

# Discussion of “Black Tax: Evidence of Racial Discrimination in Municipal Borrowing Costs”

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# The Black Tax: Existence

- Municipal borrowing costs increase with % of municipality population that is Black
  - 10% increase in % Black population increases annual costs by about 5 bps (Avg. cost = 270 bps)
    - $\$24M \times (1.0005)^{15} = \$18,000$
  - DC 45%, Baltimore 63% -> 10 bps higher cost
- Bergstresser, Cohen, and Shenai (2013) – “going from 100% white to 100% nonwhite would be associated with a 24 basis point increase in bond yields.”

# The Black Tax: Existence (Table 3)

- Additional variables to include as controls:
  - Underwriter efficiency – E.g., Underwriter FE, # deals, # per deal, lead share
  - Financial advisor usage
- Discretize % Black population – Are there non-linear effects?
- No relationship between offer amount and issuance costs –
  - Table 2, Column 3: Offer Amt (M) = 0.001 (Not Significant)
    - Maybe subsumed by county demographics???
  - Painter (2020) Tab 3, Col 1:  $\text{Ln}(\text{Size}) = -.08^{***}$
  - Butler, Fauver, Mortal (2009), Tab 3, Col 1:  $\text{Ln}(\text{Size}) = -.0491^{***}$
  - Dougal et al (2019), Tab 3, Col 3:  $\text{Ln}(\text{Amount}) = -11.79^{***}$
  - Harris and Piwowar (2006), Bergstresser, Cohen, and Shenai (2013)

# The Black Tax: Existence

Below Median Black Pop	Above Median Black Pop
13,659 bonds	52,839 bonds
274k population	851k population
\$14M offer amount	\$26M offer amount
2.56% annual cost	2.74% annual cost

- Black people tend to live in cities vs rural areas
- Is % Black pop a proxy for urban vs rural, population density?
- **Solution:** Use a matching estimator

# The Black Tax: Ratings

- Page 5, “To focus on the least opaque bonds, which would most appeal to institutional investors, we restrict our analysis to rated deals and obtain a final sample of 66,503 municipal bonds.”
- Table 2: 16% of issues have a long-term rating
- Do you have a rating for each issue? If so, are you controlling for it or only for the long-term issuer rating?
- Use fixed effects rather than continuous variable to control for ratings
  - Include “no-rating” dummy

# The Black Tax: Explanations

- Taste-based discrimination
  - Buyers dislike Black people, Black areas
- Statistical discrimination
  - Buyers believe % Black population proxies for risk
  - Municipal risk models may include county demographics – If race implies risk, then it should already be reflected in ratings
- Paper finds evidence for both:
  - Taste-based: Tax higher in more racist areas, time periods
  - Statistical: Tax concentrated in larger offers and offers that lack a long-term rating

# Statistical Discrimination?

- Argument based on offering size and rating sorts (Table 5)
- Results possibly driven by power issues:
  - Tax only exists in large offering size sample
    - But, small offering amounts are made by rural areas where there are few Black people, i.e., no variation in % Black pop in small offer size sample
  - Tax only exists in no-LT rating sample
    - But, LT-rating sample is 1/5 the size of no LT-rating sample

# Taste-Based Discrimination?

- Cross-sectional variation in racial animus
  - Need to formally test for difference in estimated coefficients across high/low animus sub-samples
- Time-series variation in racial animus
  - Why did Obama election reduce Black tax?
    - Because it was correlated with a reduction in prejudice?  
OR
    - Because it was correlated with expectations of favorable federal policies for Black cities which would decrease credit risk?
  - Unclear if Obama election reduced or increased prejudice
    - Likely depends on survey population

# Taste-Based Discrimination?

- **Better Test:** Shut down the credit risk channel
  - Sub-sample analysis using only AAA-rated issues
  - **Sub-sample analysis using only insured issues**
    - Include Insurer or Insurer-Year Fixed Effects
    - Limit sample to pre-crisis period

# What is the Mechanism?

- If Taste-Based:
  - Discrimination at buyer level – Higher liquidity risk
    - Longer time in dealer inventory?
- If Statistical:
  - % Black pop correlated with city financials
  - Discrimination at municipality level
    - Higher risk of social unrest – E.g. Rodney King riots, George Floyd protests
    - Violent protests may cause a shortfall in municipal finances (Matheson and Baade 2004)
  - Discrimination at the state level
    - Black cities potentially less likely to obtain financial help from their state when they encounter fiscal difficulties
      - Government-level variation?

# Thank You!