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

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11th annual Municipal Finance Conference
Brookings Institute
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*(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: Ln(Size) = -.08***
  - Butler, Fauver, Mortal (2009), Tab 3, Col 1: Ln(Size) = -.0491***
  - Dougal et al (2019), Tab 3, Col 3: Ln(Amount) = -11.79***
The Black Tax: Existence

- 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

<table>
<thead>
<tr>
<th>Below Median Black Pop</th>
<th>Above Median Black Pop</th>
</tr>
</thead>
<tbody>
<tr>
<td>13,659 bonds</td>
<td>52,839 bonds</td>
</tr>
<tr>
<td>274k population</td>
<td>851k population</td>
</tr>
<tr>
<td>$14M offer amount</td>
<td>$26M offer amount</td>
</tr>
<tr>
<td>2.56% annual cost</td>
<td>2.74% annual cost</td>
</tr>
</tbody>
</table>

2022 Municipal Finance Conference
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!