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

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

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

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

- **State and local government bonds provide 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, paying all the principal and interest. If the current system were replaced with one in which the federal government provided grants or loans, the federal government would inevitably appropriate control over infrastructure and economic development decisions that are now made, and effectively so, at the state and local level.

- **The exemption of state and local government bond interest from federal tax helps lower the cost of infrastructure for state and local governments.** Because investors do not pay tax on state and local bond interest, they charge state and local governments lower interest. This lowers the cost of infrastructure financed with state and local bonds, thus lowering taxes, fees, tolls, and other charges used to pay off the bonds.

- **Restrictions on the exemption of state and local government bonds will increase state and local borrowing costs, which will be passed on to the public.** Investors would demand higher interest payments. 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 specific public purposes by the Internal Revenue Code, the burden of these increases will be borne reg emissively by middle and lower income individuals.

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

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

NABL is composed of 2700 attorneys nationwide and exists to promote the integrity of the municipal market by advancing the understanding of and compliance with the law affecting public finance.

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