Deficit reduction and its potential impact on the public finance industry

by Ed Cavezza

As readers of this article are already well-aware, reducing America's budget deficit is not only one of the most important issues facing our lawmakers today, it is also one of the most contentious. The strong divisions that exist on this issue can be seen in the recent failure of the "Super Committee," the 12-member, bipartisan group selected from members of the House and Senate that had been tasked with developing a plan to reduce the nation's deficit by $1.5 trillion over the next 10 years. Several other prominent politicians, including both Republicans and Democrats, have called for reducing the deficit by an amount even greater than the $1.5 trillion goal of the Super Committee. Further, many of our lawmakers have made promises or pledges to their constituents to reduce or eliminate the deficit. Deficit reduction is clearly an issue that deserves our lawmakers' attention and will be a vital component of the political landscape for foreseeable generations.

There are, of course, many different ways to reduce the nation's deficit, although plans generally fall into one of three categories: increasing government revenues, either by raising taxes or reducing certain tax exemptions; decreasing government expenditures through cuts in spending on various programs; or a combination of the first two approaches. In debating the merits of various plans to reduce the deficit, the tax-exempt municipal bond market has not received the headlines given to many other more politically-charged programs. However, the public finance industry has still been a target of several different plans put forward. I believe that reducing or eliminating the current tax exemptions for municipal bonds would be a serious mistake, having drastic and long-lasting impacts on both the economy and individual taxpayers.

Depending on their politics, those attacking the public finance industry portray the existing tax exemption as either a "tax loophole" that creates an unnecessary governmental expense or as a subsidy for the rich. Unfortunately, while these catchphrases create quick sound bites for the person pitching his or her plan, they minimize public finance to a budget gimmick and ignore both reasons why the exemption was created within the tax code, and the important benefits the exemption creates.

It is impossible to overstate all of the public improvements that were built, created or enhanced by local governments, state governments and other select organizations that were able to access the capital markets more efficiently with tax-exempt municipal bonds. Small local governments rely on tax-exempt municipal bonds to finance everything from ensuring access to water and sewers, to building public libraries, to protecting their citizens with adequate and up-to-date fire and police departments. School districts use tax-exempt municipal bonds to build school buildings and upgrade equipment to help teach our children. Large cities use tax-exempt municipal bonds to build convention centers to attract business and provide jobs. Nonprofit organizations such as hospitals rely on tax-exempt bonds to build new state-of-the-art facilities and acquire technology that keeps us healthy or cures us when we are sick.

Without the tax-exempt bond markets, many smaller governments and organizations would have less access to the general capital market, and the larger governments and organizations would be forced to borrow at higher rates to fund their projects. This environment will lead to fewer projects, fewer benefits to the public and fewer jobs created. Further, when local governments are forced to borrow at higher rates to fund their projects and services, the increased interest costs would ultimately be borne by the local taxpayers. These negative repercussions are rarely mentioned by those attacking public finance, but are vital to fully understanding the true impact of eliminating the tax exemption, rather than just trying to fit such action neatly into a particular political ideology's agenda.

As a public finance professional for three decades, I have seen firsthand the benefits of the current tax exemption. In my career, I have had the opportunity to represent more than one out of four of Ohio's more than 600 school districts, and in that representation have helped them build or upgrade essential school buildings, as well as acquire and enhance their technology to better serve Ohio children. This example, however, is just the tip of the iceberg when it comes to the benefits that the tax-exempt bond industry provides to national, state and local economies.

Public finance helps build infrastructure, protect and educate people, and enhance quality of life through important projects that create jobs and provide economic development sorely needed in today's economy.

I understand that deficit reduction is not an easy topic for our leaders to tackle. There are no simple, cut-and-dry solutions on this issue. Add political pressures and entrenched special interests, and the job gets even more difficult. No matter how our leaders choose to approach reducing the deficit, not everyone will be pleased. However, I feel that it would be a great disservice to the public to imperil one of the most important economic development tools that our nation possesses, while at the same time putting at risk the ability of public entities and other select organizations to raise money for critical and beneficial projects. The spirit of compromise must prevail and some change should be expected. However, the current tax exemption for municipal bonds and the long-term benefits that exemption creates should not be sacrificed in our collective search for fiscal sanity. ■

Author bio

Ed Cavezza is a partner with the Columbus law firm of Peck, Shaffer and Williams LLP. Cavezza specializes in municipal finance law and serves as bond counsel to cities, counties and school districts. He has represented more than one out of every four of Ohio's 611 school districts. Much of Cavezza's contact with Ohio school districts involves preparation of tax levy proceedings, lease-purchase financings and voted bond issues.