

FACT VERUS FICTION: EXAMINING OKLAHOMA'S ENERGY DISCRIMINATION ELIMINATION ACT OF 2022

Vance Ginn, Ph.D.

Byron Schlomach, Ph.D.



AUTHOR BIOGRAPHIES

Vance Ginn, Ph.D., is a leading economist and influential advocate for free-market principles and fiscal conservatism. He is a fellow at American Energy Institute, president of Ginn Economic Consulting, a fellow at more than ten free-market think tanks across the country, and former chief economist of the White House's Office of Management and Budget. He earned his doctorate in economics at Texas Tech University and resides in Texas.

Byron Schlomach, Ph.D., has had a 30-year career in state-level public policy, most recently sitting on the City Council in Piedmont, Oklahoma. He was Director at the 1889 Institute in Oklahoma for six years, Director of the Center for Economic Prosperity at the Goldwater Institute in Arizona for eight years, and Chief Economist for the Texas Public Policy Foundation for four years. He was an analyst in the Texas Comptroller's office, and was a legislative aide for a Texas lawmaker. Byron researches and writes broadly in public policy including economic development, transportation, public education, health care, government finance and transparency, and occupational licensing. He takes credit for starting the push for greater online government financial transparency and for price transparency in health care. Byron holds a B.S. and Ph.D. in economics from Texas A&M University.

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INTRODUCTION

A [recent paper](#) commissioned and published by the [Oklahoma Rural Association](#) on Oklahoma's [HB 2304](#), known as the Energy Discrimination Elimination Act (EDEA) of 2022, attempts to present a case that the law will have adverse economic impacts on Oklahomans. Oklahoma County District Judge Sheila Stinson recently [suspended the state law](#).

Upon review, the paper presents a flawed analysis of the legislation, an act that would protect and preserve fiduciary principles in public investing in the state. A comparison of Oklahoma municipal bonds with a national index shows Oklahoma's interest rates varied by less since September 2022, before the law went into effect in November 2022 and when the Treasurer issued the restricted financial companies list in May 2023. This indicates that EDEA did not cause interest rate movements and that the paper's results come from cherry-picking the data and specific states.

The EDEA legislation, a crucial attempt to guide sound state and local decisions, is based on fiduciary duties of financial actions rather than political decisions influenced by Environmental, Social, and Governance (ESG) biases. Whether

well-intended or not, these biases ultimately distort profitable economic activities, leading to lower investment returns and economic prosperity through government mandates rather than market forces.

The paper's oversight of crucial factors, such as the upward trend in interest rates, and its methodological challenges of correlation versus causation, coupled with its erroneous attribution of increased municipal borrowing costs to the state's EDEA, present substantial threats to future fiduciary duties of state and local governments. This brief analysis delves into these shortcomings, reinforcing the primacy of fiduciary duty and profitability over ESG criteria, and the broader ramifications of government-mandated ESG actions in Oklahoma. Ultimately, the State of Oklahoma wisely countered the undue influence of ESG biases with taxpayer money in state and local government fiscal activities, instead promoting a balanced approach that places financial performance and fiduciary duty at the forefront. This strategy optimizes taxpayer funds, benefiting the environment, social issues, governance, and people's well-being.

THE ENERGY DISCRIMINATION ELIMINATION ACT

The Energy Discrimination Elimination Act (EDEA), passed in 2022 and effective November 1, 2022, restricts Oklahoma's state and local governments from doing business with financial institutions that avoid investing in fossil fuel industries. The legislation protects the state's vital oil and gas production and related jobs from the adverse effects of state or local government ESG-driven divestment campaigns that target these industries. The law aligns with similar measures taken by states like Texas and Florida, which argue that such policies safeguard their economic interests by ensuring continued investment in essential energy resources.

EDEA is specifically designed to counteract the growing trend among financial institutions to shun investments in fossil fuel industries due to ESG pressures. By enforcing this law, Oklahoma ensures that its oil and gas sectors, which are crucial to its economy, remain robust and well-funded. The act mandates that state entities, including pension funds and municipal governments, can only engage with financial institutions that do not discriminate against the energy sector. This move is seen to protect jobs, ensure energy security, and maintain economic stability within the state.

SUMMARY OF THE ORA REPORT

The Oklahoma Rural Association's report evaluates the impact of the Energy Discrimination Elimination Act on Oklahoma municipalities. The analysis claims that the EDEA has increased municipal borrowing costs by approximately 59 basis points (0.59%), a 15.7% increase compared to some states without such legislation. The study attributes this increase to reduced financial competition, contributing to higher interest rates for municipal bonds, crowding out other expenditures, and delaying or abandoning infrastructure projects. These findings are why the paper suggests that the EDEA law has failed and should be removed.

Assumptions and Findings

Digging into the report's assumptions, the analysis posits that the EDEA directly causes an increase in borrowing costs by limiting the pool of eligible financial institutions that can provide capital to municipalities. This reduced competition purportedly leads to a 59-basis point increase in interest rates on municipal bonds compared to otherwise, contributing to higher taxes or reduced public services to offset these higher borrowing costs and delaying or canceling infrastructure projects. The report suggests that the EDEA has caused significant economic harm to Oklahoma communities, particularly in rural and underserved areas.

Methodological Flaws in the Report

The ORA report uses a differences-in-differences econometric approach to compare borrowing costs in Oklahoma with those in states without similar EDEA laws. However, the assumptions and methodology reveal critical shortcomings.

First, despite the author's claims, his analysis fails to establish a causal relationship between the EDEA and higher municipal borrowing costs. [Rising interest rates](#), driven by the Federal Reserve's rate hikes since 2022 following [excessive expansionary monetary policy](#) due to the COVID-19 pandemic, increasing economic uncertainty in oil-producing states caused by Biden administration policy, inflation expectations, and declining credit availability, present far more plausible explanations for [increased borrowing costs](#).

Second, the analysis does not adequately control other factors influencing borrowing costs, such as changes in Treasury bill rates, economic conditions, and local fiscal policies. Oklahoma's tax cuts in January 2022 further complicate the analysis by potentially impacting the attractiveness of local governments issuing tax-free municipal bonds, creating greater demand in Oklahoma for borrowed funds and differentially increasing borrowing costs for Oklahoma communities.

Additionally, and perhaps most importantly, comparing these states and periods does not accurately reflect the broader economic and

financial environment, introducing biases into the results. For example, the author selected neighboring states as controls but omitted New Mexico, raising questions about whether the chosen states moved in parallel with Oklahoma before the EDEA's implementation. There was also a substantial outflow of funds from [municipal bonds nationwide](#) in 2022 and 2023. The ORA paper's author also ignored wider trends in Oklahoma's municipal interest rates compared to broader indexes, further begging the issue of cherry-picked data. The paper's failure to establish parallel movement introduces significant biases in the analysis.

Rising Interest Rates and Municipal Bonds

Since the EDEA's passage, the Federal Reserve has raised its [federal funds interest rate target](#) 11 times, bringing it to the current range from 5.25% to 5.5% or an effective federal funds rate of 5.33%, the highest in over 20 years. This rapid increase, aimed at curbing inflation, has affected borrowing costs, including Treasury bill rates and municipal bond rates in Oklahoma and elsewhere. Consequently, attributing higher borrowing costs solely to the EDEA law is misleading.

The EDEA bill was effective on November 1, 2022. The Oklahoma Treasurer reported the first restricted financial company list on May 3, 2023. These two important dates represent potential breakpoints for market reaction to the legislative and Treasurer actions. Suppose these events contributed to higher interest rates on municipal debt in Oklahoma. In that case, we should expect a significant trend difference in the the [S&P Municipal Bond Oklahoma Index](#) and the broader S&P Municipal Bond Index. Figure 1 below shows that these two rates have had a very close relationship since these dates. The two rates have moved in tandem over much of the last decade but have had an even closer relationship since September 2022, before the passage of the law and well before the Treasurer issued the restricted list. The closer relationship between the two indexes also started well after early 2022 when the Federal Reserve started raising its federal funds rate target that started the strong upward trend in the U.S. Treasury Bill Index, also shown in Figure 1.

Figure 1

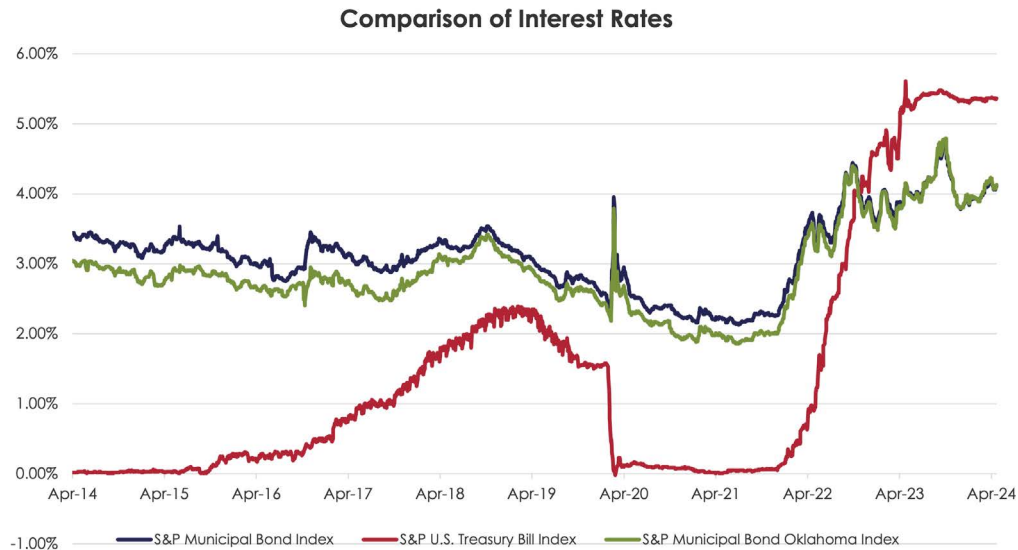


Figure 2 provides an even stronger argument that something other than the EDEA law is driving the rise in Oklahoma's municipal borrowing costs. This figure shows, over time, the difference between the broad, national S&P Municipal Bond Index and the more specific S&P Municipal Bond Oklahoma Index.

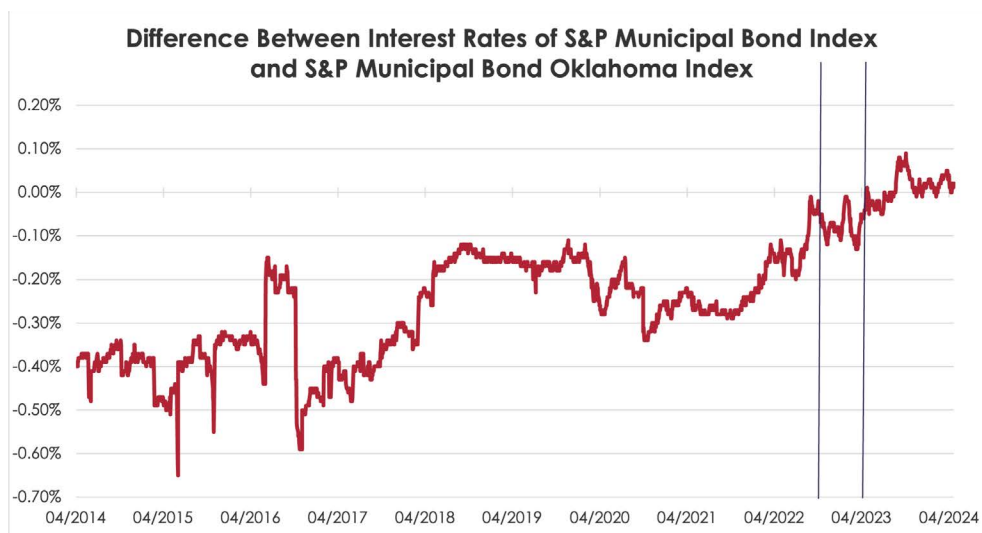
What stands out in Figure 2 is that for most of the decade illustrated, Oklahoma's municipal borrowing rate index was lower than the broader measure. This flipped only late in 2023, *after a 2-year trend of Oklahoma rates rising relative to the nation's, a trend that started well before the EDEA's passage and implementation.*

Prior to the upward relative trend in Oklahoma's municipal borrowing rates, the trend was obviously downward. An explanation for this could be the Trump administration's encouragement of oil exploration and drilling, a policy that could not be felt early in Trump's term due to his administration's slow start in getting organized. Covid-19 caused the gyrations in the downward trend, which continued into 2022. This would have been about the time Biden administration policies, which have been pointedly hostile to the oil industry, would have been implemented and their impacts felt. Since then, the upward trend in Oklahoma's municipal borrowing interest rates relative to the nation's

has been unrelenting. However, if anything, the upward trend since EDEA implementation has moderated compared to what it was prior to the EDEA's passage.

The ORA paper depends on data from 2018 into 2023. This alone is a cherry-picking of the data, as Figure 2 shows. Obviously, the EDEA had no impact on the current upward trend in Oklahoma's municipal borrowing interest rates, as they were trending upward long before the EDEA's passage and implementation. A econometric analysis cannot "see" this, but it can return erroneous and biased results when trends are not recognized.

Figure 2



These comparisons challenge the ORA report's conclusions and suggest that broader macroeconomic trends, rather than state-specific legislation, drive the observed changes in municipal borrowing costs. These comparisons also indicate the increased competitiveness of these markets as they recently tend to move together more closely, contributing to an improved outlook for the future.

Broader Economic Implications

Governments pushing for ESG actions have broader economic implications. Prioritizing ESG [criteria](#) over financial performance often

stifles economic growth by diverting capital from high-performing investments. Compliance with ESG criteria adds to [operational costs](#), reducing the competitiveness of businesses. Government-mandated ESG investing distorts market activity, leading to inefficient capital allocation. These economic distortions negatively impact job creation, innovation, electricity reliability, and overall economic prosperity.

Opportunity Costs of ESG Investing

Governments mandating ESG investing overlook the opportunity costs associated with such policies. Divesting from reliable energy sources like oil and gas in favor of renewable energy projects often result in [lower returns](#) and economic disruptions. States with significant economic output from the oil and gas sector, such as Oklahoma and Texas, face significant spillover effects from reduced investment in these industries. These [spillover effects](#) include job losses, reduced economic activity, and [lower tax revenues](#), which ultimately create ripple effects on the broader state economy.

Higher Management Fees for ESG Funds

ESG funds often have [higher management fees](#) compared to traditional funds. This is due to the additional research and analysis required to evaluate ESG criteria. Higher fees erode the overall returns for investors, making ESG funds less attractive from a financial perspective. Higher management fees are a significant drawback of ESG funds, particularly for public pension funds and other institutional investors with a fiduciary duty to maximize returns for their beneficiaries. These higher costs offset any potential benefits of ESG investing and lead to [lower net returns over time](#).

COMPARING OKLAHOMA'S EDEA WITH SIMILAR LAWS IN OTHER STATES

Oklahoma's Energy Discrimination Elimination Act (EDEA) is part of a broader trend among states to counter ESG government mandates that disadvantage key industries. States like Texas and Florida have

enacted similar laws prohibiting state investments in companies that boycott fossil fuels. Texas, for example, passed [legislation in 2021](#) that restricts its government entities from contracting with or investing in companies that divest from fossil fuels. Similarly, [Florida in 2023](#) adopted regulations barring state pension funds from considering ESG factors in their investment decisions, emphasizing the need to maximize financial returns and avoid ideological agendas.

These “anti-ESG” laws in states like Oklahoma, Texas, and Florida are driven by a need to protect their economic interests, particularly the oil and gas industries, which are crucial to their economies and workforce. The lawmakers in these states argue that ESG mandates can lead to reduced investment in these vital sectors, potentially resulting in job losses, decreased economic activity, and lower tax revenues. The EDEA, for instance, aims to ensure that financial firms working with the state do not boycott fossil fuels, thereby maintaining investment and support for Oklahoma’s energy sector.

In contrast, states like California, Vermont, and Connecticut have embraced ESG criteria, promoting divestment from fossil fuels and encouraging investments in renewable energy. California, known for its aggressive environmental policies, has implemented measures to divest state pension funds from reliable fossil fuels and invest in unreliable renewable energy projects. Vermont has advocated for state pension funds to divest from fossil fuel companies to prioritize environmental concerns. Connecticut has recently implemented policies to ensure state investments adhere to ESG standards, including divestment from firearms manufacturers.

“Pro-ESG” states believe incorporating ESG criteria into investment decisions can drive positive social and environmental outcomes, leading to long-term sustainable growth. They argue that such policies align with broader societal goals and can mitigate environmental risks, improve corporate governance, and enhance social responsibility. However, these states pursue a policy path of imposing higher business costs and potentially sacrificing financial returns for broader social goals. Critics argue that ESG mandates lead to increased operational costs, reduced competitiveness, and inefficient capital allocation, ultimately harming the state’s economy and constituents.

The divergent approaches to ESG investing reflect these states' broader political and economic priorities. "Anti-ESG" states prioritize not picking winners and losers in the marketplace while maximizing financial and economic outcomes that will support prosperity and benefit the environment. In contrast, "pro-ESG" states focus on pursuing (unattainable) long-term environmental and social goals, even when it means accepting potential short-term financial trade-offs. This ongoing debate highlights the complexities and challenges of integrating ESG criteria into public investment decisions. It underscores the need for a careful, balanced approach considering the economic and societal tradeoffs.

THE IMPORTANCE OF FIDUCIARY DUTY

Fiduciary duty requires investment managers to prioritize financial returns for their beneficiaries. This principle is fundamental to ensuring that investment decisions are made in the best interest of the individuals and institutions relying on these funds for future financial security. Including ESG criteria in investment decisions can conflict with this duty by introducing non-financial, political criteria that may not align with maximizing returns. Using ESG criteria in public pension funds and state investments can lead to lower financial performance and increased risks, as highlighted by [critiques](#) and [evidence](#).

The debate around fiduciary duty versus ESG criteria is a core economic argument. According to the principles espoused by most economists, the primary responsibility of businesses and investment managers is to maximize shareholder value. Diverting from this objective to pursue environmental, social, and government goals undermines the financial performance of investments and compromises the fiduciary duty owed to taxpayers and beneficiaries. Pursuing ESG criteria should not come at the expense of financial returns, especially when managing taxpayer funds in government pensions, bonds, or programs.

A key issue with integrating ESG factors is [the subjectivity and lack of standardized measurement](#). ESG criteria are often based on qualitative judgments that vary widely between analysts and rating agencies.

This lack of consistency makes it difficult to assess the true impact of ESG factors on financial performance. Moreover, the complexity of ESG factors can obscure transparency and accountability in investment decisions, making it harder for stakeholders to evaluate performance accurately.

CONCLUSION

The Oklahoma Rural Association's report on the state's Energy Discrimination Elimination Act and its purported impact on municipal borrowing costs contains significant methodological flaws. It fails to establish a causal relationship between the EDEA and higher municipal borrowing costs. Changes in federal policy with respect to the oil industry, first positive under President Trump and now decidedly negative under President Biden, are more plausible explanations for Oklahoma's relatively increased borrowing costs. Furthermore, the push towards ESG investing overlooks the opportunity costs associated with divesting from reliable energy sources like oil and gas, which are crucial to Oklahoma's economy.

Given the methodological flaws in the ORA study, it should not be used as a reason to question or delay the implementation of protections put in place by the elected representatives of states like Oklahoma and Texas against asset managers using the assets of those states to push ESG-aligned political objectives.

Policymakers should ensure that investment decisions prioritize profitability and fiduciary responsibilities over politically-driven, subjective ESG criteria through increased transparency, [independent audits](#), and clear rules. This approach will better safeguard economic interests and promote sustainable growth, benefiting the broader community and the environment.

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