Hidden Tax Hikes on the Ballot

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Millions of Americans will vote on state and local tax hikes on the November 6 ballot. They may not know that, however, because governments have disguised the hikes as "bond issues." There will be hundreds of general obligation bonds on the ballot across the country to raise billions of dollars for state and local schools, parks, transit systems and other items.

Bonds are debt, and that means higher taxes down the road when principal and interest are due. Many voters are apparently fooled by these hidden taxes because they usually approve bonds by large margins of 75 percent 25 percent or so.

General obligation debt is a popular way of financing government spending, but it is an expensive and imprudent way to do so.

State and local governments issue bonds to finance infrastructure, but debt is not the only way to do that. Much government infrastructure is financed on a pay-as-you-go basis, meaning constructing facilities in sequence over time with a portion of annual tax revenues. Some states, such as Idaho and Wyoming, buck the trend and issue very little debt.

Debt financing is more expensive than pay-as-you-go funding because of the interest payments, but also because governments pay fees to the municipal bond industry. Thousands of well-paid underwriters, traders, advisers, bond insurers and other finance experts are part of the overhead costs of debt financing. With debt-financed infrastructure, billions of dollars a year are going to Wall Street, not to schools and parks.

A further cost of state and local debt is corruption. The municipal bond industry has been plagued by "pay to play" scandals, which involve finance firms providing campaign contributions and other benefits to government officials to win bond business.

Debt financing is riskier than pay-as-you-go funding. When you give politicians the ability to borrow, many of them cannot restrain their spending impulses. In recent years, we have seen Greece, Puerto Rico, Detroit and other places burn their fiscal houses down from their debt-fueled spending.

Rising state and local debt is particularly worrisome today because many state and local governments also have large unfunded obligations in their worker pension plans. State and local debt totals more than $3 trillion and unfunded obligations are around the same, depending on how the obligations are measured. Both represent costs being pushed forward onto future taxpayers.

State budgets are already being squeezed because a rising share of spending is going toward interest costs and payments to shore up pensions. In California, the state budget noted, “The increasing reliance on borrowing to pay for infrastructure has meant that roughly one out of every two dollars spent on infrastructure investments goes to pay interest costs, rather than construction costs.” In Kentucky, pension spending has risen from 5 percent of general fund spending in 2008 to 15 percent today.

In Illinois, pension costs now consume a quarter of the general fund budget. The state’s rising pension and debt costs have made the state’s bonds the worst rated in the nation, which in turn has imposed higher interest costs on Illinois taxpayers.

Bond financing is appropriate for major infrastructure projects that rely on user charges to pay back the debt over time. But what does not make sense are the general obligation bonds placed on ballots that impose burdens on taxpayers for items such as schools and parks.

For these routine taxpayer-supported capital projects, debt provides no free lunch. Rather than borrowing, policymakers should plan ahead for such projects and allocate a portion of ongoing tax revenues for construction and renovation.

General obligation bonds are good for politicians, but not for the public. They allow politicians to claim credit for spending while evading the responsibility for higher taxes. They enrich finance industry middlemen and make government budgets opaque.

With today’s strong economy, tax revenues are pouring into state and local coffers. Governments should have plenty of money to spend on infrastructure without imposing more debt on future taxpayers.

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