
Texas's Wall Street Showdown Over Gun Laws Costs Taxpayers Hundreds of Millions.

- **Finding is from research paper studying 8 months of issuance**
- **GOP law knocked BofA, Goldman out of market over gun stances**

Texas taxpayers are footing the bill for the state's war with Wall Street over guns.

The state's municipal borrowers have been hit with as much as $532 million of extra debt costs because of a new GOP law that's led some banks to step back from Texas's bond market. That's the conclusion of a new paper by Daniel Garrett, a University of Pennsylvania professor, and Ivan Ivanov, a principal economist at the Federal Reserve.

The researchers examined sales in Texas's $50-billion-a-year municipal-bond market after a law took effect in September that targeted banks for their gun policies.

The legislation, known as Senate Bill 19, bars governments from entering into contracts with companies that "discriminate" against firearms entities. It has caused banks including Bank of America Corp. and JPMorgan Chase & Co., among the biggest underwriters of state and city debt nationwide, to stop most public-finance business in the state.

The study found that "the exit of the targeted underwriters from the Texas market has significant impact on underwriter competition and that the remaining banks are unable to offset the adverse effects of removing banks from the market." The result is "large adverse effects for borrowers."

The working paper offers an in-depth study into the cost borne by Texas governments after the law took effect. Market participants and opponents of the legislation have warned that Texas Republicans' move to punish the banks could raise expenses for cities, counties, school districts, and even the state itself, by reducing competition for bond sales.

'Very Surprising'

Garrett, a finance professor at the University of Pennsylvania's Wharton School, said the magnitude of the increase in costs was unexpected given that Texas has a competitive muni market, with many underwriters participating.

"To see even the biggest issuers affected by this sort of shock was very surprising," Garrett said in an interview. The paper examined bond sales from September through April.

The research focused on the departure of firms including Bank of America, Citigroup Inc., Goldman Sachs Group Inc. and JPMorgan Chase from the Texas municipal market, which is second only to California's in terms of annual issuance.

Citigroup paused underwriting in Texas for several months, but has since underwritten sales. JPMorgan has been moving to re-enter the market as well.

The paper looked at borrowers that have historically relied on the affected banks. It compared bonds sold on the same day with similar credit profiles and structures to those issued by governments that haven't historically favored one of the impacted firms.

The study found that the more an issuer had relied on one of the banks that pulled back from the Texas market, the more governments paid when they had to switch. Issuers with over 50% reliance on the affected banks saw a roughly 20% increase in borrowing costs as a result of the law, it concluded. The study stripped out daily market fluctuations, meaning the broad increase in long-term yields during the period didn't influence the outcome.

Garrett and Ivanov found that issuers affected by the law are avoiding selling bonds via auction, when underwriters compete for sales, a method that separate studies have shown reduces municipalities' borrowing costs. Instead, they're opting to hire underwriters in advance, the paper said.

And when they do sell via auction, they're seeing fewer bidders, the paper said.

"The number of underwriting bidders declines sharply, the variance among remaining bids increases, and the winning bid in terms of yield to maturity increases after the implementation of the Texas laws for issuers with previous reliance on the exiting banks," the paper said.

Meanwhile, the ranks of muni underwriters in Texas may get even thinner due to another new law, Senate Bill 13, which restricts governments from working with companies that "boycott" the fossil-fuels industry.

This measure, which also took effect in September, has caused some banks to lose out on Texas muni deals as issuers wait for the Republican state comptroller to decide which companies should be restricted under the law.

"If more banks leave, these costs will go up," the paper said.

Garrett and Ivanov will have a chance to get feedback on the paper next month, when they present it at the Brookings Institution's Municipal Finance Conference.

Bloomberg Markets

By Amanda Albright and Danielle Moran

June 13, 2022