The Potential Economic and Tax Revenue Impact of Texas' Fair Access Laws

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by

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Summary

Over the past several decades, Texas has established itself as a center of growth and development, becoming the 8th largest economy in the world and home to more Fortune 500 headquarters than any other state in the nation. There are a number of contributing factors, not the least of which is the low-tax limited, limited regulatory environment that welcomes a wide range of industries and firms.

In the 87th Session of the Texas Legislature, lawmakers passed Senate Bills 13 & 19, barring any Texas municipality from contracting with banks if they are found to be restricting funding to oil & gas companies or discriminating against firearms companies based on their line of business. Some institutions perceived as boycotting based on affiliations or fiduciary decisions have either exited the municipal bond market or have been kicked out. In a 2023 study entitled *Gas, Guns, and Governments: Financial Costs of Anti-ESG Policies*, Dr. Dan Garrett of the University of Pennsylvania and Dr. Ivan Ivanoff of the Federal Reserve Bank of Chicago examined the consequences. Their study found that competition in the public finance market was indeed reduced due to these laws, and that interest costs were 0.144 percent higher as a result. This paper expands on this initial work by examining the second part of the equation; the transaction costs associated with bond deals post-legislation and the impacts on the Texas economy that stem from them.

Further examination of transaction costs associated with issuing debt, specifically the underwriters spread, shows a sharp increase in the fiscal years 2022-23 in the wake of the laws' implementation. Applying the historic average from fiscal years 2015-21 implies excess costs of $270.4 million. These funds are no longer available for the basic functions of government; when run through a model of the Texas economy, this translates to $668.7 million in lost economic activity, value-added of $342.6 million, $180.7 million in annual earnings, 3,034 full-time, permanent jobs, and $37.1 million in State and local tax revenue. Said differently, the economy would have to produce approximately $2.84 billion in Gross State Product to make up for the excess cost and associated loss of public sector revenue. These findings illustrate that when government attempts to mandate values (no matter what kind) to business, the market loses, and taxpayers bear the consequences.

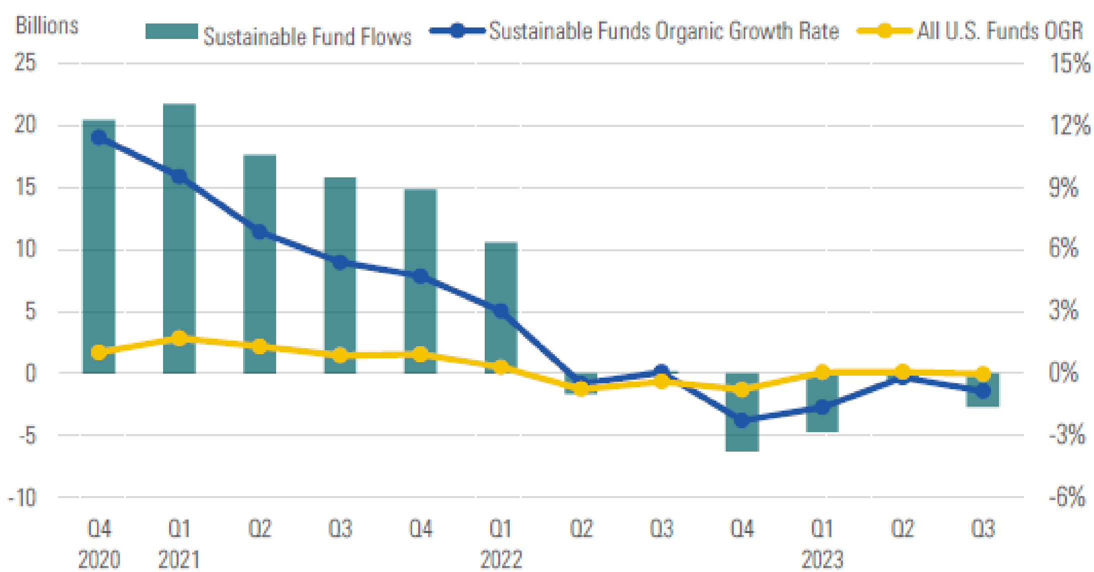
The Texas economy has long benefited from a pro-business climate. However, we are seeing a tightening of the competitive bond market in Texas due to enforcement actions pursuant to Texas' 2021 Fair Access law, which could stall this significant progress. This has consequences: less competition (due in part to significant barriers to entry) leads to higher interest costs, which in turn reduces the resources that enable service-provision that has negative economic and tax revenue implications. Texas is well-served by a business climate that on the public side features low taxes, light-touch regulation, adequate investment in infrastructure and education, clear enforcement of laws and property rights, and a laissez-faire approach to how individuals and firms choose to otherwise conduct their business.

Introduction

Environmental, social, and governance (ESG) refers to a set of standards for a company's behavior in the marketplace. Specifically, environmental criteria consider how a company safeguards the environment, including corporate policies addressing climate change, for example. Meanwhile, social criteria examine how it manages relationships with employees, suppliers, customers, and the communities where it operates, while governance deals with a company's leadership, executive pay, audits, internal controls, and shareholder rights.

Aside from the impact on actual firm operations, investors and other capital providers such as banks began over the past twenty years to employ ESG criteria to manage risk and maximize opportunities in emerging markets. This trend peaked about five years ago; investment in ESG financial products accelerated sharply during the 2019-21 period before cooling to some degree recently, especially in the United States. According to Morningstar, total global ESG assets were at $2.74 trillion as of third quarter 2023, with Europe accounting for the vast majority (84 percent). Meanwhile, ESG investing in the US slowed markedly leaving the US at approximately 11 percent of the global total.

Figure 1: Recent Trends in US ESG and Overall Funds



Source: Morningstar, TXP, Inc.

Interest and adoption of ESG policies in the financial sector for business reasons, including mitigating risk, fiduciary pressure from customers and shareholders, and capitalizing on growth opportunities, has in turn created concerns related to discrimination in the provision of capital against certain types of industry activity, specifically in Texas related to firearms and fossil fuels despite most large financial institutions continuing to invest in fossil fuels and provide banking services to the firearms industry. In the 87th Session of the Texas Legislature, lawmakers passed Senate Bills (SBs) 13 and 19, barring any Texas municipality from contracting with banks that restrict funding to oil & gas or firearms companies. As a result, CITI and Barclays have been forced to exit Texas municipal finance market due to a perception of discrimination.

A significant potential consequence of fewer market participants in municipal finance is reduced competition leading to increased costs. In theory, the level of total market participation should be independent of any individual participant; when one departs, another takes its place. However, this assumes manageable barriers to entry; in the case of public finance, the capital requirements needed for such large scale projects and the institutional relationships and knowledge are significant obstacles for potential entrants.

In a 2023 study entitled *Gas, Guns, and Governments: Financial Costs of Anti-ESG Policies*, Dr. Dan Garrett of the Wharton School at the University of Pennsylvania and Dr. Ivan Ivanoff of the FRB of Chicago examined the issue, using data from the Texas market for the immediate period following the laws' implementation in 2021 through April 2022. Their analysis found that, over this period, interest rate costs were higher than would be expected absent the law(s). The study quantified this impact as follows:

> Municipalities in Texas issued $31.8 billion in municipal bonds from September 2021 through April 2022, or about $4 billion per month, and have an average 1.35 standard deviations reliance on the targeted banks accounting for issue size within the triple difference estimation sample (≈ 0.319/0.237). Assuming there are no spillover effects to control borrowers in Texas, our estimates imply that barring banks with ESG policies led to 14.4bps *(i.e., 0.144 percent)* higher yields on the average dollar of borrowing.

Another area where the impact of reduced market competition could manifest itself is in the transaction costs associated with each bond deal done at the State and local level. Similar to a mortgage, the sale of bonds comes with one-time costs of issuance as well as interest payments over the life of the debt. The Texas Bond Review Board (TBRB) provides annual reports on State and Local public sector finance each fiscal year (the twelve months through August 31st), which include collective information on the volume of activity, as well as specifics related to individual transaction costs, such as bond counsel, financial advisor, etc. One area interest is the underwriter's spread, which is the amount representing the difference between the price at which securities are bought from the issuer by the underwriter and the price at which they are reoffered to the investor, generally including the takedown, management fee, expenses, and underwriting risk fee. The exit of underwriting firms could reduce competition, which would then lead to an increase in these fees.

Public Finance Implications in Texas

As of the end of Fiscal 2023, the TBRB reports that the State issued a total of $10.58 billion in bonds (both refunding and new money) while local jurisdictions collectively issued $47.02

billion, for a total of $57.60 billion. As a reminder, these bonds are issued to cover the capital costs of fundamental government functions, such as building schools and new transportation infrastructure. Underwriting spread is typically expressed as “dollars per $1,000 of bonds issued.” See Figures Two through Four.

Figure 2: New Public Debt Issued in Texas by Fiscal Year ($Billions)

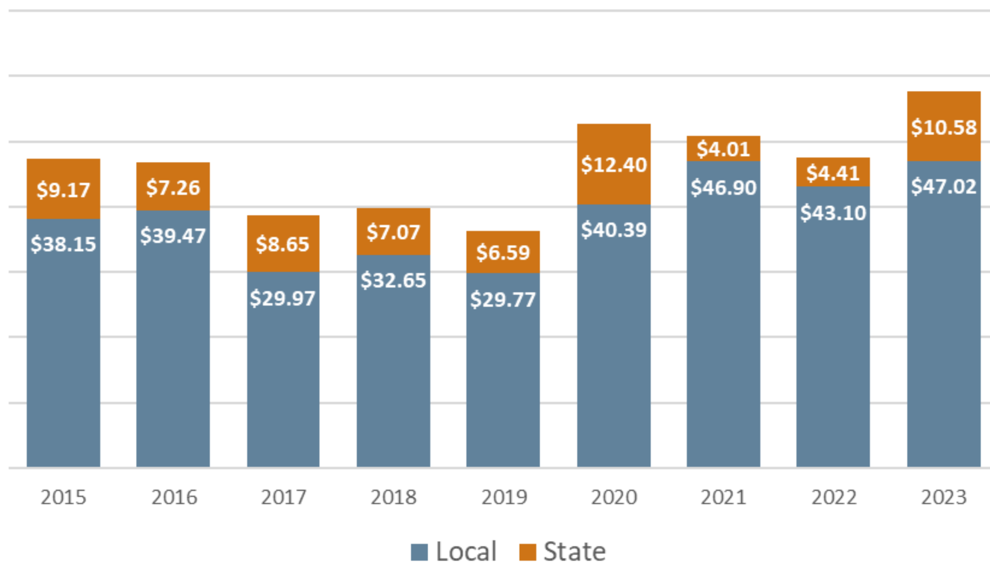
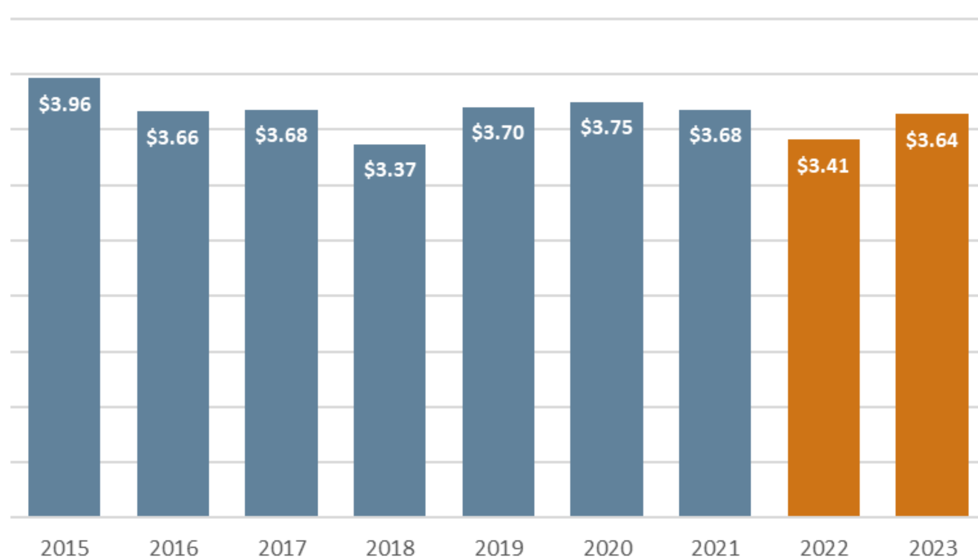
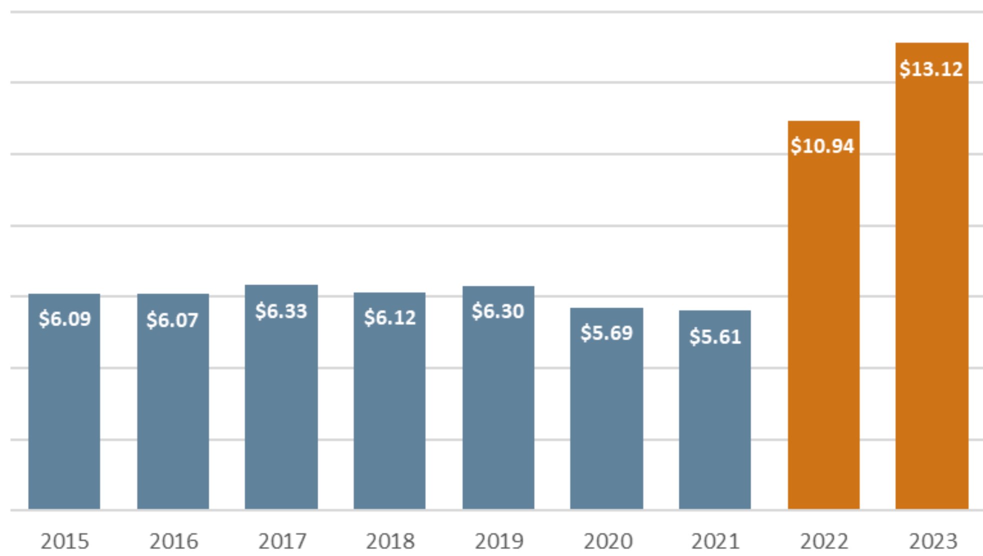


Figure 3: Average FY Underwriting Spread (per $1,000 of State bonds issued)



Source: Texas Bond Review Board, TXP

Figure 4: Average FY Underwriting Spread (per $1,000 of Local bonds issued)



Source: Texas Bond Review Board, TXP

Direct Financial Implications

Typically, the State of Texas has far fewer issuances (24 during Fiscal Year 2023 compared to 1,127 reported at the local level that same year), for a far higher average dollar amount per bond issues ($224.4 million vs. $38.9 million locally). As Figure Three indicates, there is little sign of any external impact on underwriters spread at the State level post-2021. The situation appears to change locally, however, as the underwriters spread more than doubled from fiscal year 2021 (the last year before the anti-ESG laws were implemented) to fiscal 2023. This has real financial implications. By way of illustration, assume that average underwriters spread cost from fiscal 2015-2021 ($6.03/$1,000 of bonds issued) were in place during fiscal years 2022-23, when the average underwriters spread was $12.03/$1,000 of bonds issued. Given average annual local issuance of $45.7 billion those two years, that means that issuance costs associated with underwriters spread were $270.4 million higher annually than if the historic level of costs were in place.

Economic Impact Methodology

In theory, these funds are no longer available to be used for the standard functions of government, which in turn has economic implications. The next step is to translate the direct impact of these increased costs into the total economic impact through an input-output model of the Texas economy that allows measurement of the secondary, or "ripple" effects.

Economists use a number of statistics to describe regional economic activity. Four common measures are:

- Output (also known as Economic Activity and equivalent to top-line revenue), which describes total economic activity and is equivalent to a firm's gross sales or top-line;
- Value Added which equals gross output of an industry or a sector less its intermediate inputs or purchases from other firms used in the production process;
- Labor Income which corresponds to wages and benefits; and
- Employment which refers to jobs that have been created in the local economy.

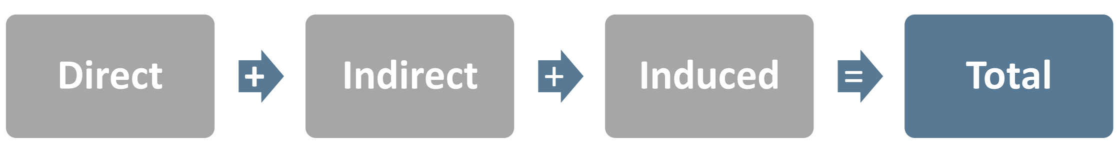
The economic impacts extend beyond the direct activity outlined above. In an input-output analysis of new economic activity, it is useful to distinguish three types of expenditure effects: direct, indirect, and induced.

Direct effects are production changes associated with the immediate effects or final demand changes. The cost of providing public safety (salaries, equipment, etc) are examples of a direct effect.

Indirect effects are production changes in backward-linked industries caused by the changing input needs of directly affected industries – typically, additional purchases to produce additional output. Providing equipment to the EMS staff, for example, requires manufacturers to increase production. These downstream purchases affect the economic status of other merchants and workers.

Induced effects are the changes in regional household spending patterns caused by changes in household income generated from the direct and indirect effects. Both EMS employees and those who work at the equipment provide realize increased income from government spending. Induced effects capture the way in which this increased income is spent in the local economy.

Figure 5: The Flow of Economic Impacts



The interdependence between different sectors of the economy is reflected in the concept of a "multiplier." An output multiplier of 2.5 for example, means that for every $1,000 injected into the economy, all other sectors produce an additional $1,500 in output. The larger the multiplier, the greater the economic impact. In this analysis, TXP used the RIMS II input-output multipliers produced by the U.S. Bureau of Economic Analysis for the Texas.

Economic Impact Results

The estimated direct impact of higher underwriters spread costs associated with reduced public finance competition at the local level yielded a total average annual impact during FY 2022-23 of $668.7 million in lost economic activity, value-added of $342.6 million, $180.7 million in annual earnings, and 3,034 full-time, permanent jobs. The table that follows details the total impacts, both summarized and detailed by industry sector. As would be expected, the lion's share of the activity tends to be found in the Government sectors, where the majority of spending occurs.

Table 1: Average FY 22/23 Economic Impact of Higher Underwriter Spread ($ Millions)

	Output	Value-Added	Earnings	Jobs
Agriculture, etc.	$1.89	$0.65	$0.41	19
Mining	$11.87	$7.22	$2.97	21
Utilities	$9.03	$5.27	$1.38	10
Construction	$48.45	$21.14	$14.71	250
Durable Manufacturing	$20.11	$8.16	$4.35	66
Non-Durable Manufacturing	$36.23	$9.00	$5.87	65
Wholesale Trade	$20.17	$12.17	$5.19	57
Retail Trade	$22.55	$14.90	$8.16	228
Transportation & Warehousing	$18.38	$8.89	$6.25	113
Information	$14.14	$7.27	$2.65	33
Finance & Insurance	$48.31	$26.79	$12.65	192
Real Estate	$41.12	$29.71	$6.65	277
Professional Services	$30.04	$20.17	$14.68	186
Management of Firms	$6.84	$4.33	$3.11	31
Administrative & Waste Services	$18.20	$11.17	$7.92	193
Educational Services	$3.57	$2.49	$1.68	42
Health Services	$23.44	$14.41	$10.87	185
Arts/Entertainment/Recreation	$2.11	$1.30	$0.81	31
Accommodation	$2.19	$1.32	$0.62	18
Food Services	$8.89	$4.68	$2.89	110
Other Services (including Govt.)	$283.09	$132.02	$67.05	909
Households	NA	NA	$0.22	16
Total Annual	**$668.74**	**$342.63**	**$180.68**	**3,034**

Source: TXP, Inc.

A loss of economic activity also has revenue implications for State and local government. As of FY 2021 (the most recent data available), State and local government received $216.75 billion from their own sources (essentially, from taxes and fees). During that same period, Texas' Gross State Product (the equivalent of Value-Add) was at $1.99 trillion, meaning that for every dollar in total value-add the State and local public sector generated $0.1084. Given the estimate of $342.6 million of lost value-add above, that means the public sector in Texas further loses $37.14 million beyond the $270.4 million in excess costs. Said differently, the economy would have to produce approximately $2.84 billion in Gross State Product to make up for the excess interest cost and associated loss of public sector revenue.

Conclusions

Texas is now witnessing a surge in expansions within the financial services industry, a sector once dominated by states like New York and Illinois. For example, as of the end of 2023, almost a million Texans work in financial services, compared to less than 800,000 five years earlier. This surge is due, at least in part, to global firms responding to the opportunities that Texas presents.

The Texas economy has long benefited from a pro-business climate, a situation enhanced in the most recent regular session of the Legislature in a number of ways, not the least of which being an $18 billion property tax cut – the largest in the state's history. However, there has been a tightening of the competitive bond market in Texas due to enforcement actions pursuant to Texas' 2021 Fair Access law, which could undermine this significant progress. Recently, two major banks, Citi and Barclays were dropped from underwriting municipal bond deals, and more may follow as further enforcement actions are announced. This has consequences, as outlined in the body of the report: less competition (due in part to significant barriers to entry) leads to higher interest and transaction costs, which in turn reduces the resources that enable service-provision that has negative economic and tax revenue implications. Texas is well-served by a business climate that on the public side features low taxes, light-touch regulation, adequate investment in infrastructure and education, clear enforcement of laws and property rights, and a laissez-faire approach to how individuals and firms choose to otherwise conduct their business. Adherence to these core principles is the foundation of much of Texas economic success and is likely to assume an increasing role as we continue to transition to an economy based on ideas and information. In simple terms, when government attempts to mandate values (no matter what kind) to business, the market loses, and taxpayers bear the consequences.

Legal Disclaimer

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Appendix 1

Senate Bill 13 & 19, 87th Session of the Texas Legislature, as Enrolled

SB 13 Bill Analysis

Senate Research Center S.B. 13

By: Birdwell et al.

Natural Resources & Economic Development

6/7/2021

Enrolled

AUTHOR'S / SPONSOR'S STATEMENT OF INTENT

Oil and natural gas represents nearly a third of Texas's GDP and funds more than 10 percent of the state's budget. The burgeoning fossil fuel discrimination movement is denying capital to our responsible, hard-working energy businesses, which means the energy we need will be less affordable and less secure. Along with this, investment and pension managers who invest based on political trends undermine their fiduciary duty and threaten our workers' and retirees' futures.

S.B. 13 prohibits Texas state agencies that invest funds from investing in financial companies that boycott energy companies. Specifically, it requires the Comptroller of Public Accounts of the State of Texas (comptroller) to prepare and maintain a list of all financial companies that refuse to deal with, terminate business activities with, or otherwise take any action that is, solely or primarily, intended to penalize, inflict economic harm on, or limit commercial relations with a financial company because the company engages in the exploration, production, utilization, transportation, sale, or manufacturing of fossil fuel-based energy and does not commit or pledge to meet environmental standards beyond applicable federal and state law.

This list is then provided to the state agencies that invest funds, who in turn send a letter to the listed companies informing them that they are subject to divestment if they do not stop boycotting energy companies within 90 days. If the company does not stop boycotting energy companies, the state agency is required to sell, redeem, divest, or withdraw all publicly traded securities of the company unless the holdings are indirect holdings managed by investment funds or private equity funds.

A state entity can cease divesting from one or more listed companies only if clear and convincing evidence shows that: (1) the state governmental entity has suffered or will suffer a loss in the hypothetical value of all assets under management by the state governmental entity as a result of having to divest from listed companies; or (2) an individual portfolio that uses a benchmark aware strategy would be subject to an aggregate expected deviation from its benchmark as a result of having to divest from listed companies.

S.B. 13 further states that a governmental entity may not enter into a contract with a company for goods or services unless the contract contains written verification from the company that it does not boycott energy companies and will not boycott energy companies during the term of the contract. This provision only applies to a company with 10 or more full time employee and that has a contract value of $100,000 or more.

(Original Author's/Sponsor's Statement of Intent)

S.B. 13 amends current law relating to state contracts with and investments in certain companies that boycott energy companies.

SB 19 BILL ANALYSIS

Senate Research Center	S.B. 19
	By: Schwertner et al.
	State Affairs
	6/7/2021
	Enrolled

AUTHOR'S / SPONSOR'S STATEMENT OF INTENT

Large banks and other financial institutions in our country have quietly enacted policies to restrict gun sales and exert pressure on the firearm industry. These institutions hold our money and attempt to use financial pressure to infringe upon our Second Amendment rights. This is unacceptable. S.B. 19 would prevent any company with at least 10 employees from the benefits of state or other government contracts valued at $100,000 or more unless the company verifies in writing that it does not have an internal policy or directive that discriminates against members of the lawful firearm or ammunition industries.

This bill will ensure that any company in Texas with a policy that attempts to restrict gun or ammunition sales will not be allowed to benefit from tax dollars through state contracts.

(Original Author's/Sponsor's Statement of Intent)

S.B. 19 amends current law relating to prohibited contracts with companies that discriminate against the firearm or ammunition industries.