Bowyer Research

Report Attacking Oklahoma Anti-ESG Law Has Serious Flaws

Overview

A study titled "Unintended Consequences of the Energy Discrimination Elimination Act in Oklahoma" was published on April 21, 2024 by the Oklahoma Rural Association. Dr. Travis Roach, an associate professor and chairman of the Department of Economics at the University of Central Oklahoma, conducted this study, which is highly critical of the state's Energy Discrimination Elimination Act (EDEA). The EDEA was enacted by the legislature to target financial firms that boycott the oil and gas industry. It aims to prevent financial institutions from using ESG (environmental, social, and governance) policies against the fossil fuels industry.

Here are the key, but highly questionable, allegations from Dr. Roach's study:

- The EDEA has led to unintended negative consequences for Oklahoma's economy and communities
- An unnecessary increase in municipal borrowing rates
- Compared to non-EDEA adopting states, Oklahoma municipalities have experienced a 15.7% increase in borrowing costs.
- As a result, $184,777,344 in additional expenses for local municipalities since the policy's enactment (approximately $10,869,256 per month).

The study also issues warnings about numerous harrowing alleged negative effects from the law:

- Higher taxes
- Reduced expenditures on public works
- Delays or abandonment of infrastructure projects

The study claims to establish the effects of the legislation on borrowing costs by comparing the borrowing costs of municipalities in Oklahoma to that of municipalities of a control group of "surrounding states," both before and after the implementation of the law. It argues that this "difference of a difference" approach demonstrates an increased cost of borrowing in Oklahoma relative to the control group.

However, the study has serious methodological shortcomings. These shortcomings matter a great deal given the fact that pro-ESG activists see Oklahoma as the model of how to win in deep red states. Oklahoma is now where the red state vs. ESG movement battle is currently being fought most vociferously. This deeply flawed report has been used as a weapon in that battle without being questioned by local media.

Methodological Flaws

The most serious problem with the study is its pattern of cherry-picking data in a way that suits the desired conclusion. The report's claim that it compares Oklahoma to neighboring states does not account for, nor even acknowledge, the exclusion of New Mexico. The control group includes Arkansas, Colorado, Kansas, Missouri and Texas, but not New Mexico. Why? New Mexico adjoins Oklahoma and, of course, faces borrowing costs like every other government entity. And, like Oklahoma, it is an economy with a robust oil and gas industry. Why exclude it from the group the report uses to set a baseline of comparison? Whatever the motive or rationalization for excluding it, such an exclusion appears to throw out data that is likely to undermine the author's desired conclusion. To explain, let's look at average bond ratings in the relevant states and per capita income as a percentage of the US average (data courtesy of Jim Iredale Sr. Portfolio Manager at Vident Financial who focuses on fixed income for the firm):

State	Bond Rating	Per Capita Income/Avg
Arkansas	AA1	.79
Colorado	AA1	.110
Kansas	AA2	.92
Missouri	AAA	.86
New Mexico	AA2	.79
Texas	AAA	.93

We see that New Mexico is a lower income state and has a lower bond rating on average than the other states in the control group. Lower bond ratings mean higher borrowing costs. For example (also courtesy of Vident) here are some recent data comparing municipal bond yields and credit ratings:

Bond Rating	Bond Yields

AAA	2.67
AA1	2.8
AA2	2.9

So, arbitrarily throwing out the New Mexico data has the effect of making the control group's borrowing costs lower, making Oklahoma look worse by comparison. It is certainly not good practice to throw out inconvenient data, and in this case, it is done surreptitiously. The decision to exclude New Mexico is simply not mentioned.

But even if the control group had included all neighboring states with no convenient exclusion of the relatively low credit quality New Mexico, that still would leave open the question of why compare to neighboring states as opposed to comparable states? For instance, the Dakotas might have more comparability to Oklahoma than, say, Kansas. This methodological decision seems designed to come to the preordained conclusion that Oklahoma's anti-ESG bill is harmful to the state. *A liberal-leaning pro-ESG author (more on that below) came to a pro-ESG conclusion.*

Other methodological problems present themselves:

The report appears to ignore credit ratings in its methodology. But, of course, credit rating is overwhelmingly the most important factor driving borrowing costs. Anyone knows that an individual's credit score affects his or her borrowing costs. The same is true for state and local government borrowers. There can be a wide range of credit scores even between municipalities in the same state. Failing to control for that variable introduces noise into the analysis.

This is a general weakness with the approach of the study overall. It compares local borrowers instead of focusing on state borrowing. There are data limitations which make this necessary. Oklahoma has an unusual aspect to its state borrowing which predates the passage of the law.

"The Oklahoma Constitution requires voter approval of all state general obligation (GO) bonds and further requires that they are secured by a specific tax in addition to the pledge of the full faith and credit and taxing power of the State. The Oklahoma Building Bonds Commission was created to issue GO bonds following voter approval of a $350 million authorization in 1992. The final payment on these bonds was made in July 2018. As of December 31, 2023, the state had no governmental purpose GO bonds outstanding."

So, the comparison of borrowing costs cannot be a state-to-state comparison, which would be a cleaner approach. However, though this is a necessary limitation to the study's approach, it is still a limitation, which forces a focus on municipal borrowing. This introduces the noise that appears due to different municipalities having different credit ratings. The author should have at least tried to filter out that noise by comparing municipalities to other municipalities of the same credit rating.

In addition, the study ignores the effects of Oklahoma's tax cuts. The state cut the income tax rate in 2022 the same year the law came into effect. Higher taxes make municipal bonds, a tax-favored vehicle, more valuable. Conversely, lower taxes make them less desirable and therefore tend to raise the yield. For example, according to Jim Iredale of Vident Financial, "A high tax state such as California can end up with borrowing costs 20 or 30 bp higher than the market."

Also, the study makes no distinction between competitive underwriting and negotiated underwriting, which can affect borrowing costs.

Furthermore, the report focuses on the interest rate paid, not the fees paid. But if the thesis is that EDEA decreases competition, that would most naturally show up in fees charged, rather than interest rates, which are set by the market. Imagine if there were suddenly fewer stock brokers in your town and less competition. The price of stocks would not likely be affected: stock and bond prices are set by the market. What would change is the transaction fees. If the thesis is that the market is less competitive, the natural test is to look at fees, not market prices. The author could argue that the lack of a robust underwriting market means that the firms not on the banned list would not have the expertise or investor networks necessary to procure the best price for the bond issue. However, that argument lacks plausibility.

Even after the exclusions, there is still an extremely robust municipal bond market and many large, experienced underwriters not on the banned list.

Treasurer Russ's list initially banned 13 companies (since been decreased to 6):

- Blackrock

- Wells Fargo
- JPMorgan Chase
- Bank of America
- State Street
- Grosvenor Capital
- Lexington Partners
- FirstMark Fund Partners
- Touchstone VC
- WCM Investment Management
- William Blair
- Actis
- Climate First Bank

That leaves:

- RBC
- Jeffries
- Morgan Stanley
- Citi
- Goldman Sachs
- Raymond James

These are the second, third, fourth, sixth, eighth and tenth largest underwriters in America and they are still eligible to be bond underwriters in Oklahoma. That's not exactly a dearth of suppliers. It seems unlikely that it has been or will be a hardship to have the majority of the top ten municipal underwriters as a pool from which to hire services. Iredale of Vident explained that these state exclusions have not created a shortage of bond underwriters, just a “reshuffling” among the top providers. (Note: lists of top ten underwriters vary slightly depending on how they are calculated.)

Factual Errors

The author claims that Blackrock does not boycott fossil fuels: "There is no evidence that these financial institutes boycotted the fossil fuel industry at all" (page 5). But this is clearly false. The legal definition of boycott under Oklahoma law is a broad one and includes the taking of any actions intended to penalize, inflict harm on, or limit commercial relations with a company because of its involvement with fossil fuels. Treasurer Russ's questionnaire to asset managers on which he based his exclusion list includes questions relevant to advocacy against fossil fuels, membership in anti-fossil fuel associations as well as proxy voting.

Blackrock, the center of the controversy, is a member of the Climate Action 100+ and of the Net Zero Asset Manager Alliance and other anti-hydrocarbon organizations. Furthermore, it has an extensive history of advocacy against carbon emissions (the natural effect of using fossil fuels) as well as voting for anti-fossil fuel proposals at roughly ten times the rate at which it votes for pro-fossil fuel proposals on corporate ballots. In addition, it has supported proposals pressuring companies to defund climate skeptic groups over 170 times last year alone and for anti-fossil fuel proposals almost 600 times. (2395_sfof.pdf (realclear.com))/(Advice to BlackRock: Attack the problem, not your customer (dallasnews.com))

The author claimed in an interview that "the law is purported to go after firms which have some type of ESG products…these companies it seems like they have a single or a couple of investment products which consumers could choose if they elected to which is directed towards stocks that have environment or social or governance as part of their goals…The way this law has been interpreted by the Treasurer is that any large financial firm that has these products, they are 'targeting the oil and gas industry.' The Hot Seat: Pushing Back On Anti-Oil And Gas Legislation (news9.com)

But this charge is also false. Treasurer Russ did not exclude banks based on whether they had one or two ESG funds. He gave his reason in writing (Oklahoma Demands Answers from Financial Institutions over ESG Policies (breitbart.com)) and in an interview with me (Oklahoma and the Battle of Blackrock | Salem Podcast Network). Exclusions are based not only on divestment from fossil fuels, but also on advocacy against them. The idea that these financial institutions are banned simply because they have one or two ESG funds seems made up out of whole cloth.

The question is: what do these companies do in terms of advocacy and voting with their non-ESG branded funds? Answer: they still advocate for ESG policies.

Lack of Transparency About Funding & Bias

The media campaign promoting this report failed to identify the author's political leanings. His published history shows a clear pattern of favorability towards ESG policies. It's fine for an environmentalist to write reports criticizing an anti-ESG law, but surely that should be made clear. His academic papers support environmentalist conclusions. His social media posting is uniformly left of center across the board, attacking the state's school choice program, attacking pro-life laws for causing income equality, poking at field goal kicker Harrison Butker's commencement speech, downplaying people's concerns about rising fuel costs, and ridiculing conservative concerns about Biden's war on energy. Since one particular interview emphasized that the funder of the study is not known for its liberal leanings, it seems worth noting that the author clearly is.

There are also transparency issues with the funding of the study. The Oklahoma Rural Association funded the study, but where did it get the funding itself? Its 990 forms show minimal revenues in recent years. Furthermore, the group's website contains minimal content other than that regarding its opposition to the EDEA law. That is, in fact, the only study published on its website as of this writing. Given the fact that some of the deepest pocketed firms in the world are opposed to this law and have been using that money in surreptitious ways to block it (PRESS RELEASE: Docs reveal Oklahoma AG Gentner Drummond's secret ties to BlackRock – American Accountability Foundation), it's worth asking more about the ORA. Before the study, it listed its board members, but that list has since been scrubbed from the website. And it is clear that pro-ESG activists think of Oklahoma as the template to defeat similar laws around the country, "If we can beat the [EDA] in deep red Oklahoma, then the other states that are going to see this law implemented — they can beat it as well," (Oklahoma bid to blacklist BlackRock bombs in a big way, and the oil state may set back anti-ESG investing efforts in 19 other states | RIABiz). Are the media outlets which gave uncritical coverage to the opponents of EDEA not the least bit curious to know more about the funding of this study and the very convenient timing of the media campaign around its release?

Since transparency is important, I'll happily reveal my biases: I'm a libertarian-leaning conservative who is deeply skeptical about ESG policies and helps institutional investors who are also skeptical about ESG align their proxy voting with that view.