# [Political Tax Avoidance Chokes Off Infrastructure Investment.]

Every state or municipal government will eventually face the question of whether to raise taxes. Since the era of George H.W. Bush, officials answer increasingly “No.”

“It’s politically hard to make a case for tax increases, and particularly at a time when people have less money in their pockets,” said Lucy Dadayan, a senior policy analyst with the Nelson A. Rockefeller Institute of Government.

The nation’s reluctance to talk taxes has resulted in a drop in borrowing for needed infrastructure as well as missed opportunities to take advantage of historically low interest rates to finance long-term projects.

The political response to rebuilding the Washington D.C. Metro, the nation’s second-largest subway system, has been, don’t expect a bailout.

States increased taxes by $33 billion in response to the Great Recession, 38 percent less than the $54 billion raised after the 1990 recession, according to a 2015 study by the Rockefeller institute.

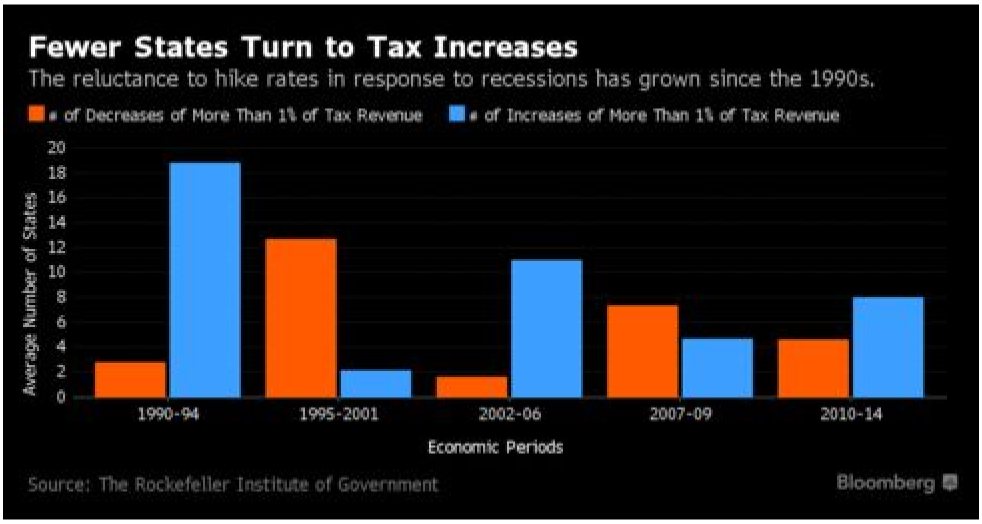
Meanwhile, some states still haven’t recovered completely from the 2008- 2009 financial crisis. At some point, something will have to give. Sooner or later they’ll have to raise taxes.

“It’s inevitable,” Dadayan said. “Otherwise, the fiscal systems are not going to be sustainable over a long period of time.”

George H.W. Bush’s famous 1988 mantra, “Read my lips: No new taxes,” has stuck with state and local government officials to this day, said Emily Evans, a former Nashville councilwoman who is now a managing director at investment research firm Hedgeye Risk Management.

“We are not past that point at all,” said Evans. It varies, “depending where you are. If you’re in a really deep red state like Tennessee, we’re really not past it. If you’re in the purple and blue states, there’s a whole lot more open mindedness about it.”

While Bush’s promise had an impact, so did what happened afterwards, she said. The president eventually raised taxes and didn’t win a second term. “That stands in the minds of most elected officials as a serious problem,” Evans said. “If I raise taxes, I won’t get reelected. That’s the equation. That still is a big part of the thinking that goes into those decisions to vote ’yes’ or ’no’ on new tax projects.”




One example of a changing approach to tax increases can be seen in the state sales tax, said William Fox, a business professor at the University of Tennessee at Knoxville, who studies the subject.

During the 1980s recession, about 30 states raised their rates, he said. The number of states that enacted increases fell to about 20 during the 1990s and continued to decline during the 2000s to the mid-teens, Fox said.
"The pressure is ever-stronger on keeping taxes low," he said. "If you went back into the 1980s, when money got tight in state governments, particularly during recessions, what you would get is a wave of tax-rate increases," he said. "While that is true today, the propensity for that to take place has fallen over time."

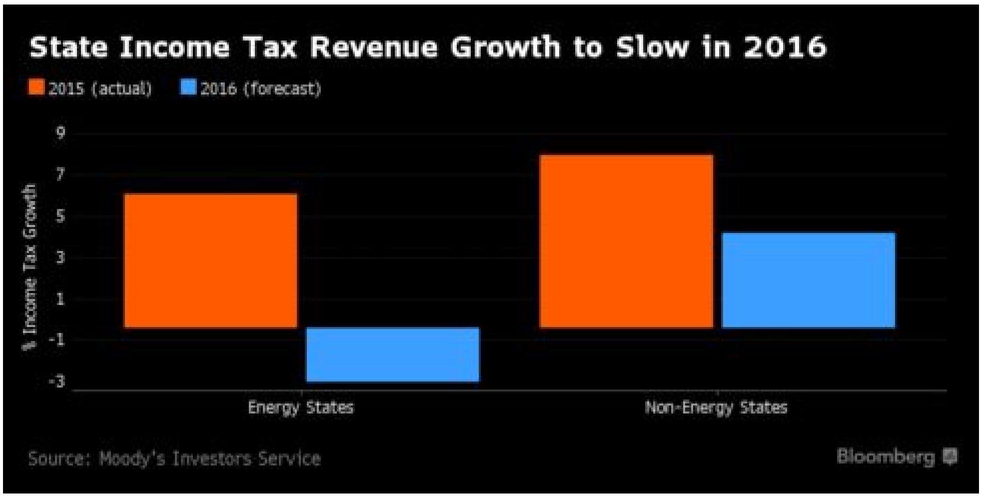
The impact of politicians' reluctance to raise taxes has been felt in the municipal market. New-money municipal issuance has averaged $150 billion annually from 2011 to 2015, which is a marked decline from the previous 10 years, according to an April report by Citigroup Inc.

New-money issuance averaged $242 billion annually during 2001 to 2010, Citigroup found. "In other words, state and local debt as a source of funding for needed projects has been running, on an inflation adjusted basis, at least 45 percent lower over the past five years than it was over the prior 10," Citigroup said in the report.

"State and local governments aren't able to keep up with new project funding needs and urgently needed major maintenance and replacements, and the extent to which they are falling behind continues to grow," Citigroup said.

This reduced level of borrowing is "astonishing" given the state of the country's infrastructure, said Citigroup strategist George Friedlander. "The Republican tax pledge still exists — 'we will not raise taxes in any way that is not offset by reductions in spending somewhere else,"' he said. "That's a big issue. The whole concept of cost-benefit when it comes to infrastructure has vanished. It is not part of the discussion right now.

"Is there a benefit in raising spending on infrastructure which, in terms of keeping us competitive with the rest of the world, will pay an economic benefit down the road? Well, probably, yeah, but nobody cares."




Additionally, politicians' concerns about raising taxes are preventing them from taking advantage of historic low interest rates, said Michael Mazerov, a senior fellow with the Center on Budget and Policy Priorities. "In most cases, those services and the infrastructure is going to be paid through bonding," he said. "Interest rates are so low now that this is a time when states should be investing in infrastructure."

Governments only have a few choices when budgets get tight — taxes are one of the only ways they can generate revenue. Another option is to refinance debt to delay final repayment. This can be a "trick" that state and local governments resort to instead of raising taxes, Evans said.

Evans saw this happen first hand during her time on the Metropolitan Council of the Metropolitan Government of Nashville and Davidson County in 2010. The council approved the issuance of $600.2 million in general obligation bonds, which included retiring commercial paper and refinancing debt. Evans said the refinancing resulted in about $48 million in additional debt service payments because it extended the life of the debt.

The council did so after the mayor at the time promised residents he would not raise property taxes, she said.

"Instead of doing one, cutting expenses, or two, raising revenue, [the mayor] opts for a refinancing of outstanding debt, which cost the taxpayers," she said. "There wasn't any other compelling reason to refinance that debt."

**Two Choices**

Richard Riebeling, the chief operating officer for Nashville's mayor's office, disputes the $48 million figure, and says the refinancing was one of the smartest things the city did from a financial standpoint during that time.

"It was real simple," he said. "We were in the middle of a recession. The city had two choices that were very poor. One was raise taxes on people during the middle of a recession, which was not a very good idea.

Or second, you significantly reduce services. And so neither of those were strong options, so the third was a slight restructuring of our debt to move back some principal a few years."

Nashville and Davidson County enacted a 53-cent property tax increase per $100 of assessed value for fiscal 2012-13. Riebeling said economic conditions supported a property tax increase.

"There was a need to continue to fund schools and the other needs of the city," he said. "We did a small property tax [increase] that year because we thought it was the right thing to do. Could we have re-done the debt again? Probably. Would it have been the right thing to do? No, it would have been the wrong thing to do. This restructuring of the debt is not something that you do very often at all."

One of the first major modern instances of voters voicing their displeasure with tax policies was in 1978, when California voters enacted Proposition 13. The referendum enacted a limit on property tax rates. It was one of the first laws that put a hard limit on municipalities' ability to raise revenue, Fox said.

To be sure, voters can also approve tax increases, like Californians did in 2012 with Proposition 30, which temporarily increased sales and income taxes.

Voters may be willing to raise taxes for specific issues such as education, said Vladimir Kogan, a political science professor at Ohio State University. "It's not like voters are clamoring for this," he said. "It's a matter of selling it."

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