National Association
of Bond Lawyers

Tax-Exempt Bonds: Their Importance to the National Economy and to State and Local Governments

The tax exemption of the interest on State and local government bonds is a proven, effective way to provide needed funding for public infrastructure and the related benefits to the economy from job creation and business development.

- **The exemption of state and local government bond interest helps lower the cost of capital funding for state and local governments.** Any repeal of or change to the exemption of state and local bond interest, including making state and local government bond interest subject to tax for higher-income taxpayers, will increase borrowing costs for state and local governments. The burden of such changes will fall primarily on state and local governments and through them on their taxpayers and ratepayers, not on high-income federal taxpayers.

- **State and local government bonds provide funding for critical infrastructure.** With limited exceptions, state and local government bonds fund capital projects. Unlike Treasury bonds, state and local government bonds are generally not used to fund deficits. State and local government bonds finance schools, roads and highways, bridges, hospitals, universities, airports, water and sewer facilities, and other infrastructure that powers our economy.

- **Changes to the exemption of state and local government bonds will increase state and local borrowing costs, which will be passed on to the public.** These increased borrowing costs will be passed through to taxpayers, ratepayers (e.g., of a municipal water system or utility), or other users (e.g., hospital patients, students or residents in low income housing). Since the facilities benefitted by state and local government bonds are limited to specified public purposes by the Internal Revenue Code, the burden of these increases will be borne regressively by lower and middle income individuals.

- **Principles of federalism support maintaining the current exclusion of state and local government bond interest.** States cannot tax interest on Treasury bonds. Similar treatment of state and local government bonds is consistent with the reciprocal principles of federalism and has a long-standing historical basis.

- **State and local government bonds encourage local control over the development of infrastructure.** State and local governments set the priorities for infrastructure and economic development and shoulder the burden of these investments. If the current system were replaced with one in which the federal government provided grants or loans instead of the assistance now provided by the exclusion of interest on state and local debt, the federal government would inevitably appropriate control over infrastructure and economic development decisions that are now made, effectively, at the state and local level.

- **Infrastructure is important to our economy.** The development of infrastructure provides construction jobs with related multiplier affects to local economies. Public infrastructure is also important to economic activity (i.e., airports, highways, and electric, water and sewer utilities are important to existing businesses and the creation of new businesses).

- **Limiting or eliminating the exemption will mean less infrastructure investment.** Unless substantial amounts of other federal funds are made available state and local governments will be discouraged from infrastructure investments. A lack of investment in infrastructure will hurt long-term economic growth and, in the short term, result in loss of construction-related jobs.

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Additional Information

PUBLICATION	DATE	AVAILABLE AT
Tax-Exempt Bonds: Their Importance to the National Economy and to State and Local Governments, National Association of Bond Lawyers	August 2012	http://www.nabl.org/uploads/cms/documents/2012_08_02_NABL_Tax_Reform_White_Paper.pdf
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Tax-Exempt Bonds: A Description of State and Local Government Debt, Congressional Research Service	June 2012	http://www.nabl.org/uploads/cms/documents/2012-13313-1.pdf
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Portfolio Substitution and the Revenue Cost of the Federal Income Tax, Poterba and Verdugo	June 2011	http://hdl.handle.net/1721.1/61961
Policy Position: Public Finance, National Governors Association	February 2012	http://www.nga.org/cms/home/federal-relations/nga-policy-positions/page-edc-policies/col2-content/main-content-list/public-finance.html
Federal Tax Policy and Preserving the Tax-Exempt Status of Municipal Bonds, Government Finance Officers Association	June 2005	http://www.gfoa.org/index.php?option=com_content&task=view&id=2204
Built by Bonds, Council of Development Finance Agencies	November 2011	http://www.cdfa.net/cdfa/cdfaweb.nsf/ord/builtbybonds.html/$file/CDFA-Built-by-Bonds.pdf
Flow of Funds Accounts of the United States, March 8, 2012, Table L.211, Federal Reserve Board	March 2012	http://www.federalreserve.gov/releases/z1/20120308/accessible/l211.htm
Statistics of Income, Individual Income Tax Table 1.4 All Returns: Sources of Income, Adjustments, and Tax Items, by Size of Adjusted Gross Income, Tax Year 2009, Internal Revenue Service	July 2011	http://www.irs.gov/pub/irs-soi/09in14ar.xls
Municipal Bonds, 2009, Internal Revenue Service	Fall 2011	http://www.irs.gov/pub/irs-soi/11ebfallbulmunbond.pdf