Opinion/Editorial

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Texas' Strength Clear In Recent Bond Sale
By Tom Pauken

A recent bond sale by Texas that is expected to save taxpayers more than $110 million and ease the tax burden on employers is a stark contrast with other states and nations who have been punished by the bond market for their fiscal irresponsibility and poor prospects for economic growth.

Greece, Ireland, Spain, California and Illinois have all made headlines in the last year for polices that have led to downgrades in their credit ratings and an increase in the cost to sell their bonds – and that's if they are fortunate enough to find investors who will pay for their bonds at all. Even the U.S. itself, once considered the world's safest place for investment purposes, is seeing signs that investor confidence in U.S. Treasuries may be threatened. Moody's, one of the three major credit rating agencies, warned in mid-December that the U.S. risks losing its AAA credit rating if policymakers in Washington continue to ignore the growing deficit.

Amid all this bad news, investors recently gave the Texas economy a ringing endorsement. In November and December, $2.1 billion dollars in Texas bonds were sold on behalf of the Texas Workforce Commission (TWC) at rates favorable to Texas. Those rates came thanks to excellent ratings from all three of the major credit rating agencies. TWC is using the proceeds from the sale to replenish its trust fund and pay unemployment benefits without having to take out costly loans from the federal government.

Understanding why the bond sale is such a success story for Texas requires some background on the unemployment insurance (UI) process and on how the bond market works. All states are required to maintain an unemployment compensation trust fund that is used to pay unemployment benefits. The trust fund is funded by a tax paid by employers. In economically healthy times, Texas' trust fund typically maintains a positive balance. As a result of the most serious national recession since the time of the Great Depression, by July 2009 the Texas UI trust fund faced a deficit in light of the increased demand for unemployment benefits. At the time the federal government advanced funds to most states, including Texas, to keep their trust funds solvent. Originally interest free, the federal loans were set to begin charging interest in January 2011 at a 4.1 percent annual rate. Instead of having to pay that 4.1 percent rate, TWC issued three series of bonds that will pay an

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overall interest rate of approximately 2.8 percent to investors.

Selling the bonds rather than borrowing from the federal government benefits Texas in two ways. First, the difference between the two interest rates will save TWC and Texas employers more than $110 million. Secondly, whether we had sold the bonds or taken the federal loan, the money to pay back either obligation would have come from taxes paid by employers. Under the bond sale, repayment can be spread out over a 10-year period of time. This means that the tax burden on employers also can be spread out over that time rather than compressed into a single year, as would have been required had we taken a loan from the federal government.

The low returns – called the "yield" – which investors are receiving on Texas' bonds aren't available to every state that seeks to enter the bond market. One strategist, representing a large asset management firm, told Bloomberg news that the Texas bonds "did not come cheap." In the municipal bond market "cheap bonds" refer to bonds that have high yields. Texas was able to keep its yield low – even as short-term market forces emerged during the sale were pushing rates upward – because investors have confidence in the Texas economy and the fiscal responsibility of our state government.

Investors make that determination largely based on the evaluations made by the three credit rating agencies: Standard & Poor's (S&P), Moody's and Fitch Ratings. In evaluating the Texas economy prior to the recent bond sale, all three credit raters gave Texas high marks. Moody's and Fitch both gave Texas their second highest rating, Aa1 and AA+, respectively; S&P gave Texas its highest possible rating, AAA. All three praised Texas for having a strong, diverse and broad employment base. Fitch declared that Texas' "long-term economic prospects are very strong." It noted that despite taking a hit from the current national economic crisis "solid employment growth has resumed" in Texas.

Facing $61 million in interest payments to the federal government, Florida is planning on imposing a special assessment on employers. That has led a Florida business leader, Randy Miller, to point to the Texas bond sale as better approach. Miller specifically notes that Texas has saved interest costs by selling its bonds at a lower interest rate than the federal government is charging.

For states like Illinois, the outlook is much gloomier. Governor Pat Quinn is hoping to sell $8.75 billion in bonds to help pay overdue invoices. If the legislature approves this proposal, Illinois will have to pay a much higher yield. It currently pays almost 2 percentage points more on its 10-year bonds than the market average.

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Moody's rates Illinois lower than any other state, A1, while S&P rates California at the bottom of all states in terms of financial risk.

Despite the tough economic challenges caused by a sluggish national economy, Texas has remained remarkably resilient. This latest bond sale illustrates that Texas is better positioned to weather the economic storms than any other large state in the country. Texas remains the number one place in America to do business. Our recent bond sale reflects the confidence that investors have in the Texas economy.

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