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Federal Tax Proposals Would Cut Jobs, Growth and Infrastructure in States.

WASHINGTON—The National Governors Association (NGA) and The Council of State Governments (CSG) today released a study that found repealing federal tax provisions that most affect state and local budgets "would bring a net loss of approximately 417,000 jobs and $71 billion in real GDP" over the next 10 years.

The study, Macroeconomic Analysis of Federal Tax Proposals Affecting State and Local Budgets, analyzed two scenarios: one would place a 28 percent cap on the value of both state and local tax deductions and the earned interest exclusion for municipal bonds; the other would repeal both entirely. Although the magnitude of the effects of these scenarios varies significantly, the overall result is similar— higher tax burdens decrease consumption and savings rates, while lower levels of infrastructure spending decrease construction activity and the economic spillover associated with it.

"The study's analysis of the potential effects on jobs, growth and investments in infrastructure shows how proposals to repeal or limit these tax provisions that benefit state and local investments run a real risk, if enacted, of creating unintended consequences," said NGA Executive Director Dan Crippen.

Because both the cap and repeal scenarios would increase the interest rates that state and local governments pay on the municipal bonds they use to finance their investments in infrastructure, borrowing costs would increase by as much as $33 billion over the next decade, thereby decreasing investments in infrastructure.

Even more staggering, the study, prepared by Moody's Analytics, found that "the tax consequences of the two proposals prove much more damaging to economic growth." For example, "the tax proposals in the capped and repeal scenarios result in a 10 year tax increase of $187 billion and $1.1 trillion, respectively." In addition, the construction and manufacturing industries would see a significant decrease in demand under a full repeal scenario, resulting in 125,000 less jobs by 2023, according to the study.

"Limiting the tax deductibility of state and local taxes and changing the tax treatment of municipal bonds is a surefire strategy for killing jobs, curtailing growth and adding cost to infrastructure projects. The numbers don't lie. These changes would be disastrous," said CSG Executive Director David Adkins.

As part of the cap scenario, the study includes the administration's proposal to offset some of the increased borrowing costs by providing limited direct subsidies to state and local borrowers through a new taxable America Fast Forward Bond (AFFB) program. The study, however, emphasizes the cap scenario is "filled with a number of unquantifiable factors, which would likely result in higher economic cost."

It also warns that "arbitrarily reducing the value of the municipal bond market" could set a dangerous precedent, possibly causing permanent uncertainty about interest rates, opening "a door that cannot be closed" and raising borrowing costs for states and local governments "in perpetuity." Additionally, recent subsidy payment reductions because of sequestration in the Build America Bond program, the proposed AFFB's forerunner, will likely make AFFB less beneficial to issuers than the estimates included in this analysis.

The study complements recent studies of the National Association of Counties (NACO) and the Urban-Brookings Tax Policy Center in that it projects the 10-year macroeconomic effects of capping or repealing tax provisions that assist states and local governments. The NACO study, in particular, estimated that a 28 percent cap or full repeal of the interest exemption on municipal bonds would have cost states and local governments $173.4 billion and nearly $500 billion respectively, over the past 10 years.

The full report is available at:

http://www.nga.org/files/live/sites/NGA/files/pdf/2013/1311MoodysReport.pdf