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Written testimony offered by:

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Committee members:

Thank you for the opportunity to share the highlights of research I have conducted on the pricing and issuance costs faced by historically black colleges and universities (HBCUs). My testimony today is based on the research manuscript, "What's in a (school) name? Racial discrimination in higher education bond markets," which was published in the *Journal of Financial Economics* in December 2019, which I have submitted separately to the committee. My co-authors on the study are Casey Dougal of Florida State, Pengjie Gao of Notre Dame, and William Mayew of Duke University.

Economists have been interested in discrimination for many decades, and indeed, have documented race and/or gender disparities in wages, job placement and retention, home ownership, mortgage rates, access to capital and dozens of other outcomes. A key empirical challenge, however, is that simply comparing differences in average outcomes between groups formed by gender, race, age, or other characteristic may not always paint a complete and accurate picture.

The reason is because these or other characteristics may be correlated with other determinants of the outcome of interest. Consequently, it is rare to find examples where we can be almost certain that we have accounted for such competing factors, other than discrimination. Although no real-world study can be 100% perfect in this regard, studying municipal bonds issued by colleges and universities provides a close approximation to this ideal.

There are three reasons why.

First, when you buy a bond, all that should matter is the financial return – that is, whether you're paid back according to the contractual terms. Compared to labor markets or other settings, this simplifies the analysis since the notion of the issuer's quality or productivity is well defined, and relatively objective. Second, there is a well-accepted way of measuring an issuer's ability to pay called *credit or bond ratings*. By comparing two issuers with the same credit rating, we (as researchers) can account for credit quality in the same manner that investors do. Finally, in about half the cases we will study, universities with low credit ratings purchase credit insurance, which allows them to adopt the credit rating of the parent insurance company. In these instances, we can compare two universities not only with the same credit rating, but with the same insurance company, an extremely precise control for creditworthiness.

With these advantages as a backdrop, we collect data on 4,145 college-issued municipal bond offerings between 1988 and 2010, of which 102 were conducted by HBCUs. Our analysis asks two questions. First, do HBCUs pay more in issuance fees, versus similar non-HBCUs? Second, once HBCU bonds have been placed in the market, do they trade at lower prices, or otherwise show evidence of discrimination by investors?

The answer to the first question is yes. HBCUs pay about 20% more in fees to underwriters, which are the brokers that sell, or place, the bonds with investors. This increases to 30% if we focus on states with historically high levels of racial animus, specifically in the Deep South. These analyses account for the fact that HBCUs may be smaller than non-HBCUs, may have different credit ratings, or may differ in other important ways.

The answer to the second question is maybe. On average, HBCU-issued bonds appear to trade at somewhat lower prices than otherwise similar non-HBCU bonds, but the differences are small, and in most specifications, not statistically significant. However, we do find that when HBCU-issued bonds are traded, it takes about 23% longer to find a willing buyer.

What factors explain these results? Due to tax reasons, municipal bonds offer the largest advantages to investors residing in the same state as the issuer. What this means is that HBCUs, by virtue of being located mostly in the American South and Southeast, may face collective reluctance from what should be their most receptive investor base. If wealthy investors in their home states, due to racial animus, disproportionately shun HBCU-issued bonds, we would expect to find results similar to what we document in our analysis. Because underwriters have a harder time finding willing buyers, they will charge a higher commission. Critically however, the effects of discrimination may or may not manifest in bond prices, because the higher selling effort by underwriters should be, and appears to be, sufficient to secure prices that are close to fair market value. Of course, ultimately HBCUs do pay higher costs for accessing debt markets in either case, whether their bonds trade for lower prices, or whether they pay higher issuance costs.

One possible policy tool available to help remediate the challenges documented by our study would be affording investors of HBCU-issued bonds *tax exemption* from state and local taxes. The effect of this policy would be to remove the tax disadvantages an investor living in, for example, New York or California currently faces when potentially investing in an HBCU-issued bond from another state.

Thank you for your attention, and I look forward to any questions you may have.