Statement
Submitted for the Record
by
Treasurer David Lillard (R-TN) and Treasurer James McIntire (D-WA)

April 15, 2015
U.S. Senate Committee on Finance
Attn: Community Development and Infrastructure Tax Reform Working Group
219 Dirksen Senate Office Building
Washington, DC 20510-6200

We appreciate the opportunity to submit for the record our comments regarding infrastructure, and to specifically convey our views on the tax treatment of municipal bonds. As State Treasurers, and bipartisan leaders of the National Association of State Treasurers (NAST), we have seen firsthand the importance of municipal bonds for maintaining and building new infrastructure projects at the state and local level. For this reason, we write to oppose the repeal or limitation of the exemption of municipal bond interest from federal and applicable state income taxation. We also oppose other policy changes that would curtail the use or diminish the value of tax-exempt bonds.

Since 1913, tax-exempt bonds have been the primary mechanism used to finance state and local infrastructure projects. Three quarters of all public infrastructure projects in the United States are built by the states and local governmental entities. The elimination or reduction of the tax exemption would severely impair the ability of states and municipalities to address our deteriorating infrastructure and build worthy new job-creating projects.

The need to address our infrastructure has never been greater – according to the American Society of Civil Engineers, the nation should spend $3.6 trillion by the year 2020 to meet its critical infrastructure needs.[1] In the age of constrained budgets, state and local governments will quite simply be unable to address this need without access to a robust tax-free bond market. Changes to the current tax treatment would cause states and localities to pay higher borrowing costs which will result in lower infrastructure spending, less jobs, and increased taxes on sales, property or income.

We are aware there is an argument that the current tax exclusion is not 100 percent efficient in delivering the tax benefits to state and local issuers. We believe this line of reasoning misses some key aspects that should be considered by policymakers. First, this conclusion is not without debate. Academic research has suggested the "cost" to the federal government is far less, and that reasonable substitution to other investments by current municipal bond investors would dramatically reduce the "savings" achieved by changes to the tax exemption for municipal bonds.[2]

Moreover, there is no evidence that a more efficient model exists to the 100 year old model of excluding income from municipal bonds. Tax credit bonds have not been enthusiastically adopted by the market, and setting the credit rate can prove difficult and therefore inefficient. Limiting the tax benefit for municipal bonds would add economic inefficiency into the system by including additional risk premium into the pricing of bonds. Additionally, some of the inefficiency of the municipal bond

[1] www.infrastructurereportcard.org

[2] James Poterba and Arturo Ramirez Verdugo: *Portfolio Substitution and the Revenue Cost of Exempting State and Local Government Interest Payments from Federal Income Tax*

market may be attributable to the changes in federal tax policy over the past several years which inherently make bonds with tax benefits more variable.

Finally, the argument over the efficiency of the tax benefit assumes the only beneficiaries of the current tax treatment are the taxpayers who own municipal bonds. This conclusion ignores the reality that infrastructure build with state and locally issued municipal bonds benefits a wide spectrum of constituents, far more broadly than just the holders of these bonds. This includes users of roads, schools, municipal water systems, and other infrastructure across the country. We urge policymakers to consider this perspective in any analysis that determines who benefits from municipal bonds.

There have also been recent proposals by Congress and the Administration to create additional tax credit bonds or create bonds designed to enhance public private partnerships. While many of these proposals have merit and would be welcomed by states and municipalities, they cannot replace tax exempt municipal bonds without serious disruption. In 2013, the Securities Industry and Financial Markets Association (SIFMA) concluded that tax credit bonds "have not achieved the level of market acceptance as traditional municipal bonds, so a wholesale transition to tax credit bonds would be risky for the market and for issuers."[3] Based on the 2012 IRS Statistics of Income (SOI) data, only 0.4 percent of all municipal bond proceeds are from tax credit bonds. We have very significant concerns that any attempt to scale up such a small tax credit bond market to the scope of the municipal bond market would risk severe disruption. The resulting market uncertainty would cause additional costs and lost efficiency that would benefit no users in the marketplace or in state, local or federal government. Congress should instead ensure that the municipal bond market remains as economically efficient as possible by clarifying to issuers and investors that the tax-exempt status of municipal bonds will not be changed.

In conclusion, we believe that tax exempt municipal bonds are the only proven way for states and municipalities to build and maintain our highways, bridges, schools, hospitals, and other important infrastructure in our communities across the country. If Congress limits, repeals, or tries to replace tax exempt municipal bonds, many critical infrastructure projects would be foregone,

We look forward to continued dialogue with the working group, the Committee, and Congress as you explore reforms to the tax code.

Sincerely,

David H. Lillard, Jr. NAST President and Tennessee State Treasurer	James McIntire NAST Senior Vice President and Washington State Treasurer

[3] http://www.sifma.org/workarea/downloadasset.aspx?id=8589943106