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Texas Fought Against ESG. Here's What It Cost

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When states boycott financial institutions over their ESG policies, it can have a chilling and costly effect on competition in the bond market, according to a new paper from Wharton's Daniel Garrett.

● ESG ● PUBLIC POLICY

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A Texas law that bans its municipalities from doing business with banks that have ESG policies against fossil fuels and firearms is driving down competition for borrowing and costing taxpayers millions in extra interest, according to a new study from Wharton.

In their paper, Wharton assistant finance professor **Daniel Garrett** and **Ivan Ivanov**, an economist with the Board of Governors of the Federal Reserve System, documented the financial impact of Senate Bills 13 and 19, which took effect Sept. 1, 2021. The legislation is aimed at protecting Texas' reliance on the oil and gas and firearms industries by prohibiting local jurisdictions from contracting with banks that have adopted environmental, social, and corporate governance policies against those industries. That means cities can no longer use those banks as underwriters for municipal bonds, which are one of the main ways that cities raise money.

After Texas passed the law, five of the largest underwriters exited the market: JPMorgan Chase, Goldman Sachs, Citigroup, Bank of America, and Fidelity.

"This is a really big rule for the municipal space," Garrett said. "This is not the first time we've seen states use municipal markets as a way to enforce bank behavior they want to see, but this is new in its scale in that five large banks left Texas. [They] used to underwrite about 35% of the debt in the market, so they've left a really big gap."

> **"I think it does have a chance of becoming more common going forward."**

Garrett joined **Wharton Business Daily** on SiriusXM to talk about the paper, "**Gas, Guns, and Governments: Financial Costs of Anti-ESG Policies**." In their study, the co-authors analyzed data from the first eight months of the law and estimated that Texas cities will pay an additional $303 million to $532 million in interest on $32 billion in bonds.

“It’s a really substantial increase in borrowing costs,” Garrett said.

Cities often have “sticky” relationships with their underwriters and choose the same banks over and over again to facilitate their bonds, according to the co-authors. The regulatory change unstuck those relationships, forcing municipalities to negotiate borrowing terms with other financial institutions that suddenly had less competition because the big banks left. Borrowing costs increased by about 40 basis points for jurisdictions that previously relied on the exiting underwriters for a majority of their issues.

“I think what’s really interesting about this story is who leaves,” Garrett said. “It’s not a random selection of banks. It’s a selection of banks that are making profit-maximizing decisions, and they’re choosing to leave, and they happen to be the largest.”

More States Joining the Anti-ESG Push

Garrett said the research has implications beyond Texas because a growing number of states are enacting similar legislation to boycott financial institutions over ESG policies that appear to threaten their livelihoods or run contrary to prevailing political values. According to a **Reuters report**, there are 44 bills or new laws in 17 conservative states — including **Oklahoma**, **West Virginia**, Arkansas, and Kentucky — that punish Wall Street for taking stances on issues ranging from gun control and abortion to diversity and climate change.

“I think it does have a chance of becoming more common going forward,” Garrett said. “Since interstate banking deregulation, we don’t see states have a lot of other markets they can really punish banks using, and that's why the public finance space becomes really important for these social fights."

The paper doesn't debate the politics or take a position; the researchers wanted to focus on the financial costs of anti-ESG policies. In addition to quantifying the increased debt burden on taxpayers, the study directly shows how such legislation reduces competition in the bond market.

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"What this winds up leading to is more segmentation in an already segmented municipal bond market in the U.S.," Garret said, adding that it could create "potentially bad outcomes for the people who rely on these banks for credit access and don't actually have anything to do with the ESG fights that are being had."

Financial institutions also have to consider whether leaving a state over ESG regulation is worth the trade-off, he said. There is no single set of standards for ESG, so it's hard for states to craft specific legislation. In Texas, the law has so many loopholes and exceptions that the state comptroller in March began sending out letters asking financial institutions to detail their climate policies. In an effort to re-enter the market, both Citigroup and JPMorgan Chase have said their policies are in compliance with Texas law, Garrett said.

“I’m not sure how much willpower there is in Texas to uphold the ongoing equilibrium we saw after Sept. 1,” he said. “But people realize that it’s costly and we kind of need to keep an eye on costs incurred by this.”