to the range of ceilings on all three types of obligations. But among local governments, somewhat more variety is evident. A slightly larger number of States have established maximum interest rate ceilings on the main types of long-term debt issued by local jurisdictions. On the other hand, the average level of the ceilings appears to be somewhat higher.



Impact of Interest Rate Ceilings

If we look behind the summary, however, we can begin to see the influence of the rate limitations on the capital market behavior of State and local governments. The experience of three of the four States with ceilings of less than 6 per cent on general obligations is especially instructive. California -- with a 5 per cent limit -- is the most dramatic example of a State that has suffered because of a low ceiling. It topped the list of States in the volume of bonds displaced in 1969, and one banker estimates that California was able to sell only one-tenth of the bonds needed to finance public projects in that year. In Arkansas, where the rate varies between 5 and 6 per cent and where securities must be sold at par, it is reported that virtually no buyers can be found for city, county and other governmental agency bonds. In fact, it is reported that -- for all practical purposes -- these local units in Arkansas have been out of the capital improvement business for some time. In Kansas, with a 5-1/2 per cent ceiling, the number and dollar volume of issues are both reported to have declined significantly in 1969 compared with the levels reached in the preceding year. It is also reported that both California and Kansas are planning to revise their interest rate ceilings in the near future.

The most striking fact about the eleven States with ceilings on general obligations between 6 and 7 per cent is that about half of them (Colorado, Illinois, Oklahoma, Utah and Virginia) have legislation

pending to raise the limit. In the meantime, the adverse effects of the existing ceilings have been substantial. For example, it is reported that Mississippi is finding it almost impossible to sell bonds at the 6 per cent ceiling. Apparently some dealers in the State will take the issues at that rate -- if the government will agree to let them have the use of the funds for a specified amount of time. In Alabama, the city of Birmingham is said to be relying heavily on revenue bonds which do not have a ceiling. In Illinois, the city of Chicago has found the interest rate ceilings particularly disruptive. Until recently, the 6 per cent limit was suspended until July 1, 1971, and during this period the City can try to sell issues at 7 per cent. Even so, Chicago is reported to be having considerable difficulty selling its obligations to the banks. The Chicago school system has been hit particularly hard.

About half of the States which now have ceilings of 7 per cent or more on general obligations only recently raised their limits to this level. Included in this group are Michigan, Missouri, Oregon and Pennsylvania. Moreover, Michigan and Pennsylvania have only temporary authorization for the higher ceilings. Undoubtedly, some borrowers which do not have high-grade ratings find it difficult to borrow even at these limits -- unless they are willing to limit themselves to relatively short maturities. For instance, it was reported that local governments in Kentucky are having trouble selling bonds

at 7 per cent and are relying heavily on one-year bond anticipation notes.

Finally, for a number of State and local governments with no official ceilings, the situation is not as firm as it may seem. For example, in both New York and New Jersey, the ceiling was suspended for about one year, and by mid-1970 the ceilings are scheduled to return to the previous levels of 5 per cent and 6 per cent, respectively. Moreover, in some States which may or may not have official ceilings, the State usury laws ordinarily apply. Thus, in some cases even where no specific ceiling is set, there actually may be an effective legal limit to interest rates that can be paid on municipals. Consequently, if market yields were to continue to rise as they did over the last year, a fairly large number of States would have to rewrite their usury laws as well.

Before closing this part of the discussion, we should pause briefly to take note of the State of Maryland's experience -- although the facts are widely known. It will be recalled that until last December the ceiling on the State's general obligations was 5 per cent. However, since its issues were rated Aaa, Maryland had experienced no difficulty in selling bonds until it attempted to market \$40 million of construction bonds in late November of last year. At that time, high-grade municipal bond yields were rapidly approaching 6-1/2 per cent. Maryland was faced with the alternatives of halting construction, borrowing from the current operating surplus (a short-run solution at

best), or changing the ceiling. As it happened, a special session of the legislature was called which -- among other actions -- removed the 5 per cent ceiling altogether. But before that action could be taken, the State had to face an extremely difficult situation -- and (as mentioned below) some of the temporary moves which were made in the interval are prime examples of the real burdens imposed by interest rate ceilings.

The conclusions which can be drawn with respect to the structure and impact of statutory interest rate ceilings on State and local government debt can be stated succinctly: while the existence of ceilings remains rather widespread, a large number of States raised or suspended such limitations during the last year or are now considering such increases. In fact, in some cases, States which lifted their rate ceilings last year may well have to do so again if bond flotations remain heavy. With the exception of California (which must submit a proposed rate change to the voters in a general election), every major borrower raised or suspended ceilings last year. If they had not taken these steps, they would have been unable to sell bonds under the market conditions prevailing during most of the last twelve months -- and many of them (especially California) are still encountering obstacles.

Decline in Commercial Banks' Demand for State and Local Government Debt

As is widely known, the commercial banks have traditionally provided the principal outlet for municipal issues. This strong

demand undoubtedly reflected the advantage of tax-exempt income to the banks. In addition, however, many banks also seemed to have accepted an obligation to assist their own State and local governments with their financing problems, and this willingness to assist was frequently enhanced by the deposit of public funds. But in 1969, a conjuncture of adverse circumstances -- including reduced bank resources, low interest rate ceilings, and uncertainties over Federal income tax reform -- brought about a sharp decline in commercial banks' participation in the municipal bond market.

Last year, net purchases of State and local government issues by commercial banks amounted to only \$1.2 billion -- in contrast to \$8.7 billion in 1968 and \$9.0 billion in 1967. The decline was even more dramatic when the changes in commercial banks' holdings are compared with the net funds raised by these governments. Last year, the banks' share represented only 14 per cent of the total. In 1967, the banks expanded their holdings by an amount greater than the total rise in liabilities of State and local governments: the total rose by \$7.7 billion and bank holdings by \$9.0 billion. In 1968, the banks absorbed nearly 90 per cent of the total increase.

Of course, as indicated above, some part of the commercial banks' lessened demand for municipal issues can be attributed to the generally reduced availability of credit at these institutions last year. But this is by no means the entire story. There certainly was

a sharp decline in 1969 in the volume of funds advanced by commercial banks to all borrowers. Last year, this total was about \$9.6 billion, compared with \$39.3 billion in 1968 and \$36.5 billion in 1967. Even so, State and local governments got a substantially reduced share in 1969 -- only 12-1/2 per cent of the total, compared with 25 per cent in 1967 and 22 per cent in 1968.

As I stressed above, I believe a good part of the lessened taste of commercial banks for municipal obligations reflects the adverse effects of the low limits on interest rates which many State and local jurisdictions can pay. To test this conclusion, we have made a special analysis of the year-to-year changes in State and local government securities held by weekly reporting member banks in a dozen States during the three years 1966-1969. For the most part, these States (on the average) have been the leading borrowers through the issuance of long-term securities over the last five years. The details of the analysis are shown in Tables 2 and 3, attached.

Among the twelve States, there were four (California, Maryland, New York and North Carolina) which had interest rate ceilings of 5 per cent or less on general obligations through much of 1969. As indicated in Table 2, the actual holdings of State and local securities by banks in these four States declined from the end of 1968 to the end of 1969. The average decline for this group was about 10 per cent. For all weekly reporting member banks, holdings of municipal obligations also declined -- but by only 7 per cent. Banks in all of the other States

shown (except those in Pennsylvania) recorded moderate increases over this period. The decline in holdings by Pennsylvania banks may be explained by the fact that the rating of Philadelphia bonds was reduced sharply by private rating agencies in late 1967,

Table 3 shows ratios of member banks' holdings of State and local obligations to total securities held. Again, it is clear that banks in those States subject to low interest rate ceilings have adjusted their investments in a way that is in sharp contrast to the experience of banks in States not under interest rate limitations. In general, the ratio of State and local obligations to total securities has been rising for all banks from the end of 1966 to the end of 1969. However, from the end of 1968 to the end of 1969, the increase in the ratio at banks in States not subject to low interest rate limitations has been much greater than in those States where such interest rate limitations apply. In fact, the ratio for this latter group has been about unchanged. For example, the change in this ratio for banks in the four States which were subject to a 5 per cent interest rate limitation ranged from -2.2 to 2.9 with a mean of 0.5 from the end of 1968 to the end of 1969. The range in this ratio for banks in those States, in our sample, not subject to such limitations was 3.4 to 7.9 with a mean of 6.1, or more than ten times greater than the ratio for the low interest rate States. (This comparison excludes banks in Pennsylvania for the reasons stated above. However, inclusion of these data would not change the result significantly.)

It is hazardous to infer too much from these data since the number of banks reporting from each State varies appreciably. Nevertheless, the pattern seems too closely correlated not to reflect some common portfolio adjustment by banks in States where low interest rate limitations are in effect.

All of the rough calculations presented above show banks in States with low interest rate ceilings holding relatively fewer State and local obligations than do banks in States where no such constraint exists. In addition, it can be inferred from the data that the market for State and local obligations, at least so far as the banking system is concerned, is segmented, and in large part such securities are not readily traded on an interstate basis. If these securities were more easily traded, one would expect to see more uniform movement in the portfolio adjustments of banks as the obligations of some States come under interest rate constraints. That is, banks in States with low interest rate ceilings would substitute obligations from their home State for the securities of States with higher rates. On the basis of the data available, such substitution does not appear to take place in a significant volume.

The holdings of State and local securities by banks located in the State of Maryland appear to follow the general pattern of banks located in States with low interest rate ceilings. (The change in the Maryland law came too late in the year to have much effect on the holdings of banks in the State.) Holdings of such securities by Maryland



banks declined almost 11 per cent from the end of 1968 to the end of 1969, about in line with the experience of other banks in States where low interest rate ceilings were in effect. The ratios of State and local securities to total securities at Maryland banks reinforces the above pattern. This ratio was about unchanged from the end of 1968 to the end of 1969, increasing only 0.6 per cent, compared to the average increase of 6.1 for banks in States with higher interest rate ceilings.

In summary, the data for weekly reporting member banks show that from the end of 1968 to the end of 1969 large banks seem to have followed a consistent pattern of reducing the importance of State and local obligations in their portfolios. The data also show that at banks in States where interest rate ceilings permitted on general obligation securities are out of line with market rates of interest the portfolio adjustment was much more drastic than in those States where such ceilings did not apply.

#### Market Displacements and the Search for Alternative Sources of Funds

With the traditional commercial bank market for State and local government issues falling away, these jurisdictions have been forced to search vigorously for other means of adjusting to stringent capital market conditions. In many instances, these alternatives have been unwieldy and often more expensive than public market borrowing based on the full faith and credit of the issuing agency.

In the first place, though, many would-be borrowers simply had to stand aside from the market at the time they originally planned to sell bonds. A rough indication of the extent of this interruption in plans is given by the volume of displacements as reported by the Bond Buyer. In this series, displacements include issues which were postponed, on which no bid was received, or on which all bids were rejected. At the beginning of January, 1970, the cumulative total of municipal displacements (cumulative from September 3, 1968, when the series was started) was \$2,836 million. Although this is a large backlog of displacements, one should be cautious in interpreting its meaning, since it probably underestimates the actual volume of issues put aside -- at least temporarily. Moreover, the series cannot capture those issues which were never initiated because local officials knew it would be useless and costly to advertise bonds, given the prevailing level of yields.

State and local officials -- faced with restricted access to the long-term capital markets because of ceilings on general obligations -- have relied more heavily on revenue bonds, short-term borrowing, increased taxes or curtailment of expenditures. In 1969, a substantial number of government units resorted to one or more of these measures. Revenue bonds or issues of special authorities often have more liberal interest rate ceilings than those on State general obligation bonds. Therefore, a number of governments use

special building authorities which can issue revenue bonds and then lease the facilities back to the school or library official which cannot market their own bonds. This is not a new device, of course, but it is reported that a number of jurisdictions (particularly school districts) relied on such special authorities much more frequently in 1969.

Short-term borrowing by State and local governments increased sharply last year. Preliminary estimates suggest that the total may have reached about \$11.9 billion, a rise of \$3.2 billion over the amount recorded in 1968. At this level, short-term borrowing would represent more than half of the \$23.4 billion of total new issues offered in 1969. This was a record proportion by a large margin. The 1968 share of short-term issues in the total (just over one-third) was about the average for the decade of the 1960's. In many cases, however, there are legal limitations on refunding short-term obligations, so this means can provide only a temporary solution to the financing problems of most units.

A number of State and local governments have also found it necessary to take special steps (or to engage in special persuasion) to induce buyers -- particularly commercial banks -- to purchase newly issued obligations. A good example of this is reported from Chicago. The leading banks in that city agreed to take \$45 million of a proposed \$145 million tax anticipation borrowing after the State of

Illinois agreed to place \$15 million in non-interest bearing deposits with those banks. Another example of banks' response to special appeals is found in the State of Maryland. Late last year, when difficulties in selling bonds arose because of the then existing 5 per cent rate ceiling, the State Treasurer negotiated with six large Maryland banks and obtained commitments from them to lend \$12 million to the State for a few months until the Legislature could act at its regular session in February. The banks agreed to lend the money at 5 per cent, well below the prime rate. In passing, it should be noted that at least some of these banks held a sizable amount of public deposits -- which undoubtedly was a factor in their consideration of the appeal to participate in the loan pool for the State.

Still other examples of the alternatives on which State and local governments have depended to raise funds could be cited. However, they all tell the same story: low interest rate ceilings greatly limited the access of many of these units to the capital market in the last year of sharply rising market yields.

#### Effects on State and Local Government Expenditures

Because we have only incomplete data on capital outlays by State and local units, it is difficult to assess the impact of these borrowing problems on their level of spending. Surveys conducted by the Federal Reserve System in 1966 (a year in which long-term

borrowings by these governments were \$1.4 billion lower than original plans) did not show a significant decline in capital spending as a result of the reduced availability of credit. However, there was no long period of ready availability of funds between the credit stringency of 1966 and the end of 1968 which would have permitted these governments time to build up their liquid assets and increase the borrowing flexibility. Moreover, the short-fall between planned and actual long-term borrowing in 1969 was undoubtedly much greater than the \$1.4 billion estimated for 1966. While we have no direct measure of this gap for last year, the decline of over \$4 billion in long-term bond sales in 1969 compared with the volume in the previous year certainly does suggest that it was quite large.

Therefore, it is expected that the impact on construction spending in 1969 was more severe than in the earlier period. The latest State and local government construction figures available (for the third quarter of 1969) suggest that an adverse impact of reduced municipal long-term borrowing was already appearing by the end of last summer. In the twelve months ending last September, State and local outlays for new construction rose by 7 per cent; in the same period a year earlier, the rise was close to 9 per cent. Moreover, in the most recent period, expenditures on educational facilities showed no change, whereas in the previous year such outlays rose by 3 per cent.

Local governments, which finance almost two-thirds of their capital outlays by means of long-term borrowing, will probably be affected more severely in this respect than State governments, which rely on long-term bonds to finance about half of their construction expenditures. Given the present emphasis on control of the Federal budget, it is unlikely that Federal grants to the States and subdivisions will expand enough to take up the slack.

Thus, if these governmental units are to find relief -- and if their capital investment is not to be hampered continuously -- they must have greater access to the capital markets. Removal of low interest rate ceilings on their debt is one necessary step in the right direction.

#### Outlook for State and Local Government Borrowing

Trying to assess the outlook for State and local governments in the capital market is obviously very difficult. Furthermore, this difficulty is compounded by the need on my part to avoid making any suggestion about the probable future course of monetary policy. Nevertheless, a number of elements underlying such an outlook can be marshalled.

In 1969, long-term offerings of securities by State and local governments averaged between \$800 million and \$900 million per month, and the monthly average was smaller in the second half than it was in the first half of the year. In January, it is estimated that the volume was about \$1.3 billion. The sale of these issues was facilitated by a decline in municipal yields through mid-month, and the lower interest rates also induced the reoffering of several issues previously

postponed. The improved market conditions in the first part of January were in turn helped by a strengthened dealer inventory position, and a large percentage of the January offerings was of a high quality with shorter-term maturities. In recent weeks, however, the calendar of anticipated long-term financing has built up to a sizable volume, while purchases have been concentrated relatively more on shorter maturities. The result has been a rebound in long-term tax-exempt yields.

Given the steadily expanding backlog of displacements and the continued buildup in the forward calendar, the volume of municipal flotations may remain very large for a number of months. Over the longer run, the need to finance a high -- and even rising -- level of capital formation in State and local jurisdictions will almost certainly become more -- rather than less -- pressing.

Against this prospect, it would seem impractical for public officials to put off the removal of outdated interest rate ceilings in the hope that market rates will soon decline to levels comfortably within present ceilings. In addition to the expected volume of newly generated issues, the supply of municipal securities has been artificially suppressed, and is potentially anywhere from the \$2.8 billion recorded in the Bond Buyer's displacement series to the estimated \$4 - \$5 billion shortfall in planned borrowings in 1969. Certainly no one would argue that the need for schools, housing,

utilities, transportation, and other public facilities will be any less.

In the meantime, the major element of uncertainty in the interest rate picture is the demand for tax-exempt securities. The reduced purchases by commercial banks and the challenge to the tax-exempt market among individuals which was raised by tax reform legislation last year both depressed demand for municipal securities so much that even the sharp fall in volume in 1969 could only be absorbed at the cost of sharply rising market yields.

Individual buying will undoubtedly pick up again if there are no further moves by Congress to eliminate the tax exemption privilege. Commercial bank purchases obviously will depend on general credit market conditions, but it would seem unlikely that there would be sufficient demand by banks to absorb the potential supply which would come to market if municipal rates were to ease significantly. This implies that, even if municipal yields decline somewhat from their present high levels, they probably will not return to pre-1966 levels in the near future. While flow of funds data suggest that corporations increased their holdings of municipals substantially during 1969, it appears that most of their purchases were of short-term securities. Thus, it would be extremely unwise for State and local governments to count on these firms as a lasting outlet for their obligations.



Instead, they should really set to work trying to improve their access to the long-term capital market. While this effort must go forward on a number of fronts, the removal of outdated statutory limits on the interest rates they can pay on long-term debt is a necessary move -- which ought to be made without further delay.

Table 1. Statutory Interest Rate Ceilings on State and Local Government Securities, by State and Type of Obligation, January, 1970

Area and Level of Ceiling	State Governments			Local Governments			Comments
	General Obligations	Revenue Bonds	State Agency	General Obligations	Revenue Bonds	Local Agency	
<u>Under 6 per cent</u> (On General Obligations )							
Arizona	5	5	5	6	6	None	
Arkansas	Varies	Not issued	Varies	6	6	6	State: Usually 5 per cent.
California	5	Varies	5	5	Varies	7	State: Some agencies have 7 per cent ceiling.
Kansas	5-1/2	6	5-1/2	5-1/2	6	5-1/2	
Montana	5-1/2	5-1/2	6	6	6	6	
<u>Between 6 and 7 per cent</u> (On General Obligations)							
Alabama	6	6	Varies	None	None	None	Local: 8 per cent usury limit applies.
Birmingham				6-1/2	None	Varies	
Alaska	6	6	6	None	None	None	
Hawaii	6	None	Not auth.	7	6	Not auth.	
Illinois	6	6	6	6	6	6	Local: Chicago limit suspended until July 1, 1971
Chicago				7	None	None	
Iowa	6	7	Not issued	7	7	6	
Kentucky	6-1/2	6-1/2	6-1/2	7	7	7	

	State Governments			Local Governments			Comments
	General Obligations	Revenue Bonds	State Agency	General Obligations	Revenue Bonds	Local Agency	
<u>Between 6 and 7 per cent</u> (On General Obligations) (continued)							
Mississippi	6	6	6	6	6	6	
New Mexico	6	4	6	6	None	6	
North Dakota	Not issued	6-1/2	Not issued	6	6	Not auth.	
Oklahoma	6	5	Varies	6	Not auth.	None	
Utah	6	6	6	None	None	None	
Virginia	6	6	6	6	6	6	
<u>7 per cent and over</u> (On General Obligations)							
Colorado	7	None	None	6	6	6	
Florida	7	7	7	7-1/2	7-1/2	7-1/2	
Michigan	8	8	8	8	8	8	
Missouri	8	8	8	8	8	8	
Nevada	7	Not issued	7	7	7	7	
Oregon	7	Not issued	Not issued	7	7	7	
Portland				6	Not issued	Not issued	Local: Portland ceiling in City Charter.
Pennsylvania				7	7	7	From 6 during July 1, 1969 to July 1, 1970
Philadelphia				None	None	None	Exception: 6 on port, transit and street bonds.

	State Governments			Local Governments			Comments
	General Obligations	Revenue Bonds	State Agency	General Obligations	Revenue Bonds	Local Agency	
<u>7 per cent and over (cont'd)</u>							
South Carolina	7	7	7	7	7	7	
Tennessee	10	10	10	10	10	10	
<u>No ceilings</u> (On General Obligations)							
Connecticut	None	None	None	None	None	Not issued	
Delaware	None	6	6	6	6	6	
Georgia	None	None	None	None	7	7	
Idaho	None	None	None	None	None	None	
Indiana	None	None	None	None	None	None	
Louisiana	None	None	None	None	None	None	
New Orleans				None	6	6	
Maine	None	None	None	None	None	Varies	
Maryland	None	None	None	None	None	None	
Massachusetts	None	None	None	None	None	None	
Minnesota	None	None	None	None	None	None	
Nebraska	None	None	None	None	None	None	Local: 9 per cent usury limit applies.
New Hampshire	None	None	None	None	None	None	
New Jersey	None	None	None	None	None	None	Limit suspended, July 1, 1969 to June 30, 1970

	State Governments			Local Governments			Comments
	General Obligations	Revenue Bonds	State Agency	General Obligations	Revenue Bonds	Local Agency	
<u>No ceilings (cont'd)</u> (On General Obligations)							
New York	None	None	None	None	None	None	Limit suspended, April 15, 1969 to April 15, 1970.
North Carolina	None	None	None	None	None	None	
Ohio	None	None	None	8	8	8	
Rhode Island	None	None	None	6	Not auth.	6	
South Dakota	None	Not issued	6	6	Not issued	6	
Texas	None	None	None	None	None	None	Local: 10 per cent usury limit applies.
Vermont	None	None	None	6	6	Not issued	
Washington	None	None	None	8	8	8	
West Virginia	None	6	6	6	6	6	
Wisconsin	None	None	None	8	8	8	
Wyoming	None	None	None	None	None	None	

Table 2. State and Local Government Securities Held by  
Weekly Reporting Member Banks in Selected States  
(Amounts in millions of dollars)

Seclected Dates	Calif. <sup>1/</sup>	Mary- land <sup>1/</sup>	New York <sup>1/</sup>	North Carolina <sup>1/</sup>	Fla.	Illinois	Mich- igan	New Jersey	Ohio	Pa. <sup>2/</sup>	Texas	Va.	All Weekly Reporters
December 28, 1966	3,759	183	6,571	433	217	1,590	1,265	584	1,473	1,342	907	297	23,410
December 27, 1967	4,740	284	8,202	511	221	1,673	1,563	728	1,930	1,950	1,043	362	29,407
December 31, 1968	5,376	280	9,448	620	310	2,111	1,821	825	2,127	2,434	1,286	424	34,500
December 31, 1969	4,880	250	8,319	560	315	2,153	1,901	856	2,134	2,087	1,206	428	31,974
Changes: (per cent)													
1966 - 1967	26.1	55.2	24.8	18.0	1.8	5.2	23.6	24.7	31.0	45.3	15.0	21.9	25.6
1967 - 1968	13.4	-1.4	15.2	10.7	40.3	26.2	16.5	13.3	10.2	24.8	23.3	17.1	17.3
1968 - 1969	-9.2	-10.7	-11.9	-9.7	1.6	2.0	4.4	3.8	0.3	-14.3	1.5	0.9	-7.3

(1) States with interest rate ceilings of 5 per cent or less on general obligations through most of 1969.

(2) The rating of Philadelphia bonds was reduced sharply by private rating agencies in late 1968, and this may have had an adverse effect on bank holdings of these securities.

Table 3. Ratio of State and Local Government to Total Securities Held by  
Weekly Reporting Member Banks in Selected States (Per cent)

Selected Dates	Calif. <sup>1/</sup>	Mary- land <sup>1/</sup>	New York <sup>1/</sup>	North Carolina <sup>1/</sup>	Fla.	Ill.	Mich- igan	New Jersey	Ohio	Pa. <sup>2/</sup>	Texas	Va.	All Weekly Reporters
December 28, 1966	44.9	40.9	48.0	55.5	39.8	44.6	43.1	53.0	46.2	47.7	43.8	50.3	45.5
December 27, 1967	51.3	49.9	50.5	56.5	35.4	41.4	45.4	55.3	48.0	51.3	44.6	51.3	47.6
December 31, 1968	49.6	48.4	52.7	59.9	43.8	44.6	46.4	54.7	51.4	57.9	47.6	54.6	50.5
December 31, 1969	52.5	49.0	53.4	57.7	51.7	50.2	52.6	61.1	57.3	59.8	55.0	58.0	53.6
Changes in Ratio (Percentage Points)													
1966 - 1967	6.4	9.0	2.5	1.0	-4.4	-3.2	2.3	2.3	1.8	3.6	0.8	1.0	2.1
1967 - 1968	-1.7	-1.5	2.5	3.4	8.4	3.2	1.0	-0.6	3.4	6.6	3.0	-3.3	2.9
1968 - 1969	2.9	0.6	0.7	-2.2	7.9	5.6	6.2	6.4	5.9	1.9	7.4	3.4	3.1

<sup>1/</sup> Same as Table 2.

<sup>2/</sup> Same as Table 2.