TEXAS PUBLIC POLICY FOUNDATION

2017-18

LEGISLATOR'S GUIDE

to the issues

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TEXAS PUBLIC POLICY FOUNDATION
901 Congress Ave., Austin, TX 78701
(512) 472-2700 Phone (512) 472-2728 Fax
www.TexasPolicy.com

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Edited by
Bill Peacock & Carine Martinez-Gouhier
Texas Public Policy Foundation

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Conservative Texas Budget

The Issue

The 2015 Texas Legislature started with the state's coffers overflowing with cash from a robust economy. Instead of discussing how much to spend, state officials discussed how much to cut taxes. This novel concept should be the starting point every legislative session.

That Legislature went on to make great strides by passing a conservative budget, defined as an increase by no more than the key metric of population growth plus inflation, $4 billion in tax and fee relief, and billions of dollars left unspent, including more than $10 billion in the state's rainy day fund.

These prudent fiscal decisions helped keep the size and scope of government from crowding out the productive private sector—the best economic stimulus—during a slowing economy.

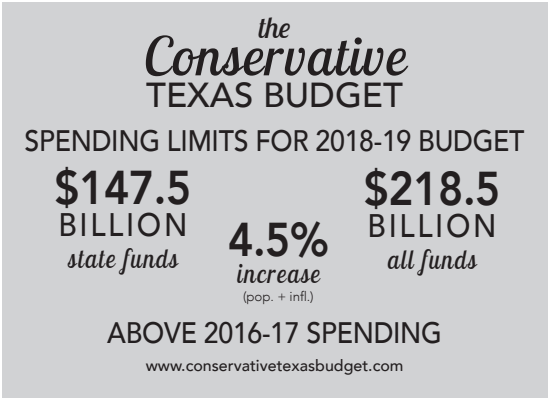
Appropriations of $209.1 billion for the 2016-17 budget period increased 4.3% from the previous biennium. The Conservative Texas Budget Coalition deemed this a conservative budget because it was below the key metric (population growth plus inflation) of 6.5% during the previous two fiscal years. This conservative budget must be the first of many given past excessive trends that have led to a total budget that is 11.8% above this key metric since the 2004-05 budget.

Along with the 2015 Legislature, legislators practiced some budget constraint in the 2003 and 2011 legislative sessions when they passed budgets that increased by less than this key metric. However, in 2005 and again in 2013, spending by subsequent Legislatures increased substantially, erasing all of the gains from previous sessions.

Given the current economic climate, there looks to be less tax revenue available than last session, so it may be easier for the 2017 Legislature to pass another conservative budget. However, there will likely be proposals to appropriate more from the state's rainy day fund for various budget areas, thereby increasing the budget by more than this key metric when the focus should be on spending less to lower Texans' tax burden.

The 13 member organizations of the Conservative Texas Budget Coalition recommend that the Legislature pass the second consecutive conservative budget that's below population growth plus inflation so that legislators will be good stewards of taxpayer dollars.

By achieving this, Texas will better deal with potentially deep downturns and other economic circumstances. This provides Texas with the best opportunity to remain a free market bastion for Texans to achieve their hopes and dreams, and a model for others to follow.



The Facts

- Texas' total state budget growth is up an estimated 11.8% above the pace of compounded population growth plus inflation since the 2004-05 budget.
- The 2015 Legislature passed a conservative Texas budget below population growth plus inflation.
- Keeping spending and taxes low is the best path for Texans to achieve more prosperity.

Recommendations

- Adopt a second consecutive Conservative Texas Budget.
- Increase the 2018-19 total budget by less than the estimated increase in the rate of population growth plus inflation based on actual data for fiscal years 2015 and 2016.
- Pass a 2018-19 budget that increases by no more than 4.5% for a maximum total budget of $218.5 billion or state (non-federal) funds of $147.5 billion.

Resources

The 2018-19 Conservative Texas Budget by Talmadge Heflin and Vance Ginn, Texas Public Policy Foundation (June 2016).

The Real Texas Budget: Why Texas Needs to Ratchet Down Spending Growth by Talmadge Heflin, Bill Peacock, and Vance Ginn, Texas Public Policy Foundation (June 2016).

TEL It Like It Is: Why Texas Needs Spending Limit Reform by Talmadge Heflin and Vance Ginn, Texas Public Policy Foundation (Dec. 2015).

Tax and Expenditure Limit

The Issue

Texas has done better economically and fiscally than most states during the past 15 years. However, one area that still needs improvement is consistently controlling the state's budget growth. Since all government spending must ultimately be paid for by taxation, limiting budget increases is essential for a competitive economy that supports prosperity.

The 2016-17 total budget of $209.1 billion is up 68.5% since the 2004-05 budget. Comparatively, the key metric of population growth plus inflation compounded over time is up an estimated 51% during this period. Adjusting the total budget for this key metric shows that total budget growth is up 11.8% above the pace of compounded population growth plus inflation since the 2004-05 budget. This excessive increase has burdened Texans with higher taxes and fees to sustain elevated spending levels and slowed economic growth.

While historically the Legislature has occasionally passed conservative budgets that increase by no more than this key metric, Texas needs to keep past costly budget cycles from repeating. This can be accomplished by passing a stronger statutory spending limit whereby the current weak limit can be traced back to three design flaws:

- **The current limit covers less than half of the budget.** In Article VIII, Section 22(a) of the Texas Constitution, the only appropriations subject to the spending limit are those derived from "state tax revenues not dedicated by this constitution," which is about 45% of the 2016-17 total budget. By not capping more than half of the budget, legislators are left with perverse incentives to move money outside the cap by dedicating funds and resort to accounting gimmicks.
- **The current measure is not a reliable indicator for the budget's growth rate.** The Texas Constitution requires that the limit be based on the growth in the state's economy—statutorily identified as personal income growth. Research finds that this measure's instability leads to costly fiscal volatility and uncertainty.
- **The budget limit relies on a projected measure of economic growth.** Since several groups submit estimates of personal income growth to the Legislative Budget Board in November before a regular legislative session for the next two fiscal years (i.e., each fiscal year is from September 1 to August 31), the projections are for about 33 months. The difficulty of accurately predicting this growth rate leads to large discrepancies between actual and projected growth rates that are never corrected later.

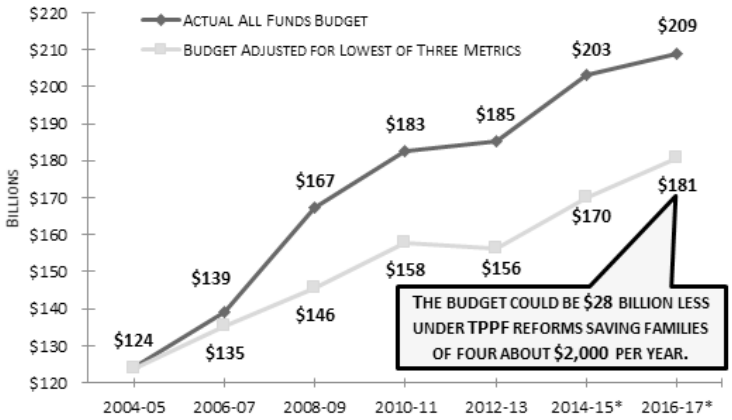
The Facts

- Texas' total state budget growth is up an estimated 11.8% above the pace of compounded population growth plus inflation since the 2004-05 budget.
- Solving the state's budgeting difficulties will require bold leadership guided by a principled approach, similar to that outlined in the Real Texas Budget.
- The current spending limit is weak because it excludes a majority of the budget, is based on the estimated growth of future personal income, and can be avoided rather easily by lawmakers.

Recommendations

- Pass a conservative spending limit that makes the following statute changes to Section 316 of the Government Code:
  - Apply the limit to Texas' total government budget.
  - Base the limit on the lowest growth rate of the Census Bureau's measure of state population plus the Bureau of Labor Statistics' measure of inflation for the consumer price index for all items, the Bureau of Economic Analysis' measure of total state personal income, or the Bureau of Economic Analysis' measure of total gross state product for the two fiscal years immediately preceding a regular legislative session when the budget is adopted.
- Put a constitutional amendment on the ballot to change Article VIII, Section 22(a), such that a supermajority vote of two-thirds in each chamber instead of a simple majority is required to exceed the spending limit.

The chart below presents the budget adjusted for these growth rates to consider what the budget would look like if the Legislature had implemented our recommended reforms in 2003 and followed them since the 2004-05 budget.



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TEL It Like It Is: Why Texas Needs Spending Limit Reform by Talmadge Heflin and Vance Ginn, Texas Public Policy Foundation (Dec. 2015).

A Labor Market Comparison: Why the Texas Model Supports Prosperity by Vance Ginn, Texas Public Policy Foundation (Oct. 2015).

Reforming Texas' Tax and Expenditure Limit by Talmadge Heflin and Vance Ginn, Texas Public Policy Foundation (Jan. 2015).

Sales Tax Reduction Fund

The Issue

The 2016-17 state budget of $209.1 billion funds education, health care, and all other areas of the budget. This budget is up 68.5% since the 2004-05 budget. However, the key measure of estimated compounded population growth plus inflation is up only 51% in that period. Had the budget followed this key measure since the 2004-05 budget, Texans would be paying $22 billion less in taxes and achieving greater prosperity.

Fortunately, the 2015 Legislature passed a budget that increased by 2.9% above the previous biennium's spending level, which was less than this key measure, but there is much more work to do. One way to continue correcting past excesses is to cut ineffective budget items.

While members attempt to reduce the amount of spending on specific programs by offering budget amendments in the appropriations process, this normally does not lead to an overall reduction in spending. Such amendments simply set aside the money cut from one program and make it available for members to appropriate for other purposes, which interested parties earnestly seek.

To resolve the incentive to spend every available dollar, a mechanism should be created that allows dollars cut from one area of the budget to be transferred to a special fund that allows legislators to actually reduce the bottom line of the budget. Dollars in the fund would accumulate until the appropriations bill is adopted. The Texas Comptroller would then determine the rate decrease and temporary period of reducing the broadest based and easiest to administer state tax (sales tax) such that the Fund is depleted. After the determined period, the tax rate would automatically revert to its original level.

The broadest, most visible, and easiest to administer tax in Texas is the state's sales tax. Therefore, this mechanism is called the Sales Tax Reduction (STaR) Fund. The many influential members of the American Legislative Exchange Council's Tax and Fiscal Policy Task Force passed a version of it last year as model legislation. A summary of the Tax Reduction Fund language follows:

> "The Tax Reduction Fund is a special fund that consists of money transferred to it by the legislature and any interest earned on money in the fund that can be used to temporarily reduce a state's tax rate. The goal of the Tax Reduction Fund is to lower the bottom line of the budget by transferring funds that may be available in the budget that would otherwise be spent and returning those dollars to taxpayers by reducing the broadest state tax."

After the STaR Fund is created, it could be funded by: 1) Legislators appropriating dollars that are from a budget surplus or saved dollars from less spending on state programs; and 2) Funds in excess of the Economic Stabilization Fund's (ESF) cap may flow directly into it rather than back into general revenue.

For the 2016-17 biennium, the Texas Comptroller calculates an ESF cap of $16.2 billion. Although the balance will likely fall below the cap at roughly $10.4 billion by the end of fiscal 2017, the cap could be reached in the near future.

With the potential of a tight budget next session, legislators will be challenged

with scrutinizing every dollar in the state's budget to restrain the size and scope of government. Instead of spending these excess funds, a better choice is to restrain government spending and provide sales tax relief; however, the difficulty for legislators to attempt to do this starts in the appropriations process.

A valuable way to reduce spending levels through the appropriations process is to include taxpayers as one of the funding constituents. With excess past spending and a rising amount available in the ESF, a priority must be to reduce the bottom line of the budget such that the good tax climate that has resulted in great economic prosperity in Texas will continue.

The Facts

- The current appropriations process, in the House, does not allow for funds cut on programs to reduce the bottom line of the budget. Instead, these funds are available to be appropriated on other programs.
- The Texas Comptroller projects that the ESF will be roughly $10.4 billion by the end of 2017, reaching towards the cap of $16.2 billion, and could reach it in the near future.
- By including taxpayers as a funding constituent, more funds available by reducing the bottom line of the budget can be used to provide tax relief.

Recommendations

- Create the STaR Fund in 2017 to provide a means in 2019 and beyond for reducing the bottom line of the budget while returning those dollars to the taxpayers by temporarily reducing the state's sales tax rate.
- By appropriating dollars that were earmarked for budget growth directly into the STaR Fund along with excess dollars in the ESF to provide a temporary reduction in the state's sales tax rate, legislators can restrain the growth of government.

Resources

Tax Reduction Fund—Model Legislation, American Legislative Exchange Council (Sept. 2015).

Protecting Texas Taxpayers: the Sales Tax Relief Fund by Talmadge Heflin and Vance Ginn, Texas Public Policy Foundation (April 2014).

Transparency and Budgeting

The Issue

It is critical for legislators to appropriately account for spent tax dollars, eliminate state budget inefficiencies, and prove why each agency and program are necessary for Texas taxpayers to fund an efficient, limited government.

Today, the General Appropriations Act (GAA), the bill creating the state budget, is laid out using a strategy-based budgeting format that is almost impossible to track programs in the budget. To determine fiscal prudence by each agency, program-level specifics are necessary. The budget should be written with each agency's revenue and expense listed by program, as well as listing the revenue source next to each line item. Changing to a program-based budgeting format would simplify the process for the average taxpayer, leading to more transparency and a greater chance for weeding out inefficiencies. This would help hold the Legislature accountable for its budget practices and help educate and empower taxpayers in the process.

The budget should be available online in as close to real time as possible during the legislative process. Fortunately, the Legislative Budget Board (LBB) took steps to create an online application on their website after the 83rd Legislature that displays the state budget by program. Taxpayers can now search for program-level spending information, a short explanation of the program, and its statutory authorization. This application is a good first step, but currently the information provided is only informational and not frequently updated, particularly as the GAA moves through the legislative process.

Another issue is the current budgeting approach too often assumes that all previous expenditures are justified and necessary. Legislators then simply add automatic spending increases on the previous budget. This budget inertia is highly inefficient. A helpful tool to improve efficiency and increase budget transparency would be to implement zero-based budgeting.

Zero-based budgeting is a complete review of each agency's budget starting from scratch to determine the necessity of programs. This method requires an in-depth analysis that takes much time and effort, but it is well worth the cost to increase budget transparency and help legislators exercise greater budget-writing control.

In 2003, Texas faced a projected $10 billion shortfall. Governor Rick Perry sent the Legislature a budget with zeros next to each agency's line item and publicly stated that he would be against any budget that included a tax increase. The Legislature was asked to do the hard work of taking a detailed examination at what had become traditional spending patterns. Ultimately, the Legislature bridged the $10 billion budget shortfall by using a zero-based budgeting approach to eliminate inefficiencies within each agency and avoid raising taxes.

Essential to successfully performing zero-based budgeting is a review of all aspects of an agency or program, including its purpose, goals, and determined metrics to gauge success. Done correctly and often, zero-based budgeting would help restrain budget growth and therefore the government's footprint so

taxes and fees can be lower than otherwise.

The Facts

- The current strategy-based budgeting format, which links appropriations to strategies and goals rather than programs, obscures government agency budgets.
- The LBB increased budget transparency by developing an online application offering the state budget by program after the 83rd Legislative Session.
- Zero-based budgeting is a more thorough budget analysis than the current approach, making it a time-consuming process. However, the method holds promise as demonstrated in 2003 when Texas legislators, faced with a $10 billion budget shortfall, balanced the state budget without a tax increase.

Recommendations

- Convert from the current strategic-based budgeting format to a program-based budgeting format, as proposed in SB 827 during the 84th Legislature.
- Post budget information online throughout the budget process so that it will be available to Texans and legislators in near real time.
- Adopt zero-based budgeting for a portion of the budget each biennium to ensure taxpayers get the most value of the programs and agencies they fund, as proposed in HB 459 during the 84th Legislature.
- Lawmakers may consider applying this zero-based budgeting to about one-third of the budget every biennium so that each portion is reviewed every third biennium. For example, education in one biennium, health and welfare in the next, and then all other budget items.

Resources

The Real Texas Budget: Why Texas Needs to Ratchet Down Spending Growth by Talmadge Heflin, Bill Peacock, and Vance Ginn, Texas Public Policy Foundation (June 2016).

Testimony before the Senate Committee on Government Organization on Budget Transparency by Talmadge Heflin, Texas Public Policy Foundation (June 2014).

Testimony before the House Committee on Appropriations Subcommittee on Budget Transparency and Reform Regarding House Bill 98 by Talmadge Heflin, Texas Public Policy Foundation (April 2013).

Using Zero-Based Budgeting in Texas by Chuck DeVore, Texas Public Policy Foundation (May 2012).

Understanding Federal Funds

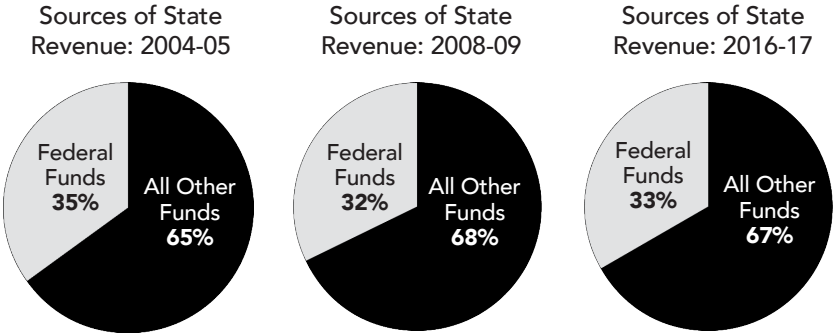
The Issue

Texas' dependency on federal funds, which includes grants, payments, and reimbursements from the federal government to state agencies, has remained around one-third of the budget during the past decade. This reliance threatens the state's financial stability and independence.

As a percentage of the 2016-17 budget, federal funds constitute approximately 33%, or $68 billion, of total appropriations. This is $726.2 million, or 1.1%, below federal aid for the 2014-15 budget.

Of the $68 billion in federal aid, Health and Human Services (Article II) was the biggest recipient with an estimated $43.2 billion, or almost two-thirds of the total. Appropriations supported by federal funds for general government functions (Article I) increased the most at 8% over the previous budget.

A valuable measure of state dependency on federal funds is the percentage of the budget from federal aid. The figures below show that federal aid went from 35% of the 2004-05 budget, declined to 32% in 2008-09, and then increased to its current share of 33%.



Source: Legislative Budget Board

This one percentage point increase in the share of federal aid from just a few budget cycles ago further burdens state legislators with more red tape and less independence from the federal government and burdens Texans in the process. From 2000 to 2013, this share averaged 33.9% in the Lone Star State, which ranks Texas as the 13th highest share nationwide with the national average of 30.3% according to the Pew Charitable Trusts.

Federal dollars per Texan increased 26% from $1,965 in 2004-05 to $2,475 in 2016-17. It is one thing for taxpayers to fund legislation that is passed by state lawmakers, but it is another thing entirely when so many state functions are directed and funded by those in Washington, D.C.

As more federal aid makes legislators more dependent on national policies, these policies crowd out the ability for state lawmakers to enact legislation that affects Texans. Specifically, growing federal aid dependency drives more state spending as legislators try to maximize federal funds, handicaps state decisions as lawmak-

ers focus on federally funded programs and lose control of the growth of the budget, and slows economic growth and job creation as private sector funds are redistributed.

As Milton Friedman said, "There is no such thing as a free lunch." The common misconception that federal aid is free is not true. There are ample examples of ways that the federal government controls the choices made by the state and threatens fiscal federalism in the process.

With massive federal budget deficits and the national debt exploding, Congress must find ways to slow spending. This change would likely affect how much states receive in federal aid. With one-third of Texas' total budget funded by federal aid, legislators could face a serious fiscal imbalance.

As written in the U.S. Constitution, states should be able to act as independent and sovereign entities. With more federal aid funding the state's budget, legislators lose their independence to act responsibly for their constituents and all Texans lose in the process.

The Facts

- Federal funds constitute approximately 33%, or $68 billion, of the 2016-17 budget.
- Federal funds per person went from $1,965 in 2004-05 to $2,475 in 2016-17, a 26% increase, burdening all Texans.
- From 2000 to 2013, the federal funds share of the budget averaged 33.9% in Texas, ranking Texas as having the 13th highest federal share nationwide.

Recommendations

- Prepare for the next federal budget crisis by identifying and measuring the cost of the mandates attached to federal funds.
- Evaluate the economic and fiscal impacts of a rising share of federal funds when writing the budget and minimize any increase in federal aid or reduce it.
- Rising federal aid funding for transportation and other state-level projects suggest legislators should consider ways to return more state dollars to fund projects without strings attached.

Resources

The Real Texas Budget: Why Texas Needs to Ratchet Down Spending Growth by Talmadge Heflin, Bill Peacock, and Vance Ginn, Texas Public Policy Foundation (June 2016).

Which States Rely the Most on Federal Aid? by Liz Malm and Richard Borean, Tax Foundation (Jan. 2015).

Budget Driver: Federal Funds by Talmadge Heflin, Texas Public Policy Foundation (Feb. 2010).

Transportation

The Issue

Years of rapid economic growth and a population growing at about double the national rate present Texas with infrastructure challenges. Working to mitigate these strains, Americans have been driving fewer miles per capita since 2006, as the Internet brings shopping, entertainment, and personal communications into homes.

The chart below shows that lawmakers boosted funding for the Texas Department of Transportation (TxDOT) over two sessions in 2013 and 2015. Proposition 1 resulted in $1.7 billion being allocated for transportation in 2015. However, due to lower oil and gas prices, Proposition 1 transfers are likely to be more modest than forecast. Proposition 7 amended the Texas Constitution to allocate revenue to the State Highway Fund from state sales taxes starting in 2018 and a portion of motor vehicle sales taxes in 2020. Further, some $1.3 billion in diversions out of the Fund 6 account for non-transportation purposes was ended in the 2016-17 budget.

Transportation Budget Summary

	2014-2015	2016-2017	2018-2019
Proposition 1	$1.7 billion	$2.0 billion (est.)	$2.0 billion (est.)
Proposition 7	N/A	N/A	$2.3 billion (est.)
Ending Diversions	N/A	$1.3 billion	Continued
Total TxDOT Funding	$19.5 billion (exp.)	$23.1 billion (est.)	$24.0 billion (est.)

House Bill 20 in 2015 contained several reforms of note. The most notable was requiring the Texas Transportation Commission (TTC) to implement performance-based planning to: generate metrics for the executive and legislative branches to measure performance; and prioritize projects using objective criteria. But the TTC was given wide latitude to ignore its project ranking criteria by allowing for discretionary funding decisions up to 10% of TxDOT's biennial budget. Since new project starts make up less than half of the overall TxDOT budget, granting 10% discretionary authority allows the TTC to ignore much of its own ranking process by allocating about 25% of spending on new projects that did not make the prioritized project list.

Design-Build Contracting

Design-build differs from traditional design-bid-build contracting in that, in the former, a contractor is responsible for designing and building the project while in the latter, a different party, usually the government, designs the project and then bids it out to a contractor to build. Design-bid-build typically results in a longer, more expensive process. In the six-year period ending in 2014, TxDOT awarded five design-build contracts totaling $3.85 billion. This method of procurement is estimated to have saved Texas taxpayers some $1.08 billion, or 22% of the total spent.

Further, according to a federal study, the national average time savings for project completion in a design-build contract versus a design-bid-build contract is ap-

proximately 14%. For example, the DFW Connector Project used design-build, shaving 28 months off the expected timeline versus the traditional bidding process. This saved $43 million in construction inflation while allowing 180,000 cars to use the DFW Connector earlier than they otherwise would have, saving about $60 million in commuter costs.

House Bill 20 raised the threshold of value for design-build contracts from $50 million to $150 million. Further, a design-build contract may not extend a maintenance agreement as part of the award for a term of longer than five years. This has the unintended consequence of discouraging designs and construction techniques that may cost more on the front-end and considerably less in maintenance costs on the back end—roads and bridges typically cost more to maintain over their lifetimes than to build in the first place.

The Facts

- Texas restricts money and time saving design-build contracts to no more than three per year and no less than $150 million. Other large states do not have parallel restrictions.
- Per capita miles driven has been flat since 2006 and, when combined with increasing fuel efficiency, alternative-fueled vehicles, and inflation, this means the fuel tax becomes less capable of funding transportation, placing a greater reliance on other revenue sources.

Recommendations

- Remove limitations on design-build contracting by striking the yearly limit of three, eliminating the minimum size of $150 million, and striking the requirement for designs to be 30% complete before going out to bid.
- Remove the disincentives to propose long-lasting designs and construction techniques by allowing contractors to assume responsibility for maintenance beyond the current five-year limitation as part of the initial contract award.
- Additional spending on transportation, if any, should be included within Texas' tax and expenditure limitation and not be in the form of dedicated funds that do not count towards the spending limit.

Resources

Texas Highway Funding Legislative Primer, Legislative Budget Board (April 2016).

Texas Department of Transportation Annual Financial Report, FY 2015, Texas Department of Transportation (Dec. 2015).

The Road Forward: Improving Efficiency in Texas Transportation Spending by Chuck DeVore, Texas Public Policy Foundation (March 2015).

Texas Department of Transportation Annual Financial Report, FY 2014, Texas Department of Transportation (Dec. 2014).

Economic Stabilization Fund

The Issue

Oil and natural gas production may have recently slowed, but the more productive wells remain online as production has not declined as much as expected through mid-2016. The oil and gas production boom for several years contributed to a large increase in severance taxes that primarily fund the Economic Stabilization Fund (ESF).

The ESF is broadly considered the state's "rainy day fund" or "savings account" that was put in place with passage of a constitutional amendment in 1988. The ballot language that Texans approved was "The constitutional amendment establishing an economic stabilization fund in the state treasury to be used to offset unforeseen shortfalls in revenue." However, there is no language in the constitution or statute identifying a specific purpose for the ESF. Regardless, the ballot language sold to Texas seems to be clear that this money is to fill unexpected revenue shortfalls. More clarity of the purpose of the fund is warranted.

Recently, the ESF balance has been used to fund various expenditures. The constitution requires a three-fifths vote in each house to close a revenue gap and a two-thirds vote in each house to use it for any other reason. In 2013, $1.8 billion in ESF dollars were appropriated to fully fund education in the 2012-13 biennium. Texans approved amendments in 2013 to take $2 billion from the ESF to pay for water projects and in 2014 that directed a portion of severance taxes to the State Highway Fund (SHF) instead of going in the ESF. According to the latest provision, a committee determined the ESF minimum balance to be $7 billion in 2015, allowing for $1.7 billion to be transferred to the SHF.

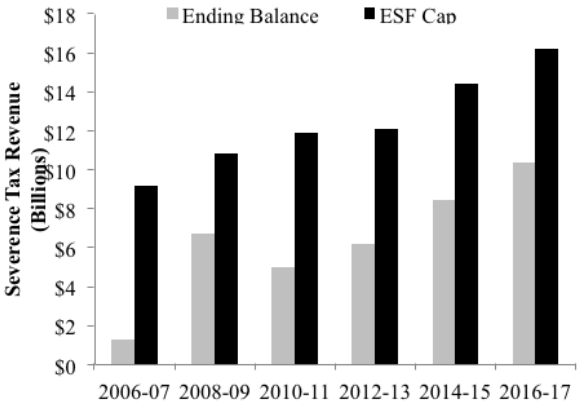
Despite these one-time and ongoing expenditures of severance taxes accumulating in the ESF, the Texas Comptroller projects that the ESF balance will increase 23% to $10.4 billion at the end of the 2016-17 budget cycle. Considering that the ESF balance cannot exceed 10% of general revenue funds excluding interest and investment income in the previous budget cycle, the cap this period is $16.2 billion. The chart on the next page shows that ESF dollars are likely to rise to the largest cap share of 64% compared with only 14% at the end of the 2006-07 period.

It is critical that lawmakers understand that this is a one-time resource to the state. If this money is spent each session, the ESF will quickly dwindle and the state's credit rating will be at risk, particularly if the amount goes below 5% of general revenue-related funds.

Given a potentially tight budget next session, there will be calls to use ESF dollars as the amount grows larger. Using one-time funds to pay for ongoing expenditures only delays needed difficult decisions that should be made with general revenue funds, while simultaneously depleting one-time funds that should be used for future emergencies, budget stabilization, or tax relief.

Put differently, no reasonable person would advise a household who is spending more than their monthly income to tap their savings account to pay for a lifestyle beyond their means. If we wouldn't advise that for a family, then why would we collectively, as a state, advise that for our government?

Oil and Natural Gas Production Tax Revenues Reach Closer to the ESF Cap



Source: Legislative Budget Board

The Facts

- The rainy day fund is expected to grow by $2 billion by the end of FY 2017.
- If the fund reaches $10.4 billion as projected, the ending balance would be a record high and reach closer to the cap of $16.2 billion.
- Using one-time funds to pay for ongoing expenses is poor public policy.

Recommendations

- Determine the desired purpose of the ESF and put it in law. Ideally, the ESF balance should be spent only on stabilizing the budget or tax relief; not on ongoing expenses.
- One option would be to create a fund to place excess ESF dollars or savings from budget cuts to return dollars to taxpayers by temporarily lowering the state's sales tax rate (Sales Tax Reduction (STaR) Fund).
- At a minimum, lawmakers should preserve an ESF balance equal to 5% of the general revenue-related funds each budget cycle but should consider conservative options, especially tax relief, with the rest.

Resources

Overview of the Economic Stabilization Fund, Legislative Budget Board (April 2016).

Why States Save, The Pew Charitable Trusts (Dec. 2015).

Preserve Texas' Rainy Day Fund in These Uncertain Economic Times by Chuck DeVore, Texas Public Policy Foundation (Oct. 2012).

Public Pension Reform

The Issue

Recent analyses documenting the imminent threat posed by unfunded state pension liabilities contributed to the 2013 Texas Legislature making several reforms, including raising the retirement age and increasing contribution rates, to the two largest state pension systems—Teacher Retirement System (TRS) and Employees Retirement System (ERS). The 2015 Legislature raised the ERS member contribution rate to 9.5% to improve its solvency.

While these are positive first steps, these pension systems should be changed from defined benefit to defined contribution plans to make them sustainable long term for beneficiaries and not burden all Texans with higher taxes.

For decades, state and local officials have overpromised on and underfunded government-run retirement plans, resulting in the accumulation of trillions of dollars in unfunded liabilities across the nation. Unfunded liabilities are the difference between promised benefits to future retirees and money available to fund those benefits. In fact, one study pegged total unfunded state and local pension liabilities nationwide at more than $4.7 trillion—or almost $15,000 per American.

In Texas, state and local governments employ 14% of workers. Most of them have a defined benefit pension plan that promises a regular payment to retirees regardless of contribution. Volatile annual rates of return and fewer contributors paying for more beneficiaries are exhausting these plans, leaving them with mounting, unsustainable liabilities.

The Pension Review Board (PRB), the state agency charged with overseeing Texas' state and local retirement systems, shows that among the 93 systems monitored by the agency, unfunded liabilities topped $60 billion in early 2016. That is an increase in pension debt of $2.7 billion since June 2015 and an increase of $7.7 billion compared with two years prior.

The funded ratio—a measure of a plan's current assets as a share of its liabilities—averaged 80% across all plans. It is generally agreed that a funded ratio of 80% or more signifies a firm financial footing, something that many of Texas' systems are on the brink of falling below.

Looking at these plans' amortization periods also hints at trouble. The PRB's guidelines for actuarial soundness recommend that a plan's amortization period ideally range between 15 and 25 years. However, 56 of the 93 plans exceeded that target in early 2016. Over a longer time horizon, fewer plans are able to achieve the recommended amortization period. A 2014 PRB report compares the financials of Texas' 93 monitored plans in 2000 and 2013. The report finds that in 2000 roughly 46%, or 43 of the 93 plans, had amortization periods at or above 25 years. By 2013, however, that figure had grown to 65%, or 60 of the 93 plans.

In 2015, TRS, the state's largest pension fund, had unfunded obligations totaling $33 billion, or $22,592 per member, and ERS, the second largest fund, had unfunded liabilities totaling $8 billion, or $32,126 per member. Assuming an overpromised 8% annual rate of return, the actuarial funded ratio for TRS is 80% and ERS is 76%, meaning that these are at or below the 80% threshold considered actuarially sound.

State pensioners have also been aging as baby boomers continue to retire leaving fewer contributors paying for more beneficiaries. According to the State Budget Crisis Task Force, the ratio nationwide of active public employees to retirees has fallen from 7-to-1 in 1950 to less than 2-to-1 today, putting more pressure on pension investment losses. A similar decline burdens Texas' pensions.

Lower rates of return and an aging population make pension reform in Texas vital. Modifications like those passed in 2013 and 2015 have bought some time for the plans, but these adjustments do little to change the long-term cost trajectory. Much more substantive changes are needed to retain solvency.

Moving Texas' public pension systems away from the defined benefit system and into a defined contribution model would restore sustainability in the system, benefitting both the taxpayers and state employees. Defined contribution plans put the power of an individual's future in their own hands instead of depending on the uncertain fortune of government-directed defined benefit plans.

The Facts

- The state's two major retirement systems, TRS and ERS, are at or below the adequate actuarial funded ratio of 80%.
- Texas' retirement system is legally liable to pay defined benefits totaling 10 to 20 times what state employees paid into the system—if investing returns drop or benefits are increased, taxpayers would be on the hook for the added exposure.
- Defined contribution systems are more sustainable than defined benefit plans since they are, by definition, fully-funded, which is why the private sector is moving in this direction.

Recommendations

- Freeze enrollment in the current defined benefit system and enroll newly hired or unvested employees in a 401(k)-style defined contribution pension plan.
- Implement either a hard or soft freeze of the system for vested employees.
- Replace current employee health care plans with Health Savings Accounts.

Resources

"A Solution to Our Public Pension Problem" by Vance Ginn and James Quintero, *Forbes* (May 2, 2016).

Now is the Time for Pension Reform by Sarah Curry, State Budget Solutions (Aug. 2015).

Keeping the Promise: State Solutions for Government Pension Reform by Senator Dan Liljenquist, American Legislative Exchange Council (Sept. 2013).

Reforming Texas' State and Local Pension Systems for the 21st Century by Arduin, Laffer & Moore Econometrics, Texas Public Policy Foundation (April 2011).

State Debt

The Issue

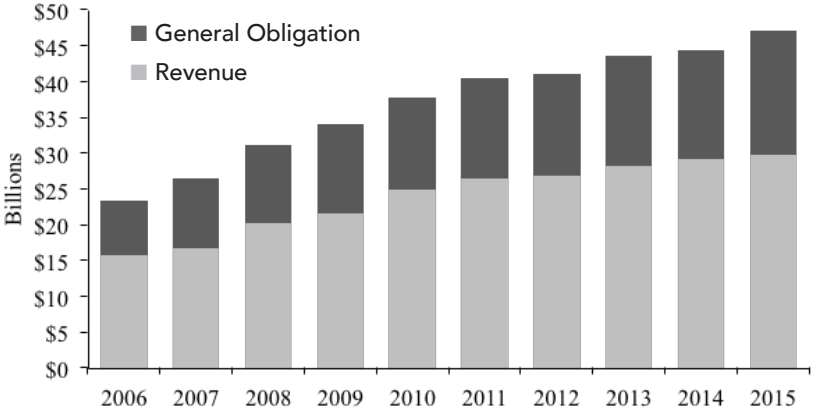
Contrary to the massive budget deficits the federal government is able to accumulate, the Texas Constitution forces state legislators to be more frugal by adopting a balanced budget. Though legislators cannot spend more than expected revenue, they can issue debt through voter-approved bond proposals for items like transportation projects, cancer research grants, and other initiatives.

Since all debt must be repaid from either the general revenue (GR) fund or specific revenue sources, more state debt results in burdening Texans with higher taxes. While new debt for these initiatives may be deemed necessary, legislators should limit increasing debt and make the cost more transparent so that Texans understand the burden on current and future generations.

In the past, the Texas Comptroller's office has taken beneficial steps in this direction by providing valuable information on the Comptroller's website texastransparency.org. However, legislators should do more by passing legislation making it mandatory to include not only the principal cost of debt (debt outstanding) but also the total cost with interest payments (debt service outstanding).

From fiscal years 2006 to 2015, the chart shows that total state debt outstanding increased by an astounding 102% to $47.1 billion, according to the Texas Bond Review Board. This translates into an increase of 53% to about $1,700 owed by every man, woman, and child in the Lone Star State. Of the total state debt outstanding, there are two types: general obligation (GO) debt and non-general obligation debt—also known as revenue debt.

Texas State Debt Outstanding for Fiscal Years 2006 to 2015



Source: Texas Bond Review Board

As defined by the Comptroller, general obligation debt "is legally secured by a constitutional pledge of the first monies coming into the State Treasury that are not constitutionally dedicated for another purpose" and "must be approved by a two-thirds vote of both houses of the legislature and a majority of Texas voters."

This debt may be issued in installments as determined by the legislatively appropriated debt service or by the issuing agency or institution and often has a 20 to 30 year maturity with level principal or level debt-service payments. Over the last decade, general obligation debt has increased by 130% to $17.3 billion.

Also noted by the Comptroller, revenue debt "includes debt that is secured by a specific revenue source and some lease purchase obligations. Generally, non-general obligation debt does not require voter approval and is not considered 'debt' limited by the Texas Constitution." Revenue debt has increased by 88.7% to $29.8 billion during the last decade.

If these trends continue, Texans will be burdened with even higher taxes and fees. A good metric of the state debt burden on each Texan is debt-per-capita. Using the latest ranking available for state debt per capita in 2013 by the Tax Foundation, Texas had the sixth lowest state debt per capita burden. Of the top five most populous states, the three most debt-ridden states are New York, Illinois, and California, which all tend to enact liberal policies.

As a percentage of unrestricted general revenue for the previous three years, the constitutional debt limit (CDL) for debt service payable is 5%. The Texas Bond Review Board shows that debt service on outstanding debt is 1.38% and debt service on outstanding debt and on authorized but unissued debt is 2.65%, which both fall below the CDL at the end of 2015.

This relatively good management of state debt provided Texas' AAA rating from all three major rating agencies since 2013. Although things look good on the surface, debt service will cut into spending on other programs and may lead to even higher taxes on Texans, slowing economic growth and individual prosperity.

Unfortunately, debt outstanding does not tell the whole story. While Texas has done relatively well managing its debt principal, debt service outstanding over the life of debt outstanding is substantially higher than the $47.1 billion. The Texas Bond Review Board notes that total debt service outstanding is $77 billion—63% more than the reported principal amount.

A grey area regarding debt is tuition revenue bonds (TRB). TRBs are obligations of the university systems that issue them and do not count against the state's debt limit because tuition revenue is pledged to service them. However, the Legislature has a practice of servicing them with general revenue. Over the next five years, Texas' state government is expected to spend nearly $1.4 billion in general revenue funds on debt service for the most recent round of TRBs, according to the Legislative Budget Board. With such a large sum of taxpayer dollars going to support these bonds through general revenue, the following question needs to be addressed: Should they be classified as general obligation bonds and require Texas voters to approve them?

By controlling spending, prioritizing debt payments, and increasing debt transparency, Texans can have a better sense of whether state lawmakers are being good stewards of their tax dollars.

continued

State Debt (cont.)

The Facts

- From FY 2006 to 2015, total state debt outstanding increased by 102% to $47.1 billion.
- Total debt outstanding per capita in Texas increased over the last decade by 53% to about $1,700 per person.
- The Bond Review Board notes that total debt service outstanding, which includes principal and interest owed, is $77 billion, or roughly $2,800 per Texan.

Recommendations

- Scrutinize all budget areas by implementing zero-based budgeting because excessive spending may result in more debt.
- Prioritize debt to consider in which order it should be paid if given the opportunity for early retirement.
- Pass legislation that provides ballot box transparency by making it mandatory to include not only the total principal cost of debt but also the total cost with interest payments and how taxes will be affected.

Resources

$15,000 Owed by Every Texan for State and Local Debt by Vance Ginn and Kiara Pillay, Texas Public Policy Foundation (April 2016).

Overview of State Debt and Other Liabilities, Legislative Budget Board (March 2016).

Debt Affordability Study, Texas Bond Review Board (Feb. 2016).

Debt at a Glance, Texas Comptroller of Public Accounts (Sept. 2013).

Taxes

Margin Tax

The Issue

Simply put, businesses don't pay taxes; consumers do in the form of higher prices, lower wages, and fewer jobs available. Given that taxes exist to fund essential government services, the least burdensome taxes should fund conservative budgets that grow by no more than population growth plus inflation.

No matter how you evaluate the margin tax, it fails the least burdensome tax test, fails to meet revenue expectations, and fails to allow Texans the opportunity to reach their full potential. Texans would be best served by eliminating this onerous tax.

The margin tax is inherently complex with multiple calculations to determine the lowest tax liability, two tax rates depending on business type, and the $1 million gross revenue exemption. Complying with it is also markedly different than complying with the federal corporate income tax, so many firms must keep separate financial books. Because of these substantial costs, firms can spend more on compliance than their actual tax liability.

This broad-based, gross receipts-style margin tax is far more complex and unique among all taxes nationwide—with only Nevada having a similar gross receipts-style tax. Since the margin tax's inception in January 2008, the Texas Comptroller's office has had difficulty accurately estimating its revenue, as noted by the cumulative $2.8 billion less in actual collections than estimated through FY 2015.

Fortunately, the 84th Texas Legislature made valiant steps to reducing the margin tax's burden. This was accomplished by cutting the tax rates by 25% and raising the ceiling to file with the E-Z computation to $20 million at a lower tax rate. These beneficial changes for a total value of $2.6 billion took effect on January 1, 2016. These cuts not only had the benefit of reducing the size of government, but employers also have more money to invest to boost the economy.

Studies modeling the dynamic economic effects of phasing out or repealing the margin tax find substantial economic benefits, including thousands of net new private sector jobs and billions in net new personal income statewide.

The Foundation's recent research includes a dynamic economic model that accounts for the private sector drain to pay for annual margin taxes and firms' cost of complying with the tax. The estimated results of full elimination before the margin tax changes made last session include:

- More prosperity: Texas could gain $16 billion in new real (inflation-adjusted) total personal income within five years compared with the baseline.
- More jobs: Net new private sector nonfarm employment could increase by 129,200 net new jobs five years after eliminating the margin tax compared with the status quo.

While eliminating the margin tax will enhance Texans' prosperity, the stakes are much higher than just one state. This transformational policy would make Texas a leader in America—and even the world—in tax policy. For example, this would allow Texas to join just three other states (i.e., Nevada, South Dakota, and Wyoming) without a corporate or individual income tax.

Slower economic growth statewide may leave a tight budget in the 2017 Legislature. However, this should not negate taking additional steps to achieve the ultimate goal of eliminating the margin tax. While cutting the tax results in a short-run drop in tax revenue, the associated dynamic increase in economic activity will likely generate additional tax revenue through other taxes that could replace some of the drop.

Depending on the fiscal and political environment, eliminating the margin tax in the next budget cycle may not be an option. Therefore, a valuable alternative is to pass legislation that would phase it out over the next two budget cycles. While phasing it out with certainty is a good option, it does reduce the potential economic gains, particularly by leaving in compliance costs. In addition, if the phase out path is chosen, it is preferable to lower the tax rates for everyone instead of raising the revenue exemption threshold that forces the burden on fewer firms.

The Facts

- Texas' margin tax is complex, costly, and difficult to comply with, giving rise to a less competitive business tax climate, for which the Tax Foundation ranks Texas 10th.
- The margin tax fails to be anything similar to a least burdensome tax, fails to meet revenue expectations, and fails to allow Texans the opportunity to reach their full potential.
- Texas does not have a revenue problem. From the 2004-05 to the 2016-17 budgets, the state's estimated total tax collections increase is 75%, much faster than the 51% growth rate of population plus inflation.

Recommendations

- Eliminate the business margin tax. An option is to phase it out over two biennia by cutting the rates. The combination of potential budget surpluses, increased tax revenue from economic growth, and modest spending restraint could fund this without imposing a new tax.
- Pass legislation requiring a supermajority (two-thirds) vote of each chamber to raise taxes or create a new tax.

Resources

Failure of Texas' Business Margin Tax by Talmadge Heflin and Vance Ginn, Texas Public Policy Foundation (Dec. 2015).

Economic Effects of Eliminating Texas' Business Margin Tax by Vance Ginn and Talmadge Heflin, Texas Public Policy Foundation (March 2015).

The Texas Margin Tax: A Failed Experiment by Scott Drenkard, Texas Public Policy Foundation (Jan. 2015).

Supermajority Requirement to Raise Taxes

The Issue

Since an increase in taxes burdens Texans, the Legislature should not raise taxes unless there is a broad consensus. Whether the state's coffers are flush or tight each session, taxpayers would benefit from a mechanism that appropriately checks the growth of government tax collections.

The challenge for conservatives is to develop a tax system that generates sufficient revenue to pay for essential government services while doing the least economic harm to consumers and employers.

The state's current tax system is expected to collect $93.1 billion in 2016-17, 75% more than the $53.3 billion it collected in 2004-05. By comparison, the compounded rate of population growth plus inflation over this period is only 51%, indicating that the tax system brings in more revenue than necessary to fund essential services.

The sales tax is expected to represent 64% of total tax collections in 2016-17 and has increased by 89% since 2004-05. As compared with the other major forms of taxation, research finds that the sales tax has been the least intrusive, the easiest to understand and pay, and is generally well-guarded against manipulation. To put it succinctly, a sales tax is the most efficient. For these reasons, the sales tax is by far the most preferable form of taxation to do the least economic harm.

Fortunately, Texas does not have a personal income tax. Research shows that the past 10-year economic performance of the nine states without a personal income tax clearly surpasses the economic performance of the nine states with the highest personal income tax rates and the 50-state average. This includes higher growth rates of gross state product, nonfarm employment, population, and state and local tax revenue.

To adhere to prudent policy that limits a rising tax burden on Texans, legislators should consider passing legislation requiring a two-thirds supermajority of the Legislature to raise taxes instead of the current simple majority requirement. Texas should be leading the way on this issue; instead, it lags behind 17 states that have some form of this requirement, according to the Washington Policy Center.

For the last two sessions, Senate Joint Resolution 27 would have achieved the goal of requiring a supermajority vote "for passage of a bill that imposes a new state tax or increases the rate of an existing state tax above the rate in effect on the date the bill was filed." But it died in committee both times.

Considering that taxes affect us all and with so much at stake—jobs, the economy, and Texans' financial well-being—legislators should conduct prudent public policy by enacting a higher threshold to raise taxes or pass a new tax.

The Facts

- A sales tax is preferable because it is simple, transparent, and levied only on the end-user.

- The 10-year economic performance of the nine states without a personal income tax clearly surpasses the economic performance of the nine states with the highest income tax rates.
- Since an increase in taxes burdens Texans, taxes should be raised with only a broad consensus.

Recommendations

- State and local governments should continue to rely on the sales tax as their main source of revenue.
- Pass legislation to require a supermajority (two-thirds) vote of each chamber to raise taxes or create a new tax.

Resources

The Freedom to Own Property: Reforming Texas' Local Property Tax by Kathleen Hunker, James Quintero, and Vance Ginn, Texas Public Policy Foundation (Oct. 2015).

How Big Government Hurts the Economy by Chuck DeVore, Nicholas C. Drinkwater, Arthur B. Laffer, and Stephen Moore, Texas Public Policy Foundation (Nov. 2013).

Testimony Regarding Senate Joint Resolution 27 by Talmadge Heflin, Texas Public Policy Foundation (April 2013).

Property Tax-Sales Tax Swap

The Issue

Texas' local property tax burden ranks 14th highest nationally and weighs heavily on homeowners and businesses statewide; but research suggests that relief may be only a few modest reforms away.

Local property taxes levied across the state increased by 101.1% compared with only a 70.3% increase in compounded population growth plus inflation from fiscal years 2000 to 2013. This substantial increase in property taxes has increased property owners' mandated tax liability by almost 30% to 9.8% of the state's median income during this period. Meanwhile, state sales tax revenue, supported by discretionary purchases, rose by 86.2%.

Voters also recently indicated their concern about the mounting property tax burden by their response to Proposition 1 on the March 2016 Republican primary election ballot that read: "Texas should replace the property tax system with an alternative other than an income tax and require voter approval to increase the overall tax burden." It passed by a wide margin with 69.5% in favor.

According to a Texas Public Policy Foundation study *The Freedom to Own Property: Reforming Texas' Local Property Tax*, Texas can entirely eliminate the property tax burden by replacing it with a reformed sales tax.

Of all the major taxes, a consumption tax (or sales tax) is the most preferable for three reasons: it is simple, transparent, and levied only at the end-user, which provides some discretion over one's tax liability. In terms of simplicity, the sales tax is among the easiest for taxpayers to understand and pay since the rate is generally known beforehand and levied automatically at the time of purchase. This unique feature sets the sales tax apart from most other taxes laden with time-consuming paperwork and other compliance costs.

The study highlights a revenue neutral swap by reasonably adjusting the state sales tax base and rate outlined in the Foundation's publication authored by the famed economist Dr. Arthur Laffer. Abolishing local property taxes and changing the current 8.25% maximum state and local sales tax rate to achieve the swap could include a reformed sales tax rate of:

- 15.7%, if the current sales tax base is used including the sale of property; or
- 11%, if all services that are taxed in at least one state are taxed in Texas including the sale of property.

One of these swaps would provide meaningful tax relief for property owners, and it would have the added benefit of strengthening the state's economy by encouraging capital investment—the primary driver of economic growth and job creation.

Based on the property tax-sales tax swap, with the 11% sales tax rate option, the Foundation estimates over a five-year period personal income could increase by as much as $63 billion, or 4.7%, higher than under the current tax system. This increase in economic activity could contribute to 337,400 net new jobs statewide

compared with no tax reform. Put simply, Texans are not able to reach their full potential from the current property tax system.

Perhaps the greatest incentive for property tax reform has nothing to do with tax relief, creating wealth, or adding new jobs; it has to do with liberty. So long as Texas' property tax remains in place, no person who lives in a home, operates a business, or has property of any kind, will ever truly own any of these. Right now, Texans effectively rent from the government, indefinitely.

The evidence supports the case for replacing property taxes with a reformed sales tax; now the political will is needed to enact such a prosperity-generating reform.

The Facts

- Repealing local property taxes and replacing the revenues with a reformed sales tax would provide meaningful tax relief, generate added wealth, spur job creation, and protect the rights of property owners.
- Over a five-year period, the Foundation's property tax reform proposal would help create tens of billions of dollars in net new personal income and hundreds of thousands of net new jobs.

Recommendations

- Abolish local property taxes and replace them with a reformed sales tax that includes an adjusted tax base and rate.
- Ideally, the reformed sales tax would closely resemble an 11% sales tax rate and an adjusted base that includes all services taxed in at least one other state, including the sale of property.

Resources

The Freedom to Own Property: Reforming Texas' Local Property Tax by Kathleen Hunker, James Quintero, and Vance Ginn, Texas Public Policy Foundation (Oct. 2015).

Enhancing Texas' Economic Growth through Tax Reform by Donna Arduin and Arthur Laffer, Texas Public Policy Foundation (Aug. 2012).

Texas Property Tax Challenge: The True Cost of Owning Property in Texas by Talmadge Heflin and James Quintero, Texas Public Policy Foundation (Aug. 2008).

The Case for Converting from Property Taxes to Sales Taxes by Talmadge Heflin, Texas Public Policy Foundation (March 2008).

Personal Income Tax

The Issue

Although no one likes to pay taxes, they are an inevitable part of funding core government functions. A policymaker's challenge is to develop an efficient tax system that provides necessary revenue while doing the least economic harm. A policymaker should take care, however, as not all methods of raising revenue are created equal.

While each tax affects behavior and distorts choices differently, the personal income tax is among the most pernicious because of the negative effects it has on earnings, productivity, and wage gains. As a consequence of these adverse effects, people are generally not able to save and consume as much as they would have otherwise. What's more, a personal income tax requires a particularly large bureaucratic apparatus for tax collection purposes, much more so than for the collection of a sales tax. With more bureaucracy comes additional costs for taxpayers which results in higher taxes and fees.

The absence of a personal income tax is ideal for state lawmakers as there are other ways to raise revenue without incurring such harmful economic effects or enlarging the bureaucracy. And to its credit, Texas is one of only nine states without a personal income tax.

While some argue that a broad-based personal income tax is needed to improve the state's overall outlook, this raises the question: How has Texas' economy performed without a personal income tax?

Texas' state and local tax burden ranks 46th nationally, according to the Tax Foundation's latest report, placing it among the very best states for taxpayers. Because of the state's comparatively friendly tax environment, Texas' private sector economy has surged forward, outperforming the nation as a whole in a number of key areas, such as:

- Texas' economy grows faster than the national average. In 2014, Texas' real gross domestic product grew by 5.2%, more than twice as fast as the national average of just 2.4%;
- Texas creates jobs at a faster rate than the rest of the nation. From 2000 to 2015, average annualized nonfarm employment increased by 1.6% in Texas while the U.S. average increased by only 0.6%;
- Texas creates a large share of U.S. jobs since the Great Recession. Texas replaced the total civilian jobs lost during the recession by December 2009; however, the rest of the U.S. did not reach its pre-recession level until January 2015 and did not surpass Texas' job creation until November 2015; and
- Texas has had a lower unemployment rate than the U.S. average. From 2000 to 2015, Texas' average unemployment rate of 5.8% was lower than the U.S. average of 6.3%, and through March 2016, Texas' rate had been at or below the U.S. average for 110 consecutive months.

Research finds clear differences among the nine states without a personal income tax compared to the nine with the highest marginal personal income tax rates and the 50-state average. The following table shows that in every category examined

the states without an income tax performed better than those with the highest income tax rates. In addition, the nine states without a personal income tax outperformed the national average in every category, often by a wide margin. Based on economic principles and empirical data, Texas' economic prospects for its citizens are best served by its current low tax, pro-growth approach rather than a new income tax.

Nine States with the Lowest and Highest Marginal Personal Income Tax (PIT) Rates (10-Year Economic Performance)

	1/1/15	2004-2014	2005-2014	2004-2014	2004-2014	2004-2014	2002-2012
State	Top Marginal PIT Rate**	Population	Net Domestic Migration†	Non-Farm Payroll Employment	Personal Income	Gross State Product	State & Local Tax Revenue‡
Alaska	0.0%	11.7%	-2.9%	11.2%	65.5%	60.7%	318.8%
Florida	0.0%	14.2%	4.4%	4.6%	43.1%	31.8%	44.0%
Nevada	0.0%	21.0%	7.0%	5.4%	35.9%	27.7%	65.1%
South Dakota	0.0%	10.7%	2.8%	10.3%	57.4%	49.0%	57.2%
Texas	0.0%	20.4%	5.4%	21.7%	75.9%	78.6%	65.7%
Washington	0.0%	14.3%	4.3%	12.3%	54.5%	57.2%	50.8%
Wyoming	0.0%	14.7%	4.9%	14.6%	76.4%	86.4%	111.5%
New Hampshire^	0.0%	2.8%	-0.3%	3.3%	43.0%	34.6%	46.5%
Tennessee^	0.0%	10.8%	4.5%	4.0%	45.6%	36.3%	54.0%
Average of 9 No Income Tax States*	0.0%	13.4%	3.3%	9.7%	55.3%	51.4%	90.4%
50-State Average*	**5.6%**	**8.8%**	**0.7%**	**6.1%**	**48.4%**	**43.6%**	**63.0%**
Average of 9 Highest Income Tax States*	10.4%	6.8%	-2.1%	4.7%	44.3%	40.1%	58.4%
Kentucky	8.2%	6.4%	1.3%	3.9%	42.7%	38.7%	39.4%
Maryland	9.0%	7.7%	-2.5%	4.0%	42.1%	40.9%	52.0%
Vermont	9.0%	1.1%	-1.5%	2.3%	41.8%	31.4%	63.6%
Minnesota	9.9%	7.3%	-1.3%	4.9%	41.7%	36.4%	52.3%
New Jersey	10.0%	3.5%	-6.0%	-0.9%	36.5%	29.5%	55.5%
Oregon	10.6%	11.2%	5.1%	7.2%	46.7%	51.3%	64.3%
Hawaii	11.0%	11.5%	-2.6%	7.2%	52.9%	45.2%	74.8%
New York	12.7%	3.0%	-7.5%	7.4%	47.3%	47.2%	70.7%
California	13.3%	9.1%	-3.4%	6.3%	47.1%	40.6%	52.5%

** Equal-weighted averages.*
*** Top marginal PIT rate is the top marginal tax rate on personal earned income imposed as of 1/1/2015 using the tax rate of each state's largest city as a proxy for the local tax. The deductibility of federal taxes from state tax liability is included where applicable.*
† Net domestic migration is calculated as the ten-year (2005-2014) sum of net domestic in-migrants divided by the mid-year (2010) population.
‡ 2002-2012 due to Census Bureau data release lag.
^ Tennessee and New Hampshire tax interest and dividend income but not ordinary wage income.

Source: Laffer Associates, U.S. Census Bureau, Bureau of Labor Statistics and Bureau of Economic Analysis

continued

Personal Income Tax (cont.)

The Facts

- Texas is one of nine states without a personal income tax.
- Personal income taxes substantially damage a state's economy because they discourage savings, investment, productivity, job creation, and economic expansion.
- The nine states without a personal income tax outperformed the nine states with the highest marginal income tax rates and the 50-state average in nearly every important economic area from 2004 to 2014.

Recommendations

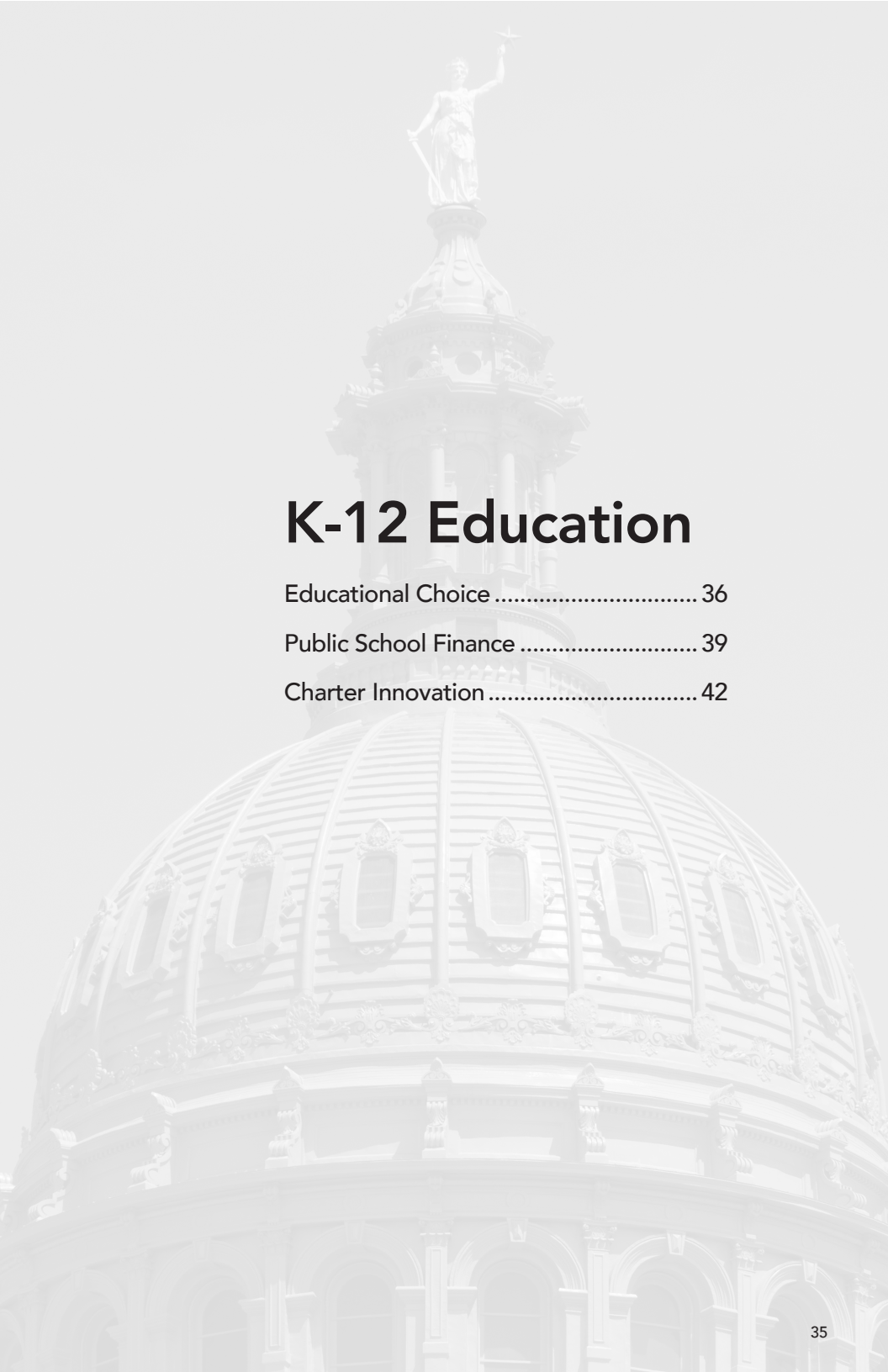
- Never create a personal income tax in Texas.
- Encourage economic growth by keeping taxes low and adopting pro-growth reforms.

Resources

A Labor Market Comparison: Why the Texas Model Supports Prosperity by Vance Ginn, Texas Public Policy Foundation (Oct. 2015).

Rich States, Poor States by Arthur B. Laffer, Stephen Moore, and Jonathan Williams, American Legislative Exchange Council (Oct. 2015).

How Big Government Hurts the Economy by Chuck DeVore, Nicholas C. Drinkwater, Arthur B. Laffer, and Stephen Moore, Texas Public Policy Foundation (Nov. 2013).



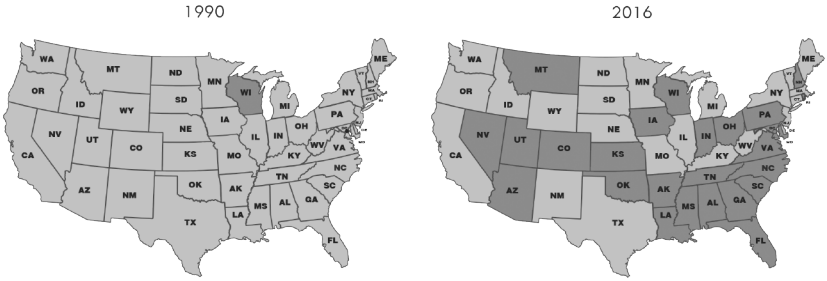
K-12 Education

Educational Choice

The Issue

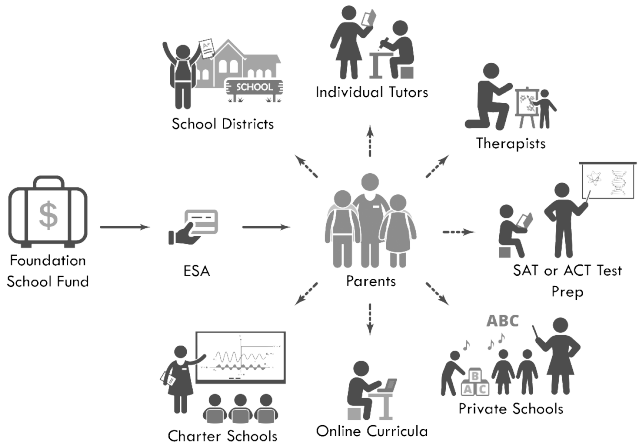
A majority of states have some form of private school choice. Texas has none. Every Texas child should be afforded the opportunity to select the educational options which best suit his or her individual needs.

The Spread of Educational Choice, 1990-2016



Texas is behind many states in educational opportunity. In 2015, Nevada passed the most comprehensive choice program in the nation that would allow almost every student in the state the freedom to select the best educational program for his or her own educational needs. Nevada did this through the Education Savings Account (ESA) program. An ESA is innovative because it can be used for a variety of educational expenses throughout a school year, including therapy, tutoring, test fees, textbooks, transportation expenses, or tuition. In addition, families can roll-over unused ESA dollars from one school year to the next. Funds remaining upon graduation can be used for higher education. Modeled after Health Savings Accounts, the ESA concept provides an offset to many of the third party pay problems inherent in education today. The figure below illustrates how ESAs might work.

Reformed Flow of Funds through ESAs



Half the nation's state legislatures have established school choice. ESAs have been established by legislatures in Nevada, Arizona, Tennessee, Mississippi, and Florida. Nevada's program is the leading model because of its near-universal availability. Nevada students are eligible for the program if they have been enrolled in public schools for 100 days prior to receiving the ESA. Students receive one of two possible ESA amounts: students who have disabilities or are eligible for the Federal Free and Reduced Price Lunch Program will receive about $5,700 in the 2015-16 school year; all other ESA students receive about $5,100. In Arizona, which has had an ESA since 2011, parents have taken full advantage of the program's flexibility. About one-third of ESA funds are expended on multiple items; in other words, a sizable number of parents choose not to use the entire ESA on tuition. In addition, when Arizona parents were given the option to roll-over unused dollars and spend them on future educational expenses—such as college tuition—they rolled-over an average of 30% of their ESA allotment.

Student performance improves as a result of educational choice. According to the Friedman Foundation, of 12 empirical studies on this topic, 11 found that student achievement improved and one found no measurable impact. Choice also has improved public school performance. Of 23 empirical studies surveyed by the Friedman Foundation, 22 found that public schools improve when students are allowed a choice. Only one found no measurable improvement. What follows is a summary of social science research on this topic; citations to these studies are contained in *Texas School Finance: Basics and Reform* (p. 58):

- A 1998 peer-reviewed study by MIT scholars found that math scores of Milwaukee school choice participants improved by 1.5-2.3 percentage points.
- A 1999 peer-reviewed study by UT Austin and Harvard scholars found that, in Milwaukee, reading scores of students in the fourth year of their choice program had improved by 6 percentile points; math scores improved by 11 points.
- A 2002 study by Stanford economists found that programs in Wisconsin, Michigan, and Arizona improved public school district achievement in Reading, Math, Science, and Social Studies.
- A 2003 peer-reviewed study by scholars at Johns Hopkins, Columbia, and Harvard found a 3-percentile point increase in math scores for African-American children and stated that choice programs have "greater potential benefit for children in lower-scoring schools."
- A 2001 study by Education Next (a non-profit journal) found that choice students in Charlotte, NC, scored 5.9 percentile points higher on math tests and 6.5 percentile points higher on reading tests.
- A 2010 peer-reviewed study from Harvard University scholars found that New York public school students in choice programs improved their math and reading scores. Math scores of students who came from low-performing public schools increased by 4-5%; reading scores increased by 2-3%.
- A 2010 study by the Federal Department of Education found that the school choice program in Washington, D.C. increased high school graduation rates from 70% to 82%.

continued

Educational Choice (cont.)

- A 2008 peer-reviewed *Policy Studies Journal* article confirmed the reading score improvement from the 2001 *Education Next* study, but did not find a change in the math scores.
- A 2006 Brookings Institution study found that African-American students in Washington, D.C., Dayton, OH, and New York, NY, scored 6 percentile points higher on their Iowa Tests than students who remained in their former school.
- A 2012 joint study by the Brookings Institution and Harvard University looked at New York's school choice program. They found that college enrollment by African-American school choice students increased by 25%. They also found that African-American enrollment in selective colleges (which have an average SAT of 1100 or greater) more than doubled.

The Facts

- Universal educational choice could lead to an additional 65,000 students graduating from high school each year as opposed to dropping out of school.
- Public schools will improve with the implementation of universal choice.
- Universal choice will drive up teacher pay as schools divert more funds to classrooms—where they have the greatest effect on students.

Recommendation

- Promote educational excellence in Texas by adopting ESAs for all Texas students, and establish a variety of educational choice alternatives.

Resources

The Education Debit Card II: What Arizona Parents Purchase with ESAs by Lindsey Burke (Feb. 2016).

ESA Handbook: A Parent's Guide, Arizona Department of Education (Aug. 2014); and *ESA Parent Handbook* by the Nevada State Treasurer (Jan. 2016).

Texas School Finance: Basics and Reform by Michael Barba, Kent Grusendorf, Vance Ginn, and Talmadge Heflin, Texas Public Policy Foundation (March 2016).

2015-2016 National School Choice Yearbook, American Federation for Children (April 2016).

How School Choice Affects the Achievement of Public School Students by Caroline Hoxby, Hoover Institution Press (2002).

Evaluation of the DC Opportunity Scholarship Program: Final Report by Patrick Wolf, Babette Gutmann, Michael Puma, and Brian Kisida, U.S. Department of Education (June 2010).

School Choice and Climate Survey, Grand Prairie ISD (Dec. 2014).

How ESAs Can Keep Texas the Land of the Free and Home of the Brave by Kent Grusendorf and Nate Scherer, Texas Public Policy Foundation (Jan. 2016).

Moral Case for School Choice by Michael Barba and Kent Grusendorf (Sept. 2014).

Public School Finance

The Issue

The Texas Constitution establishes public education through Article VII, Section 1, requires "an **efficient** system of public free schools." [emphasis added].

In the 2014-15 school year, Texas taxpayers spent a total of $60.98 billion on public education, according to the Texas Education Agency's (TEA) 2014-15 Financial Actual Report. In the same school year, there were 4,778,559 students attending Texas public schools. As a result, Texans spent $12,761 per student. (For context, the average tuition for accredited private schools in Texas was only $7,848.) Therefore, Texans spend about $255,000 for a classroom of 20 students. At the same time, according to TEA's 2014-15 Texas Academic Performance Reports (TAPR), the average annual salary for teachers was $50,715. Resources are not currently allocated in the most efficient manner to help Texas students.

As the District Court ruled in 2014, "hundreds of thousands" of Texas students are being underserved by the system. According to Judge John Dietz, "all performance measures considered at trial demonstrated that Texas public schools are not accomplishing a general diffusion of knowledge." He concluded, and the Texas Supreme Court confirmed, that the education funding structure is outdated and significantly flawed, however, he erroneously concluded that more money would resolve the systematic problems.

Public education is funded by an unnecessarily complex and inefficient system which is not student-centered. Texas' funding formulas have been cobbled together based on political dynamics, not by what works for students. As a result, the system is not efficient. In addition, the system is not equitable on a student basis, instead, all prior efforts are designed around equity for school rather than students. Detailed solutions to this problem are outlined in our *Basics and Reform* study. (p. 49-56)

The Texas Supreme Court concluded in West Orange Cove II that, "Pouring more money into the system may forestall [constitutional] challenges, but only for a time." The Texas Legislature must offer a solution to the fundamental problem of our system, which is that the system is not student-centered. This can be accomplished by reforming the student allotment based upon the following principles:

1. Shift the focus from equity for schools to equity for students.
2. Assure that the student's allotment is portable.

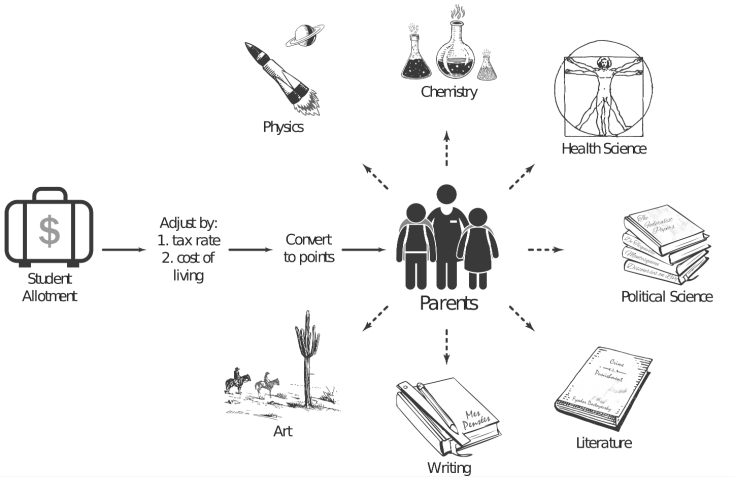
The state should establish a single student allotment, which we call the General Diffusion of Knowledge (GDK) Allotment. That allotment should then be subject to only two adjustments. First, it should be adjusted by a local school district's Maintenance and Operation (M&O) property tax rate in order to comply with the court's requirement of similar revenue at similar tax rates. For example, if the GDK Allotment were $8,000, a district with an M&O tax rate of $1.10 would be adjusted to $8,800. Second, this amount would then be adjusted for regional cost differentials based upon the U.S. Department of Commerce's Regional Price Pari-

continued

ties (RPP1) for Metropolitan Statistical Areas. With only these two adjustments, the system would increase student equity, provide transparency, and enhance efficiency.

Structural efficiency would be improved when the allotment is made portable. Funds should be portable based upon parental discretion. Such a system encourages continued dialogue between parents and school districts, and public schools begin to adjust their course offerings based on parent feedback. Early adopters of educational choice, such as Grand Prairie ISD, have found that parent satisfaction increases, and 90% GPISD teachers want to expand the choice system. As the figure below illustrates, this would effectively tie the allotment to the student, allowing them to pursue differing options based on their individual needs.

Reformed Flow of Funds within School Districts



In such a system, education finance would be transparent, efficient, and equitable. Furthermore, educators should be freed of most unnecessary regulations which excessively burden them today. Educational consumers—parents and students—would have flexibility in the ways they allocate their education dollars within the public school system. By restructuring school finance in this manner, a real market for educational services will be created within individual schools, within school districts, and throughout the state, thereby resulting in significant improved efficiencies, effective resource allocation, and superior student performance.

The Texas Supreme Court, which has dealt with school finance reform for the last 30 years, has repeatedly encouraged the Legislature to make structural reforms to the system, and did so even more forcefully in its 2016 opinion. Student-centered funding would offer Texas children the lasting promise of excellent education and equal opportunities for success.

The Facts

- Total public education expenditures in the 2014-15 school year were $60.98 billion. With 4,778,559 students in average daily attendance (ADA), per student spending is $12,761.
- The average tuition of an accredited private school in Texas is $7,848.
- A "disastrous" 14-25% of public school students fail to graduate from high school (*TTSFC v. Michael Williams, Finding of Fact*, 205-207).
- Only 18% of high school graduates from 2010-13 met the SAT or ACT college-readiness standards (*Finding of Fact*, 160).
- One-third of English Language Learners (ELL) in grades 3-12 failed to progress a grade level in English (*Finding of Fact*, 352).
- Not one student performance measure examined by the district court demonstrated sufficient student achievement (*Conclusion of Law*, 71).
- Per Judge Dietz, the system is failing to meet the needs of "hundreds of thousands" of Texas students (*Executive Summary* at page 3 and 5).

Recommendations

- Implement a student-centered funding structure for public education based solely on the delivery of a general diffusion of knowledge.
- Ensure that allotments are transparent, equitable, and portable.
- Deregulate public schools and allow educators to operate as professionals.

Resources

Texas School Finance: Basics and Reform by Michael Barba, Kent Grusendorf, Vance Ginn, and Talmadge Heflin, Texas Public Policy Foundation (March 2016).

Texas Education: Original Intent of the Texas Constitution by Kent Grusendorf, Texas Public Policy Foundation (July 2014).

How School Choice Affects the Achievement of Public School Students by Caroline Hoxby, Hoover Institution Press (2002).

Evaluation of the DC Opportunity Scholarship Program: Final Report by Patrick Wolf, Babette Gutmann, Michael Puma, and Brian Kisida, U.S. Department of Education (June 2010).

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What Keeps Texas Schools from Being as Efficient as They Could Be? by Dr. Paul Hill (July 2012).

Eric Hanushek's Expert Report for School Finance Trial by Kent Grusendorf, Michael Barba, and Dianna Muldrow, Texas Public Policy Foundation (Oct. 2014).

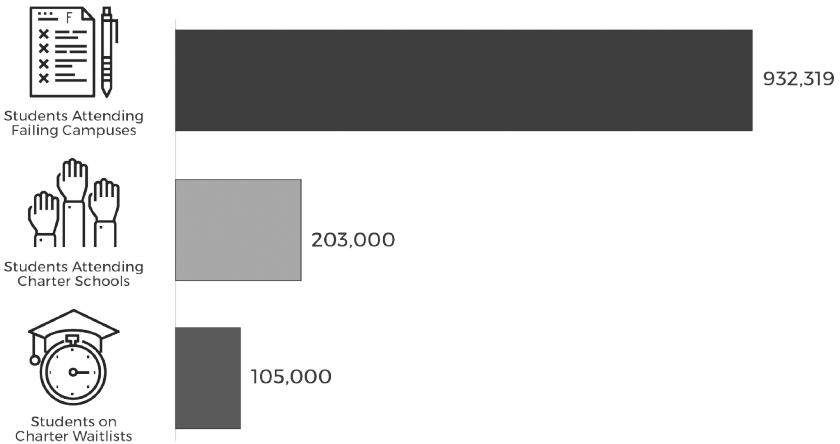
Charter Innovation

The Issue

While traditional school officials fear change, research by many economists indicates that competition from charter schools improves traditional public education. Texans must insist on doing what is best for students and teachers rather than what is demanded by those stakeholders who primarily want to defend the status quo. We should remove all restrictions inhibiting student achievement and act in the best interest of the students, teachers, and taxpayers.

One way to increase the efficiency of the education system is through the strategic expansion of charter schools. Charters provide the choice and competition needed to drive improvements to better meet consumer demand. However, charter schools are greatly restricted from growing naturally, which has led to a significant disparity between high demand and low supply. Currently, according to the Texas Education Agency, 1,532 Texas public school campuses are rated as underperforming and over 930,000 students are assigned to these failing schools. At the same time, charter enrollment sits at only about 200,000, while another 105,000 students are on waiting lists to get into a charter school that may better fit their individual needs. The figure below illustrates this problem. The Texas Legislature can make several reforms to improve this situation.

Students in Failing Schools, Students in Charter Schools, and Students on Charter Waitlists, 2015



Remove the Artificial Cap

Currently, the Texas Education Code (12.101(b-1)) limits the number of charters that the state can grant. While this cap continues to increase, its original intent was to limit the number of charter schools and slow their growth. Texas should remove the artificial limit on the number of open-enrollment charters and thereby provide more educational opportunities for future Texas students.

Establish Professional Charter Academies

Great teachers are trapped in a system which stifles innovation and undervalues their talents. Teachers are by far the most important component to successful schools and successful students, however, the traditional system often fails to fully recognize and reward their talents.

In other fields (law, medicine, accounting, engineering, etc.), professionals are afforded the opportunity to control their professional activities and reap the rewards of their individual talents through management of their own professional enterprise. A lawyer can begin his/her own firm, a doctor, his/her own practice. However, because our school finance system ties student allotments to districts rather than students themselves, most professional educators do not have that same opportunity.

Under a Professional Charter plan, experienced and highly rated educators would be able to start their own schools and receive state funding. In fiscal year 2014, M&O averaged $8,692. If five teachers started their own Professional Charter school, rented appropriate facilities, and educated 125 students, their annual revenue would be over one million dollars. While the 2014-15 Texas Academic Performance Reports shows that the average annual salary for teachers was only $50,715, under a Professional Charter system, these teachers might double their take-home pay even after covering all expenses. At the same time, they would have increased freedom from arbitrary curriculum and administrative requirements, would have greater flexibility in meeting the needs of their students, and would enjoy greater job satisfaction.

Public school teachers would be eligible for a Professional Charter if they have 5 years of experience and are rated proficient or higher by the Texas Teacher Evaluation System. No students would be assigned to a Professional Charter school; however, any Texas student would be eligible to attend. As with other professions, start-up expenses would be the responsibility of those forming the venture. The state would reimburse the professional charter holders at the end of the school year, which allows the state to avoid any financial risk caused by failed start-ups. In such a system, teachers who provide a great education for students would see a direct and immediate reward for their efforts both fiscally and professionally.

The Facts

- Educators are professionals who are effectively denied the same opportunities as other professionals.
- Many great teachers leave the profession frustrated over red tape and lack of discretion to do their jobs as they know best.
- Education is still primarily delivered through an institutional system designed over a century ago.
- According to NEA polls, teachers are not feeling trusted or respected by their administrators.
- Many school administrators oppose expansion of student and teacher choice due to self-interest.

continued

Charter Innovation (cont.)

- Restricting supply side change has protected the status quo at the expense of Texas students, taxpayers, and teachers.
- Artificial restrictions on the number of open-enrollment charter schools prohibit many students from exercising their freedom of educational opportunity.
- Over 100,000 children are on charter school waiting lists.

Recommendations

- Allow teachers to form and operate Professional Charter Academies.
- Remove the statutory cap on charter schools contained in Texas Education Code 12.101.

Resources

Urban Charter School Study Report on 41 U.S. Regions by the Center for Research on Education Outcomes (2015).

National Charter School Study by the Center for Research on Education Outcomes (2013).

What Keeps Texas Schools from Being as Efficient as They Could Be? by Dr. Paul Hill (July 2012).

Allan E. Parker's Expert Report for School Finance Trial by Kent Grusendorf and Michael Barba, Texas Public Policy Foundation (Jan. 2015).

Would School Choice Change the Teaching Profession? by Caroline Hoxby, *Journal of Human Resources* (Fall 2002).

How School Choice Affects the Achievement of Public School Students by Caroline Hoxby (2002).

Competition: For the Children by Chuck DeVore, Texas Public Policy Foundation (June 2016).

Higher Education

Higher Education Affordability

The Issue

Over the past quarter-century, average tuition has jumped 440%—four times the increase in general inflation and twice that of health-care costs. To pay for these historic price increases, students and their parents have amassed historic debt. Student-loan debt now stands at $1.3 trillion, for the first time ever surpassing total national credit-card debt.

Increases in federal student aid lead to corresponding increases in tuition sticker price, in what is known as the Bennett Hypothesis. For example, each additional Pell Grant dollar to an institution leads to a roughly 40 cent increase in sticker-price tuition. Federal regulations also raise the cost of higher education. Regulatory compliance accounts for 2% to 8% of a typical institution's non-research expenditures, costing the higher education sector an estimated $27 billion annually.

The resulting tuition and student-debt inflation has coincided with a period of sustained administrative bloat. Teachers now make up less than half of college employees on the average college campus. Between 1993 and 2007, the number of full-time administrators per 100 students at America's leading universities grew by 39%, while the number of employees engaged in teaching, research or service grew by only 18%. A poll of Texas voters found that reducing administrative overhead was one of the three most popular strategies for addressing budget shortfalls at the state's postsecondary institutions.

Texas voters' support for reducing administrative costs reflects a broader theme about how Texans see higher education affordability. In Texas, 71% of voters believe universities can improve teaching while reducing costs. In this spirit, Texas' higher education sector has spent several years developing new programs seeking to make higher education more affordable for both students and taxpayers.

Now entering its third year, the Texas Affordable Baccalaureate Program (TABP) continues to develop its approach for meeting Governor Perry's $10,000 Degree Challenge from 2011. The program, which can already provide qualifying returning students with baccalaureate degrees for between $4,500 and $6,000, recently received a $400,000 grant from AT&T to help it scale from two schools to ten. The College Credit for Heroes Program (CCH), which uses competency-based education to award veterans with credit for skills they acquired during service, has expanded from 4 schools in 2011 to 42 schools in 2016. Over 250,000 credit hours have been awarded through the program at a cost of less than $5 million, corresponding to a rate of less than $20/credit hour.

Texas can build on the successes of programs like the TABP and CCH by emulating these programs' strengths, and by experimenting with other creative approaches to making higher education more affordable. Schools across the country have reduced costs while maintaining institutional quality with innovations such as discounted Friday and weekend classes, three-semester calendars, debt counselors, and "online campuses" serving rural regions. With federal student aid—and its associated effect on tuition sticker price—not disappearing any time soon, Texas will need to get creative when designing policy solutions to make higher education in the state more affordable.

The Facts

- A national Pew survey finds 57% of prospective students believe a college degree no longer provides value equal to its cost, and 75% deem college simply unaffordable.
- Pell Grants have a pass through effect on tuition of 40 cents on the dollar. This pass through effect is about 60 cents on the dollar for subsidized loans and 15 cents on the dollar for unsubsidized loans.
- An assessment of thirteen postsecondary institutions across the U.S. found the cost of federal compliance varied from 3% to 11% of total nonhospital operating expenditures.
- Compliance costs for research are particularly steep: Research-related compliance as a percentage of research expenditures ranges from 11% to 25%.
- Asked how schools should address shortfalls, Texas voters' three favorite options were reducing administrative overhead, delaying new facilities, and requiring professors to teach more. Raising tuition or taxes were the least favorable options, garnering 6% and 10% respectively.

Recommendations

- Exempt affordable degree programs (such as the TABP) from formula funding restrictions based on past student performance—including the 30-hour, 45-hour, drop-6, and 3-peat rules—by updating and passing HB 1502 (2015-R).
- Encourage reductions in administrative budgets—like the Texas A&M system's 3.6% cut in its administrative budget between 2011 and 2015.
- Develop College Credit for Heroes, and other competency-based education designed for veterans, as a way to defray the cost of the Hazlewood program.

Resources

The Cost of Federal Regulatory Compliance in Higher Education: A Multi-Institutional Study by the Boston Consulting Group, Vanderbilt University (Oct. 2015).

Revolution Rising? Update on Texas' Affordable Baccalaureate Degrees by Thomas Lindsay, Texas Public Policy Foundation (March 2015).

Winning the "Space Race": How Universities Can Maximize Existing Space to Reduce Tuitions by Thomas Lindsay, Texas Public Policy Foundation (Dec. 2014).

(Not) Cheaper by the Dozen: 12 Myths about Higher Education's Cost and Value by Thomas Lindsay, Texas Public Policy Foundation (Dec. 2013).

"Credit Supply and the Rise in College Tuition: Evidence from the Expansion in Federal Student Aid Programs" by David Lucca, Taylor Nadauld, and Karen Shen, Federal Reserve Bank of New York Staff Reports, No. 733 (March 2016).

"Our Bloated Universities" by Mary Clare Reim, SeeThruEdu (Feb. 2016).

Higher Education Quality

The Issue

Texas higher education faces a quality crisis. Students receive higher grades now than ever before, even though studies show that too many students learn too little. Yet in spite of inflated grades and a diluted curriculum, fewer than half of the students at Texas' public four-year colleges graduate within six years of enrollment.

While this is a Texas problem, it is far from Texas' alone. The academic world was rocked by the 2011 publication of the landmark study of collegiate learning, *Academically Adrift*. *Adrift* tracked a national cohort of college students for four years, measuring their fundamental academic skills—critical thinking, complex reasoning, and clear writing—in both their freshman and senior years, using the Collegiate Learning Assessment (CLA). The results are alarming: *Adrift* found that 36% of college students nationally show little to no increase in fundamental academic skills after four years invested in college.

Feeding on and fostering the student-learning crisis is the problem of college grade inflation. Research reveals that, in the early 1960s, 15% of all college grades awarded nationally were A's. But today, 43% of all grades are A's. In fact, an A is the most common grade given in college today. Moreover, 73% of all grades now are A's or B's, meaning that a majority of college transcripts now provide little context into how well the student in question performed academically, relative to their peers.

As monetary inflation devalues the dollar, so grade inflation debases the currency of higher education—student transcripts. Before grade inflation, the college transcript served as a useful tool for employers looking to assess potential hires. A recent survey commissioned by the American Association of Colleges and Universities reveals that this is no longer the case, with two-thirds of the employers surveyed indicating that college transcripts are of either "limited use" or "no use" in determining whether a job applicant will succeed on the job.

Low graduation rates constitute the most visible symptom of the quality crisis in Texas higher education. The state performs poorly against the rest of the country, with Texas' graduation rate for public four-year universities ranked 32nd in the nation. Only 30.2% of students at four-year universities in Texas graduate within four years; even fewer, 24.4%, graduate within four years from the state's public four-year universities. An even lower graduation rate prevails at Texas' two-year colleges, where only 14.5% of students graduate within three years.

Diminished standards in higher education affect the economy. An easier curriculum and inflated transcripts pass the costs of evaluating and training new employees onto the business community. Low graduation rates wreak particular havoc on the state's economy, especially on the students themselves. Extra time in school cost students twice: first for the actual cost, and second because this time could have been spent earning income, had these students graduated on time. In even worse shape are the nearly two million students in Texas who have some college credit but no degree, having taken on debt and lost time in the workforce, but with no additional earning power to show for their efforts.

The Facts

- 57% of students believe a college degree costs more than it is worth.
- 36% of college students nationally demonstrate little to no increase in fundamental academic skills after four years in college.
- Grade inflation is real and measurable: College grade point averages have increased at a rate of approximately 0.15 points per decade since the 1960s.
- 67% of employers consider college transcripts of either limited use or no use in predicting who will succeed at the company.
- Less than a quarter of students at public four-year universities in Texas graduate in four years (24.4%), and fewer than half graduate in six years (49.0%).
- 1.9 million adults in Texas have some college credit, but no degree.

Recommendations

- Encourage universities to institute regular learning outcome assessments, such as the updated Collegiate Learning Assessment (CLA+) or the Collegiate Assessment of Academic Proficiency.
- Increase the visibility of data on student academic performance, graduation rates, average post-graduate debt burden, and average post-graduate earnings, in particular by making the reading of such information a mandatory step in the ApplyTexas application process.
- Pass legislation requiring contextualized grading, which provides, alongside the grade each student received for his/her class, the average grade given by the professor for the entire class.
- Ensure that any shift in formula funding toward a performance-based distribution balances the goals of higher completion rates and lower average graduation time with maintaining course quality.

Resources

Academically Adrift: Limited Learning on College Campuses by Richard Arum and Josipa Roksa (Chicago: University of Chicago Press, 2011).

"Graduation Rates of Texas Colleges," by Jolyn Brand (Brand College Consulting, 2015).

Complete College Texas: Is Texas Utilizing Game Changer Strategies to Boost College Completion? Not Fully (Complete College America, 2013).

Combating the "Other Inflation": Arresting the Cancer of College Grade Inflation by Thomas K. Lindsay, Texas Public Policy Foundation (Aug. 2014).

How Should Colleges Assess and Improve Student Learning? Employers' Views on the Accountability Challenge (Peter D. Hart Research Associates, 2008).

Tuition Revenue Bonds

The Issue

In 1971, the Legislature began the practice of using bonds secured with the tuition revenue of public universities as part of the state's funding for capital expansion in public higher education. Of the two types of bond used for this purpose—revenue financing system bonds and tuition revenue bonds—tuition revenue bonds (TRBs) have received much greater scrutiny, especially over the past decade.

The primary criticism of TRBs addresses the fact that unlike revenue financing system bonds, which university systems must service themselves, TRB debt service is historically covered with general revenue appropriations. Even though TRBs are structured as obligations of the universities that issue them, they are ultimately paid for—principal and interest—by Texas taxpayers.

TRBs were not widely used from 1971 to 2000. The $1.08 billion in TRBs authorized in 2001 nearly doubled the amount of TRB authorization up to that point. In the aftermath of a special session in 2006, when $1.86 billion in TRBs was authorized for 63 projects across the state, the Texas Higher Education Coordinating Board was tasked with developing an objective process for evaluating TRB requests. A period of scrutiny followed between 2007 and 2014, during which the Coordinating Board began to develop better tools for objectively prioritizing capital project requests, such as the Space Use Efficiency (SUE) score. Just $168 million in TRB debt was authorized during this time, most of which went toward financing emergency capital projects on the gulf coast in the aftermath of Hurricane Ike. This period of TRB austerity ended last year, when the 84th Legislature authorized $3.109 billion in TRB debt.

Besides concerns with the growing cost of TRBs are concerns with how much scrutiny TRB requests actually face. Under standard practice, a majority of TRB requests are bundled into an omnibus TRB bill, the passage of which authorizes many lower-priority projects that might not have received approval on their own. For example, if requests from schools with a failing grade in all three SUE score categories (classroom, lab, and overall) had been removed from last session's omnibus TRB bill (HB 100), it would have cut $606 million, or 19.5%, from the bill's final cost ($1.04 billion including interest).

In spite of opposition to the way TRBs are currently used, the most frequently touted alternatives are not without their own pitfalls. Replacing TRBs with general obligation bonds or direct funding from the Economic Stabilization Fund does not address the state's need for an objective process for prioritizing TRB requests. Public-private partnerships, often touted as the future of capital expansion at public universities, are particularly unsuited to provide an alternative to TRBs. Public-private partnerships generally require revenue-generating projects—dormitories, parking garages, cafeterias—but TRBs are restricted by statute to financing projects that cannot generate their own revenue. Other popular suggestions, such as raising the amount of Higher Education Assistance Fund (HEAF) revenue universities can pledge to service endowment fund revenue bonds, are worth pursuing, but not as alternatives to TRBs.

For the foreseeable future, Texas higher education will require state support—some in the form of TRBs—to fund capital projects. However, the Legislature can still make considerable improvements to the TRB authorization process by committing to an objective process for prioritizing TRB requests and, crucially, refusing to authorize projects of insufficient priority.

The Facts

- The 84th Legislature authorized $3.109 billion in tuition revenue bonds.
- With interest on these bonds projected at $2.24 billion, this round of TRBs will cost the state a total of $5.35 billion over the next 20 years.
- From 1971-2014, the Legislature appropriated approximately $2.6 billion to retiring TRB debt.
- The Legislative Budget Board forecasts that, over the next five years, Texas will spend nearly $1.35 billion in general revenue funds on debt service for the most recently authorized round of TRBs.
- $2.2 billion of the debt from previously issued TRBs was outstanding as of August 31, 2014, and remains to be paid in addition to payments on the most recently authorized TRBs.
- TRB debt will account for just under 20% of the $21.6 billion the state projects will be spent on public higher education capital projects in Texas over the next five years.

Recommendations

- Attach institutional Space Use Efficiency scores—already developed by THECB—to TRB bills, the same way the Legislative Budget Board attaches a fiscal note to each piece of legislation.
- Allow institutions to pledge up to 75% of HEAF revenue to service endowment fund revenue bonds (up from the current 50% limit), and allow these bonds to be paid over 20 years (up from the current 10 year limit).
- Encourage legislative collaboration on future TRB bills that places the overall efficiency of the Texas public higher education over regional and local priorities by authorizing TRB requests according to a systematic ranking of projects by objective criteria.

Resources

Prepared Testimony of Chairman Fred Heldenfels IV Before the House Appropriations Committee by Fred Heldenfels IV, Texas Higher Education Coordinating Board (May 2012).

HB 100 Bill Analysis, House Research Organization, 84th Texas Legislature (April 2015).

continued

Tuition Revenue Bonds (cont.)

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Center for Higher Education: 84th Texas Legislature in Review by Thomas Lindsay and Trevor McGuire, Texas Public Policy Foundation (Aug. 2015).

HB 100 Fiscal Note, Conference Committee Report. Legislative Budget Board. 84th Texas Legislature (R) (May 2015).

Capital Expenditures Report FY 2016 to FY 2020, Texas Higher Education Coordinating Board (Oct. 2015).

10th Amendment

Convention of the States

The Issue

This January, at the Texas Public Policy Foundation's annual Policy Orientation for the Texas Legislature, Governor Greg Abbott announced his "Texas Plan" for restoring rule of law in the United States through state-led action: specifically, an Article V convention of states.

Beyond calling for an Article V convention of states, the Texas plan proposes nine amendments designed to rein in federal excesses, establish procedures for addressing violations of the rule of law, and restore a workable framework for federalism and separation of powers.

The nine amendments described in the Texas plan would: 1) "prohibit Congress from regulating activity that occurs wholly within one State"; 2) require Congress to "balance its budget"; 3) bar administrative agencies "from creating federal law"; 4) bar administrative agencies "from pre-empting state law"; 5) "allow a two-thirds majority of the States to override a U.S. Supreme Court decision"; 6) require a "seven-justice-super-majority vote" for a U.S. Supreme Court decision that would "invalidate a democratically enacted law"; 7) limit the federal government "to the powers expressly delegated to it in the Constitution"; 8) give state officials the power to sue federal officials in federal court; and 9) "allow a two-thirds majority of the States to override a federal law or regulation."

The mechanism for introducing these amendments is Article V of the Constitution. America's founders anticipated that government would expand beyond its constitutional limits. Article V provides states the means to restore the Constitution without needing to secure the agreement of Congress, one of the federal institutions whose encroachments make state action necessary.

Some take issue with the convention of states movement despite agreeing that Washington "has slipped its constitutional bounds." They fear "a cure that might kill the patient." The killing cure feared most is a runaway convention, in which rogue delegates hijack the proceedings and transform them into a "constitutional convention." A recent legal opinion issued by E. Scott Pruitt, attorney general of Oklahoma, observes that Article V conventions may "only propose amendments. A plenipotentiary convention—a constitutional convention called for a broad and unrestrained purpose—is not authorized under the U.S. Constitution." Pruitt thus debunks the notion that what Governor Abbott is calling for is—or could become—a "constitutional convention." Though often referred to as such, this everyday-language shorthand is misleading.

But there is a deeper reason not to fear a runaway convention: If 34 state legislatures actually agreed on a convention call, it would be the first time in history. Consider all the coalitions that would need to be formed in each state, between and among states, and across the country. The historic character of such a massive coalition would both require and, in turn, enhance significantly a similarly massive increase in public awareness. Moreover, ratification of any feared rogue amendments would take 38 states, which means that merely 13 states could veto any amendment.

Where one ultimately comes down on this issue depends on one's estimation of the possible risks and rewards of such an effort. On this calculation, consider

what has become the final assessment of Antonin Scalia, whose passing has prevented him from providing further commentary on the matter. When asked about the claim that a convention of states would be "unlimited" and thus "might reinstate segregation and even slavery," Scalia rejoined, "I have no fear that such extreme proposals would come out of a constitutional convention."

We agree. Despite possible perils, the promise of a convention of states suggests that we "take this minimal risk," trusting that history will show it was "reasonable." The people are less to be feared today than the federal government. The prospect of a runaway convention is less to be feared than the reality of our runaway federal government.

The Facts

- Eight states have called for an Article V convention of states as of May 31, 2016: Alabama, Alaska, Florida, Georgia, Indiana, Mississippi, Oklahoma, and Tennessee.
- A recent Gallup poll reveals that 72% of Americans regard "big government" as a "greater threat" than "big business or big labor, a record high in the nearly 50-year history of this question."
- The nonpartisan American Council of Trustees and Alumni recently declared "a crisis in American civic education," with "survey after survey" showing recent college graduates unable to identify "the term lengths of members of Congress, the substance of the First Amendment, or the origin of the separation of powers."

Recommendations

- Texas should join the states mentioned above by passing legislation to call for an Article V convention of states when the 85th Legislature meets in 2017.
- The entire convention of states process—from state-level advocacy to national conversation and, potentially, the convention itself—should be conducted in a way that maximizes its civic educational value to the American people.

Resources

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Controlling Federal Funds

The Issue

In addition to the large share of state appropriations that come from federal funds—around 33%, or $68 billion, of appropriations in the 2016-17 budget—the federal government uses conditional federal grants to deputize state and local governments to perform tasks beyond the authority of the federal government. Unlike federal funds accounted for in the state budget, this money goes directly from the federal government to local governments, with no real opportunity for oversight by, or accountability to, the state legislature.

As states have begun to push back on the conditions attached to federal grants, even rejecting some grants on policy grounds, the federal government increasingly looks to strike deals directly with local governments, thus subverting the policy decisions made by state legislatures. Federal funds sent directly from the federal government to political subdivisions of the state have all of the problems associated with federal funds in the state budget—such as less financial stability and diminished state and local autonomy over policymaking—as well as their own set of problems, related to a lack of transparency in how these funds are authorized for receipt within the state. While we can at least refer to the percentage of the state budget attributable to federal funds, there is no reliable repository of data on federal funds given directly to local governments.

It can be incredibly difficult to track such deals (to say nothing of preventing them) because legislators currently have no formal mechanisms to gain awareness of attempted federal-local circumventions of state policy decisions. In spite of the efforts of transparency advocates like Adam Andrzejewski, whose OpenTheBooks project provides "the world's largest private repository of public spending," the highly decentralized nature of federal appropriations makes providing a full account of these funds next to impossible without the establishment of a comprehensive system for reporting and reviewing, at the state level, federal funds received by political subdivisions of the state.

The federal government's deteriorating fiscal condition makes reductions in federal funds to state and local governments inevitable and imminent. Utah, a leader in the "Financial Ready" movement, has been developing contingency plans for scenarios in which 5% and 25% of federal funds to the state are suddenly cut off, in order to prepare itself for such reductions. Given these concerns, unaccounted-for federal funds to political subdivisions put the state in a precarious financial situation on two fronts.

First, when federal funds to local governments are cut, local governments often turn to the state to backfill their losses. So under the current system of no oversight, any reduction in federal funds given directly to political subdivisions would increase their need of state support.

Second, since any reduction of federal funds to political subdivisions would also imply reductions of federal funds in the state budget as well, such a call for more support would come at precisely the time when the state budget is least able to accommodate such requests. Indeed, such a scenario would require a Texas ver-

sion of Utah's Financial Ready contingency plans. But without an accurate picture of federal funds—one that includes federal funds to political subdivisions of the state—the Legislature will remain incapable of preparing a comprehensive contingency plan for the increasing possibility of severe reductions in federal support for state and local governments.

The Facts

- Federal funds account for 33%, or $68 billion, of appropriations in the 2016-17 Texas budget.
- In spite of the work of transparency advocates, to date there remains no reliable estimation quantifying the extent of federal fund appropriations to political subdivisions of the state of Texas, either in total or as a percentage of total appropriations to political subdivisions.

Recommendations

- **Reporting Federal Funds to Political Subdivisions of the State:** Require all political subdivisions in Texas to report in real time to a state fiscal entity all federal funds received directly from the federal government and not having been passed through by a state agency. This state fiscal entity would produce an annual report detailing, at a minimum, the amount, duration, purpose, and policy conditions attached to such funds.
- **State Oversight of Federal Funds to Political Subdivisions of the State:** Establish a system of state oversight for federal funds to political subdivisions of the state. Such a system of oversight would empower state-level officials to reject federal funds found to be incompatible with existing state law, the Texas Constitution, or the Tenth Amendment to the United States. We recommend the following design for such a system:
  - If a political subdivision receives grant funds directly from the federal government (as opposed to funds passed through by a state agency), those funds should be placed in escrow until completion of a state review process.
  - During such a review process, a political subdivision would submit information on the grant to the state fiscal entity described above. The grant information provided should include, at a minimum, the amount, duration, purpose, and policy conditions attached to such funds.
  - Once the state fiscal entity receives the grant information from the political subdivision, it should be given 10 business days to complete an analysis of the grant. As part of this analysis, the state fiscal entity would request from the office of the attorney general a review of the compatibility of the grant's policy conditions with existing state law, the Texas Constitution, and the Tenth Amendment to the United States Constitution.
  - Once the state fiscal entity completes this grant analysis, it would transmit the analysis to a panel of designated state elected officials, who would

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Controlling Federal Funds (cont.)

have 10 business days to register an objection to the political subdivision's receipt of the grant funds.

- If an objection is raised within the 10 business days, the grant funds would remain in escrow until either the objection is withdrawn or the political subdivision returns the grant funds. If no objection is raised within the 10 business days, the grant would be considered approved and the political subdivision could then immediately spend the funds for their intended purpose.

Resources

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Environment

Climate Policy

The Issue

Whether labeled global warming or climate change, the theory that man-made greenhouse gas (GHG) emissions will cause catastrophic warming is the justification for onerous climate policies that will limit or eliminate the use of fossil fuels: coal, natural gas and oil. These policies have now been institutionalized in the Environmental Protection Agency (EPA) rules and in other actions across the federal government. The U.S. Congress, however, has repeatedly refused to delegate authority to federal agencies to control greenhouse gases—among which carbon dioxide (CO_2) is by far the dominant source.

CO_2 is a ubiquitous by-product of all human activity, from breathing to burning fossil fuels that power our cars and generate our electricity. CO_2 is also known as the "gas of life," as it is the catalyst for the most fundamental energy conversion on earth: photosynthesis. Although it may be possible that increased atmospheric concentration of CO_2 may generate some warming, it is not clear whether the warming would have a significant negative effect. If not, it would create a net benefit for plant growth, upon which human life on earth depends. Paleoclimatology has long recognized past geological eras with vastly higher levels of CO_2. Science still lacks an understanding of how natural variables interact and affect climate—including the sun from which almost all energy in our climate system originates.

The warming that is predicted by the models of what has become the official climate science—the U.N.'s Intergovernmental Panel on Climate Change (IPCC)—is increasingly at odds with the warming empirically observed by the most sophisticated technologies. For example, the IPCC's most recent Fifth Assessment Report backpedaled from a number of alarmist conclusions it had drawn in previous reports, questioning the degree of assumed climate sensitivity to man-made emissions of CO_2 and recognizing that a link between rising carbon emissions and extreme weather events is not likely.

Claims that the science supporting predictions of catastrophic warming are absolutely settled beyond all question belie the speculative weakness of orthodox climate science. No genuine science is ever settled beyond any question. Increasing efforts to silence climate skeptics and their employers by criminal prosecution are a chilling reminder of how fiercely politicized climate science and policy have become.

Texas is disproportionately harmed by the climate crusade both because the state has the largest energy sector in the country as well as the fact that it leads the shale revolution, which has unlocked the mother lode of oil and natural gas found in hard shale rock.

Carbon mandates have never been authorized in law by Congress. Instead, following the direction of the White House in 2009, the EPA moved forward and issued an Endangerment Finding that declared CO_2 and four other greenhouse gases as pollutants which endanger human health and welfare and are thus subject to the regulatory authority of the Clean Air Act. Under that finding, the EPA has pursued an aggressive initiative to sanction fossil fuels in regulation to reduce real pollutants and through direct control of CO_2. The EPA's Clean Power Plan (CPP) would federalize the nation's entire electric sector. The EPA's new methane

rule threatens Texas' huge energy sector. All of the EPA's carbon rules are futile in that none would reduce CO_2 by an amount that would avert the warming predicted by the IPCC. The grand plan to redesign the nation's entire system of electric generation would reduce the IPCC's predicted warming by only 0.018 degree Celsius.

Yet, without EPA interference, the U.S. has reduced CO_2 more than other countries through efficiency and innovation. The Energy Information Administration (EIA) announced that energy-related emissions of CO_2 decreased 3.7% in 2012, the lowest emission level of CO_2 since 1994. Indeed, CO_2 emissions in the U.S. are falling faster than in countries under mandates such as the European Union's Emissions Trading System or in countries like Germany that have most aggressively pursued renewable energy.

Issued in June of 2013, President Obama's Climate Action Plan is a collection of at least 50 federal government programs and initiatives with an aim to cut carbon emissions. The plan calls for the EPA's direct regulation of CO_2 in the CPP, with a seemingly arbitrary goal of reducing emissions by 17% in 2030. Its broad scope, cost, questionable need, and lack of clear legislative foundation could prove harrowing to the nation's economy and to low income families. To date, almost all of the action items in President Obama's so called Climate Action Plan have been initiated or implemented by executive action alone. Such an expansion of federal purview is more properly the prerogative of Congress rather than the executive branch.

The Facts

- Eliminating fossil fuels without a fully comparable substitute bodes energy scarcity and an energy regression that will increase poverty and stymie economic growth.
- Global average temperatures have not risen over the last 17 years as measured by NASA's remote sensing satellites and balloons, invalidating the modeled predictions of the IPCC.
- The EPA's proposed restrictions on GHGs are expected to increase the cost of a vehicle by $3,100 by 2025, and, if successful, would prevent only 0.01 degree Celsius of the expected warming, according to the EPA's own estimates.
- Modern civilizations are utterly dependent on massive consumption of fossil fuels. Economic growth and increasing fossil fuel consumption rose in lockstep throughout the 20th century.
- Abundant, affordable, concentrated, versatile, reliable, portable, and storable: fossil fuels are far superior to any alternative energies at this point in time.

Recommendations

- Urge federal policymakers to establish an independent, rigorous review of IPCC science.
- Suspend state programs that require or incentivize GHG reduction.
- Seek congressional revocation of the EPA's Endangerment Finding.
- Stand against the EPA's Clean Power Plan.

continued

Climate Policy (cont.)

Resources

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The EPA

The Issue

Over the last seven years, the Environmental Protection Agency (EPA) has carried out what the *Wall Street Journal* calls "a regulatory spree unprecedented in human history." And while this regulatory initiative would damage the overall American economy, Texas—the nation's energy powerhouse—sits in the crosshairs of the EPA's crusade. Below are some of the regulatory attacks on Texas that, in addition to the Clean Power Plan, are negatively affecting the welfare of Texans.

Ozone National Ambient Air Quality Standards
The EPA's new ozone standard would impose costs in the billions and would be infeasible for many states. The EPA's ever-changing, increasingly stringent National Ambient Air Quality Standards (NAAQS) threaten continued economic growth in Texas at a time when low energy prices create unprecedented opportunity for that growth.

In 2015, the EPA lowered the primary and secondary eight-hour ozone NAAQS from 75 parts per billion (ppb) to 70 ppb. In Texas, the EPA currently designates three areas and 19 counties (Brazoria, Chambers, Collin, Dallas, Denton, Ellis, El Paso, Fort Bend, Galveston, Harris, Johnston, Kaufman, Liberty, Montgomery, Parker, Rockwall, Tarrant, Waller, and Wise) as nonattainment areas under this new standard.

The EPA dismisses concerns about cost of the new standard by claiming huge public health benefits. The reality is that these are not benefits from directly lowering ozone levels but instead are the "co-benefits" of reducing fine particulate matter—another pollutant which is already regulated under its own federal standard. Over 75% of the health benefits that the EPA claims derive from the new ozone standard in reality stem from coincidental reduction of particulates under a NAAQS—a standard that most of the country already attains (See *EPA's Pretense of Science*).

Even if a state's attainment of the new 70 ppb ozone standard is infeasible, the EPA can enforce its compliance on pain of serious sanctions. These rigid penalties can include federal seizure of state authority through federal implementation plans (FIPs) and loss of federal highway funds. Texas and 10 other states now challenge the new ozone NAAQS in the D.C. Circuit Court.

Cross-State Air Pollution Rule
The Cross-State Air Pollution Rule (CSAPR) is another major new rule that disproportionately impacts our state. Although Texas has already reduced sulfur dioxide (SO_2) emissions by 33% since 2000, the state alone is tasked with a quarter of total mandated SO_2 reductions.

The Electric Reliability Council of Texas (ERCOT), the operator of the electric grid carrying 85% of the state's electric load, concluded that "had CSAPR been in effect [during the record hot temperatures in the summer of 2011] Texans would have experienced rolling outages and the risk of massive load curtailment." Although vacated by the Fifth Circuit Court of Appeals, most of CSAPR was ultimately upheld by the United States Supreme Court in 2014.

continued

The EPA (cont.)

Mercury Rule: The Utility MACT
In 2015, the Supreme Court rejected the EPA's rule to control mercury emissions from power plants in a rare decision that invalidated the EPA's method of estimating costs and benefits. Even before the Court's ruling, this single rule had imposed multi-billion dollar expenditures, forced closure of power plants, and led to the bankruptcy of major coal companies. Although the rule carried compliance costs that the EPA estimated at $10.9 billion per year, only 0.004% of the claimed benefits derives from direct reductions of mercury. The remainder, as in the new ozone standard, derive from the EPA's spurious use of co-benefits from reduced particulate matter.

Visibility: Regional Haze Program
When the U.S. Congress created the Regional Haze program, in the Clean Air Act amendments of 1977, it was clear that Congress intended for the states to take charge of the program. Because regional haze is an aesthetic concern rather than a public health risk, Congress authorized states to decide how to prioritize the visual benefits of reducing regional haze.

The EPA's new rules have stripped the states of this right. Since 2009, the EPA began rejecting state implementation plans for regional haze and imposing FIPs costing at least $5 billion. FIPs are the most hostile action that the EPA can take against a state, and in practice are seen as total denial of state authority. The George H.W. Bush, Bill Clinton, and George W. Bush administrations issued a combined total of five Clean Air Act FIPs versus the 54 of Obama's EPA.

Under the federal regional haze program, the EPA uses units known as "deciviews" to quantify visibility improvement. A deciview value of zero symbolizes the clearest possible visibility, with increasing value representing increasing amounts of haze. Peer-reviewed research has shown that it takes a reduction of five to ten deciviews for the average person to perceive any improvement in visibility. In December of 2015, the EPA imposed on Texas a $2 billion federal plan to attain a maximum visibility improvement of a mere 0.5 deciviews. In a 2014 report, ERCOT concluded that the Regional Haze program's CO_2 emission limits could lead to closure of 3,300 to 8,700 megawatts of coal generation in Texas.

The Facts

- The EPA projects direct annual compliance cost of $7.2 billion for the CPP. This estimate excludes all indirect costs such as back-up power for renewables and massive new transmission infrastructure.
- All six of the criteria pollutants regulated under the Clean Air Act have fallen substantially in recent decades. Ambient levels of carbon monoxide fell 82% between 1980 and 2010. SO_2 fell 76% and NO2 fell 52%.
- Over 60 planned industrial projects in Texas have been waiting more than a year for GHG permits from the EPA.
- A similar power plan to the CPP to cut carbon in Germany has driven retail electric rates to a level three times higher than the average U.S. rate.

Recommendations

- Texas should continue to develop State Implementation Plans for genuine pollutants on the basis of law, rigorous science, cost-effectiveness, and local circumstances.
- Texas should continue to legally challenge and lawfully resist infeasible EPA air quality standards unjustified by science or law.
- Congress should pass a law clarifying that states, not the EPA, are the foremost decision makers in implementing the Regional Haze program.

Resources

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Endangered Species Act

The Issue

The Endangered Species Act (ESA) has long been known as the "pit bull" of federal environmental laws because of the inflexibility of its mission to protect all species listed under the Act, regardless of cost or impact on human activities. The law makes it a felony to "take" any species listed as endangered or threatened. The extremely broad interpretation of "take" includes activity to "harass, harm, pursue, hunt, shoot, wound, kill, trap, capture, or collect, or to attempt to engage in any of these activities." The scope of a take finding extends to both intentional and non-intentional activity.

For decades, the U.S. Fish and Wildlife Service (FWS) focused its implementation of the ESA on federal lands and thus had little impact on Texas. This has changed over the last 10 years as the FWS has lengthened its listing of protected species on private land and water resources.

After seven years of litigation regarding the federal protection of the endangered whooping crane and its impact on the state's authority to allocate surface water, the federal court exonerated Texas and upheld state authority. In this litigation known as *Aransas Project v. Shaw*, an environmental group sued the Texas Commission on Environmental Quality (TCEQ) for the alleged take of a number of cranes. The Aransas Project claimed that TCEQ's past or future issuance of water rights to divert water from the Guadalupe and the San Antonio rivers caused the cranes' death. The federal district court's ruling against the TCEQ was overturned by the 5th Circuit Court of Appeals.

If the district court's decision had not been reversed, Texas' long-recognized authority to allocate surface water within its borders through the issuance of water rights would have taken a backseat to a conservation plan enforced by the federal government.

The number of areas in Texas impacted by species listed as threatened or endangered continues to grow. Concern over the listed Houston toad impeded recovery after the Bastrop fires in 2011, perhaps doubling the cost and time involved. The discovery of a single endangered spider, the Braken Bat Cave meshweaver, immediately halted construction of the last 1,500 feet of a six mile $11 million pipeline to convey water to the west side of San Antonio. In 2012, the potential listing of the dunes sagebrush lizard threatened to shut down significant oil and gas operations in the Permian Basin of west Texas. In a rare decision, the FWS decided not to list the lizard because of existing voluntary conservation plans, a decision subsequently upheld by a federal court.

Williamson County is now battling the FWS on constitutional grounds over the listing of the Bone Cave harvestman. This tiny eyeless arachnid is stalling development of crucial infrastructure in the county and its taking could lead to $50,000 in fines and one year in prison. Incidental take permits and other mitigation measures are exorbitant. Mitigation permits cost $10,000 per acre to develop within 345 feet of a harvestman cave spider and 40 times more—$400,000 per acre—within 35 feet. In November of 2015, the Foundation's Center for the American

Future (CAF) filed a suit to delist the harvestman—a species existing only within Texas. CAF's suit questions the constitutional legitimacy of federal protection of exclusively intrastate species.

Texas mussel species have been a hot ESA topic since 2009. Of the 52 known species that exist within the state, 15 are listed as threatened at the state level. Six of these 15 (the golden orb, smooth pimpleback, Texas fatmucket, Texas fawnsfoot, Texas hornshell, and Texas pimpleback) are candidate species under consideration for federal ESA listing. Listing of the mussels would lead to federal oversight of their aquatic habitats, most likely mandating augmented environmental flows in many streams and rivers in central Texas. Dedicating this water for habitat conservation would limit water supply available for human use.

The 83rd Texas Legislature passed HB 3509 to give the Texas Parks and Wildlife Department (TPWD) authority to help implement federal ESA programs. Ultimately vetoed by the governor, HB 3509 would have substantially expanded what has long been TPWD's limited land use authority over voluntary conservation programs on private land.

The Facts

- Less than 2% of listed species have been removed from the ESA's endangered list in 40 years.
- Nearly 100 species in Texas are candidate species for potential listing by 2017.
- The ESA's listing of the Delta Smelt fish forced the state of California to flush three million acre-feet of water intended for human use into the ocean instead.
- There are currently six Texas mussel species being considered for federal listing under the ESA.

Recommendations

- Texas should resist state programs that facilitate federal land use controls involved in conservation plans for listed species.
- Texas should encourage proactive state, local and private strategies to conserve wildlife by means of rigorous science and voluntary programs.
- Support the efforts of Texas Congressional members to reform the ESA.
- Maintain current program to assist local government, land owners, and businesses in challenging ESA listings and habitat conservation plans.
- Resist top-down, state-centralized programs for Texas response to ESA listings.

continued

Endangered Species Act (cont.)

Resources

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Energy

Clean Power Plan

The Issue

In early February of 2016, the U.S. Supreme Court granted a stay of the Environmental Protection Agency's (EPA) Clean Power Plan (CPP), freezing the rule's implementation until final review by the courts. In response to petitions from more than two dozen states and many industry groups, this was the Supreme Court's first stay of an administrative rule reversing the D.C. Circuit's earlier denial. Full judicial review on the merits has begun before the U.S. Court of Appeals for the D.C. Circuit. Oral arguments are to be held on September 27.

The CPP, linchpin in the Obama Administration's global warming fight, is the most sweeping regulation in EPA's history. The rule carries a $7.2 billion annual price tag. This is a conservative estimate, as total costs could double that figure. The rule has evoked the ire of constitutional scholars who view it as an insult to the fundamental constitutional provision of separation of powers; the rule far exceeds the legal authority that Congress delegated to the EPA through the Clean Air Act. In the CPP, the EPA asserts the authority to federalize and overhaul the country's electric power system, long a prerogative of state authority.

Texas currently generates 11% of America's electricity—more than any other state. Under the CPP, over half of Texas' coal-fired power plants would be forced to close, destroying the competitive electric market by making carbon content—not price, reliability, or safety—the first priority for dispatching electric generation to the grid. These are high stakes for an infinitesimal carbon payoff.

According to the EPA's own calculations, the CPP's goal to cut carbon dioxide (CO_2) emissions from electric generation by 32% would result in a mere 0.018 degree Celsius reduction in the rate of warming predicted by the Intergovernmental Panel on Climate Change (IPCC)—an immeasurable change. The rule would impose on Texas one-fifth of the total national obligation to reduce CO_2, a steeply disproportionate burden compared to other states. The national aggregate of CO_2 emissions that the EPA's rule intends to reduce by 2030 is emitted by China in less than two weeks.

The CPP's CO_2 standards would force fuel switching from coal to natural gas on a vast scale and assume a 150% increase in generation from renewable sources that cannot provide reliable energy. The EPA's rule conveniently ignores the fact that Texas, at 14,000 megawatts (MW) of installed electric capacity, is already America's largest renewable energy generator. The CPP would force the state to increase its installed renewable capacity by 200%, an additional amount of wind and solar generation that is more than any other nation produces at present. The carbon cuts necessary to meet the final goals of the rule in 2030 would limit even natural gas fired generating plants and force a massive expansion of renewables.

The CPP's heavy-handed regulations will hike energy prices in Texas and across the nation. Balanced Energy Texas, a coalition of energy providers, projects that the cost of power and natural gas would increase by an estimated $284 billion annually by 2020, raising electricity and gas bills by more than $1,000 a year—this represents a 50% increase for the average Texan. Since energy is pivotal to all manufacturing and production, prices of essentially all U.S. products will follow suit. Low-income families and fixed-income seniors will be impacted first and hurt the most.

The Facts

- To date, the U.S. Congress has never expressly authorized the direct regulation of carbon dioxide.
- The EPA projects that the CPP rule will force the early closure of over 16,500 MW of coal-fired generation by 2020—roughly 15% of Texas' total 110 gigawatts of electric power.
- Texas has joined 28 other states in a suit challenging the constitutionality of the CPP.
- The CPP will cost at least $7.2 billion annually to curb 32% of CO_2 emissions in exchange for a 0.018 degree Celsius change global warming.

Recommendations

- Texas should not expend any state resources in an effort to comply with the EPA's CPP until full judicial review on the merits by the Supreme Court.
- Texas should learn from the grim lessons of European countries who aggressively rushed to renewable energy as a way to displace fossil-fueled electric generation.

Resources

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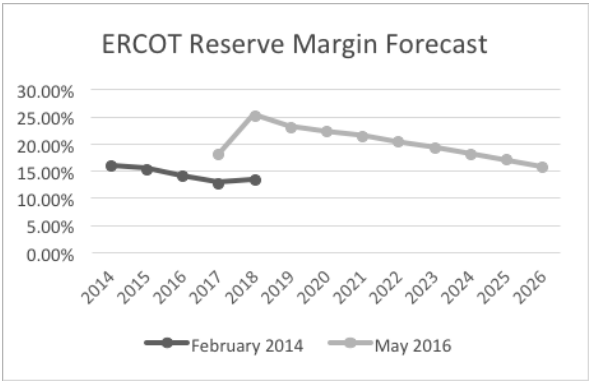
Resource Adequacy

The Issue

Forecasts in 2012 of diminishing resource adequacy set the stage for a push by generators and the Public Utility Commission of Texas (PUC) to vastly increase government intervention in Texas' world-class electricity market. A more accurate assessment of the data since then has debunked the notion that Texas needs to adopt a capacity market with subsidies to generators as high as $4 billion a year—on top of what Texans pay for electricity.

In May 2016, the Electric Reliability Council of Texas (ERCOT) forecast historically high levels of reserves: 18.2% for 2017 (as opposed to a 12.84% forecast in 2014), and 25.4% for 2018 (almost double the forecast made for that year in 2014). Thanks to its competitive electricity market, Texas has adequate resources to power Texas' growing economy for at least the next 10 years. The Foundation's research substantiates the underlying reason for future resource adequacy; new investment in generation is generally profitable and sufficient to keep up with increased demand.



As lawmakers deliberate this issue in 2017, the facts will show that Texas' competitive electricity market is working. The low electricity prices in Texas are the best evidence that Texas has an adequate supply of electricity; the law of supply and demand tells us the low prices are the result of excess supply over demand. Texas can ensure sufficient generation of electricity for years to come and improve reliability by letting competitors compete and reducing intervention in the market.

The Facts

- Texans use about 350 million megawatt hours (Mwh) of electricity a year; reliability issues involve perhaps only 1.5 million Mwh, less than 0.05% of annual use.
- Peak use is slowing, diverging from economic growth because of market innovation in demand response.
- Texas' competitive market is already maintaining resource adequacy and improving reliability, both on the supply and demand sides.
- No evidence shows capacity markets boost capacity; from 2007-11, capacity payments in PJM (the mid-Atlantic grid) funded about a 4% increase in generation while generation in Texas' energy-only market grew about 12%.

- A capacity market in Texas would result in an "electricity tax" on consumers of about $3.2 billion annually. Payments from consumers through the tax would mainly be used to increase the profitability of electricity generators and Wall Street investment firms, not to fund new generation.

Recommendations

- The PUC and ERCOT should not manipulate the operating reserve demand curve to increase revenue for generators.
- The PUC should eliminate the high system-wide offer cap.
- The PUC and ERCOT should more closely evaluate the ability of current and potential market driven demand response to handle peak load strains on the system.
- The Texas Legislature should prohibit a capacity market in statute.
- The Texas Legislature should reevaluate both the board structure of ERCOT and the PUC's reach into ERCOT's operations.
- The Texas Legislature should reorient/eliminate the Independent Market Monitor and the regulation of market power abuse.
- The Texas Legislature should reduce the PUC's excessive regulatory authority and eliminate the Texas Renewable Portfolio Standard.
- Texas policymakers should oppose the reinstatement of the federal Production Tax Credit.

Resources

Report on the Capacity, Demand and Reserves in the ERCOT Region, 2017-2026 by the Electric Reliability Council of Texas (ERCOT) (May 2016).

Debunking the Myth: Texas is Not Running out of Electricity—The Generators by Bill Peacock, Texas Public Policy Foundation (Feb. 2014).

Texas' Competitive Capacity Market by Robert Michaels, Texas Public Policy Foundation (Jan. 2014).

Electricity in Texas: Markets, not Manipulation by Bill Peacock, Texas Public Policy Foundation (Jan. 2014).

The Reliable Texas Electricity Market: Resource Adequacy Hype Doesn't Fit the Facts by Bill Peacock, Texas Public Policy Foundation (Oct. 2013).

Capacity Markets Represent a Bad Bargain for Texas Consumers by Kathleen Hunker, Texas Public Policy Foundation (Oct. 2013).

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Competition is Working in the Texas Electricity Market by Bill Peacock, Texas Public Policy Foundation (Sept. 2013).

Capacity Market

The Issue

Texas has the most competitive electricity market in the country. Nevertheless, there has been an ongoing debate at the Public Utility Commission of Texas on whether it should replace the current energy-only market with a centralized capacity market. Making such a change would reregulate the market unnecessarily and shift the costs (and risks) of new investments to consumers.

A capacity market operates by giving electricity generators yearly subsidies in exchange for a promise that they will use the guaranteed revenue to invest in new capacity. These payments are not for the electricity that generators produce, but for the amount of electricity that they could theoretically produce if their operations were running at peak efficiency and, most important, were that energy needed.

Even if successful, a capacity market would be a very expensive way to meet Texas' energy needs. Studies repeatedly show that the capacity payments alone would cost Texas consumers somewhere between $3 and $5 billion per year—an assessment that does not include design, implementation, and litigation expenses. The most recent Brattle report calculated that these hard costs would come to an annual $3.2 billion.

That money would not be offset by ensuing benefits to the state's economy. Although capacity market supporters suggest that reregulation would result in an eventual savings by eliminating future blackouts, these speculated reimbursements only arise under a straw man scenario that assumes the energy-only market will reach a long-run reserve margin of 8%. Supporters provide no independent justification for that assumption. ERCOT's energy-only market has never reached that low of a reserve margin, and current forecasts show a capacity supply substantially above the suggested amount.

In addition, there is no evidence that a centralized capacity market boosts a region's energy capacity, much less helps avoid future blackouts. Capacity payments in PJM—the regional transmission organization serving the mid-Atlantic—yielded less investment in new generation than Texas' energy-only market not only in terms of sheer megawatts but also as a percentage of the region's installed capacity, despite costing PJM consumers over $50 billion during that timeframe.

One reason for this lackluster result is that most of the funds never went to finance new generation but instead found their way into subsidizing the operational costs of existing resources. For example, more than 93% of the money paid by PJM customers went to existing generation; only 1.8% found its way to new or "reactivated" generation sources. Additionally, the bulk of capacity payments subsidized base load generation plants even though there was no shortage of investment in base load generation and even though those plants can recoup their fixed costs from energy sales alone.

Finally, capacity markets suffer from a severe design flaw that damages the grid's overall reliability and may make the market more prone to blackouts. Capacity markets interpret reliability as being dependent on the amount of capacity alone. They, therefore, offer all generators uniform payments regardless of the plant's

efficiency and ignore those characteristics that ensure that grid operators can convert and transport installed capacity to consumers. This has the consequence of eliminating price signals and discouraging investors from building plants where and when they are needed most—a perverse incentive that hurts ERCOT's overall operational reliability.

The Facts

- Numerous studies predict that a capacity market will cost Texas consumers an additional $3 to $5 billion per year, not including the market's design, implementation, and litigation expenses. The most recent Brattle report estimated that these hard costs would come to an annual $3.2 billion.
- The Brattle report claims that, even assuming the optimal scenario, where a Texas capacity market delivers on its promises and offsets some of its hard costs, capacity payments would have an annual net cost of at least $400 million.
- PJM spent $50 billion in capacity payments between 2007 and 2011 and added 7,000 megawatts of new generation, about 4% of its total install capacity. During that same period, Texas' energy-only market added 10,000 megawatts of new generation, about 12% of its installed capacity, with zero extra cost to consumers.
- In September 2013, PJM suffered a series of rolling blackouts due to unusually high temperatures in combination with mechanical issues and plants being taken offline for season maintenance. The blackouts occurred despite a fully mature capacity market and over $54 billion spent in capacity payments.

Recommendations

- Preserve Texas' energy-only electricity market.
- Reject all proposals that implement a mandatory reserve margin or a capacity market.
- Clarify that the Public Utility Commission of Texas does not have the statutory authority to restructure and reregulate the electricity market under any form of capacity market.

Resources

Capacity Markets Represent a Bad Bargain for Texas Consumers by Kathleen Hunker, Texas Public Policy Foundation (Oct. 2013).

A Texas Capacity Market: The Push for Subsidies by Kathleen Hunker, Texas Public Policy Foundation (Sept. 2013).

Reforming Texas Electricity Markets: If You Buy the Power, Why Pay for the Power Plant? by Andrew Kleit and Robert J. Michaels (Summer 2013).

Money for Nothing in the Power Supply Business by the American Public Power Association (March 2012).

Regulation of the Texas Electricity Market

The Issue

The state of Texas' world class electricity market has never been healthier. The average offer price for new service is about 10.5 cents per kWh, while the average of the 20 lowest offers is around 7.5 cents per kWh.

In addition, projections for reserves are as good as they've ever been. The current reserve margin of 16.5% is expected to reach 25.4% by 2018 and stay above 16.6% through 2025.

Today's low prices and high levels of reserves are the result of many factors, such as the low price of natural gas. But there are also many instances where prices are artificially lowered through government interference. For example, renewable energy subsidies have artificially lowered the price of electricity thanks to supporting wind power. However, consumers still pay for the electricity generated by wind, meager compared to the demand for power, through higher taxes.

Another type of interference in the market comes from various forms of price regulation and manipulation. Levying a variety of charges against energy companies, such as market power abuse, and based on the theory that making profit off energy is somehow wrong, a variety of measures were used to control prices, up to a hard price cap that exists today.

The problem with the cap for example is that it reduces prices at times of peak demand, when electricity is the most expensive to produce. If generators can't sell electricity at a profit at times of peak demand, they won't build generation plants that will supply electricity when we need it most

Calls to "fix" Texas' electricity market with more government and meddling with our "energy only," i.e., free-market, approach to generating electricity won't help—in fact, they will make electricity more expensive for consumers. The question is whether a few policymakers and regulators in Austin can somehow make better decisions about how to deal with those challenges than the collective and cooperative decisions of millions of producers and consumers in the marketplace. The appropriate long-term approach to Texas' energy market is not to regulate the market more, but to regulate it less.

If we let it work, the world-class Texas electricity market will power Texas' future.

The Facts

- Regulations such as price caps distort market forces; those distortions lead to more regulation, unless the cycle is consciously stopped.
- Renewable energy subsidies only benefit investors; consumers are forced to pay for the discounts in energy with higher taxes.
- Texas' electricity market has helped the state become the best environment for business in the nation.

Recommendations

- Eliminate wholesale price caps.
- Eliminate the ability of the PUC to disgorge revenue.
- Eliminate the PUC's emergency cease and desist authority.
- Define more clearly the concept of market power and market power abuse.
- Make compliance with the Renewable Portfolio Standard voluntary and support elimination of the federal production tax credit.

Resources

"Texas' Electricity Market can Power Our Future" by Bill Peacock, Texas Public Policy Foundation (July 2012).

HB 2133: Don't Ruin the Texas Electricity Market by Bill Peacock (May 2011).

Competition in the Texas Electricity Market by Bill Peacock (March 2011).

Texas' Renewable Energy Experiment by Bill Peacock (Dec. 2010).

continued

Renewable Energy

The Issue

Wind, water, biomass, and the sun are the oldest energy sources used by mankind. The inherent limitations of these sources motivated people to seek more efficient and reliable fuels to power society.

The peak use of windmills was in the 1930s and 1940s. Farmers stopped using them because rural electrification provided electric power far more reliable and often less expensive than wind. Yet today, we are turning back to this expensive and inefficient energy source because of government mandates and subsidies, which are driving up electricity costs for Texas consumers.

In 1999, Texas adopted a Renewable Portfolio Standard mandating that the state's competitive electric providers buy a minimum 2,000 MW of qualifying energy by 2009. In 2005, the Texas Legislature increased the RPS to 10,000 MW by 2025. Texas met the RPS target for installed wind capacity in 2010, a full 15 years ahead of schedule. Subsidies from the RPS flow to generators through renewable energy credits (RECs).

In addition to the Texas' RPS, generous federal subsidies and favorable wind conditions in the vast open plains of west Texas have encouraged wind production. In fact, the federal tax credits for renewable energy may be the driving force behind the rapid growth of Texas' wind generation; when the federal credits briefly lapsed, new wind installation in Texas dried up, despite the fact that no change had been made in Texas' RPS.

Texas' wind farms are concentrated in the panhandle region. While this makes sense insofar as this is where there is the most wind to capture, this area is far from the focus of Texas' electrical demand, which lies along the I-35 corridor. The long distance of wind generation from population centers has led to large subsidies through the construction of the Competitive Renewable Energy Zone (CREZ) transmission lines. The CREZ lines are Texas' largest subsidy for renewable energy. The cost to build the CREZ lines will be directly added to the bill of every electric consumer in ERCOT.

The total cost of subsidies for wind is tremendous, estimated to be about $13 billion for the 10-year period 2006-15. The CREZ lines cost about $6.8 billion, the federal PTC about $4.1 billion, and the state's RECs about $560 million. All of these costs are borne by citizens in their roles of consumers or taxpayers.

For wind and solar power, the difference between installed capacity and actual net generation is often substantial, because of the intermittent nature of those energy sources (the sun doesn't shine at night or when it is cloudy, and the wind does not blow hard enough or often enough to utilize a turbine's full capacity).

In addition, wind tends to blow hardest at night and during off peak months, when there is less overall demand, and not as much during the high demand summer months. For these reasons, ERCOT estimates that actual net generation for wind power in Texas is about 12% of installed capacity for non-coastal wind and 55% for coastal wind.

Another major cost of wind is the integration of renewables into the electrical grid. Because they are intermittent, use of wind and solar power requires continual back-up generation to replace this electricity on the grid at a moment's notice. Typically natural gas-fired generating units are used in an interruptible mode similar to idling a car. The cost of back-up generation is a hidden and wasteful cost of renewable energy.

A major problem with all of these costs is that they are not paid for by the investors in wind generation—as in the case of generation from traditional sources, and thus traditional market incentives cannot operate.

The Facts

- Subsidies for renewable energy in Texas totaled about $13 billion for the 10-year period 2006-15.
- Subsidies for CREZ lines ran about $6.8 billion, the federal PTC about $4.1 billion, and the state's RECs about $560 million.
- The Texas Renewable Portfolio Standard (RPS) mandates 10,000 MW of renewable capacity by 2025, of which 500 MW must be from non-wind sources.
- The backup generation and grid-related costs of wind energy could increase ERCOT's system production costs by $1.82 billion per year.

Recommendations

- Make compliance with the Renewable Portfolio Standard voluntary.
- Support elimination of the federal production tax credit.
- Require all electrical generators to meet the same standards, including renewable energy sources.
- Eliminate the 50% natural gas mandate.

Resources

The Broken Promise of Renewable Energy Subsidies by Kathleen Hunker (Nov. 2013).

Setting the Record Straight on Renewable Energy Subsidies by Bill Peacock (Feb. 2013).

The Cost of the Production Tax Credit and Renewable Energy Subsidies in Texas by Bill Peacock and Josiah Neeley (Nov. 2012).

Texas Wind Energy: Past, Present, and Future by Drew Thornley, Texas Public Policy Foundation (May 2010).

Learning from Others' Mistakes: What Europe's Experience with Renewable Mandates and Subsidies Can Teach Texas by Josiah Neeley, Texas Public Policy Foundation (Feb. 2012).

Disgorgement

The Issue

In 2011, HB 2133 granted the Public Utility Commission of Texas the power to disgorge revenue from electric companies if the revenue in question is determined to have been derived from "market power abuse" or other violations of the Utilities Code.

However, no evidence exists that market power abuse or similar anticompetitive behaviors has taken place in the Texas electricity market; in fact, the competitive nature of Texas' energy market is one of the features that makes it work so well, and ultimately has kept power affordable and reliable for Texans.

Texas' electrical market helps keep Texas going, both in terms of energy provision and in terms of economic benefits. The investment that deregulation brings not only keeps our energy secure, but also generates new jobs for Texans. In addition, the rates are affordable—far more so than when government regulation controlled the price at the turn of the century.

The threat of disgorgement, however, threatens to stifle the advantages of competition. Rather than allowing the market to self-correct, the changes brought by HB 2133 increase the type of regulation that keep electricity prices high in New York, California, and other regulation-heavy states. This regulatory risk has also reduced the incentives to invest in new generation in Texas and contributed to the concerns over reliability in Texas' competitive electricity market.

Texas' continuing economic success depends on limiting excessive regulation of its energy markets—both the exploration and production of oil and gas and the generation and sale of electricity. Disgorgement threatens the success of Texas' competitive electricity market, and threatens the success of Texas as a result.

The Facts

- Texas' electric markets have helped to lower overall prices without government intervention, and have led to increased investment in our electrical infrastructure.
- Disgorgement powers granted by HB 2133, passed in 2011, threaten the health of Texas' electrical markets.
- No evidence exists of the existence of any market power abuse or similar anticompetitive behavior in the Texas power market.
- Disgorgement is a solution in search of a problem.

Recommendation

- Repeal the provisions added by HB 2133 that allow for the PUC to exercise disgorgement authority.

Resources

A Tale of Two Markets: Telecommunications and Electricity by Bill Peacock, Texas Public Policy Foundation (March 2013).

Don't Ruin the Texas Electricity Market by Bill Peacock, Texas Public Policy Foundation (May 2011).

HB 2133 and 2134: Solutions in Search of a Problem by Bill Peacock, Texas Public Policy Foundation (March 2011).

Water

Water Supply

The Issue

Growth in the economy and population, as well as cyclical droughts throughout much of Texas, increases the urgency of providing adequate supply of water in Texas. The 2017 State Water Plan issued by the Texas Water Development Board estimates that our state will need an additional 8.9 million acre-feet of water per year by 2070 to meet the demands of a population projected to increase from 29.5 million in 2020 to 51 million.

Passed in 1997, SB 1 is a landmark water legislation that led to nationally acclaimed regional and state water supply plans. As required by the legislation, Texas has completed detailed water plans, measuring available water supply, future demand, and identifying strategies to increase supply. Sixteen Regional Water Planning Groups developed comprehensive plans, which the Texas Water Development Board (TWDB) compiled into an official State Water Plan (SWP). The most updated version is to be published in 2017. Regional Water Plans identify thousands of strategies to augment available supply by 3.4 million acre-feet per year in 2020 and 8.5 million acre-feet per year in 2070.

According to the 2017 SWP draft, only 14% of the nearly 3,100 strategies recommended by the 2012 SWP have reported some form of progress. Delays increase the challenge of meeting demands even in the near term. By law, Texas plans for enough water to meet demand during a drought of record, which refers to hydrologic conditions averaged over the decade of the 1950s. But that model may need revising, as droughts of the last few years, particularly the drought of 2011, had worse hydrological conditions than the drought of record.

Project implementation has been delayed, in large measure, by state regulatory issues and funding. Following passage of SB 1, legislation was passed that complicates new water supply projects. SB 2 in 2001 and HB 1763 in 2005 enlarged the authority of Groundwater Conservation Districts, which is now often exercised to limit or block private development of groundwater. In 2007, SB 3 established a multi-layered process leading to the Texas Commission of Environmental Quality's (TCEQ) adoption of Environmental Flow Standards. Water supply projects, based on development of groundwater and new surface water rights permits, are delayed by these new groundwater and environmental flow statutes.

The 84th Legislature saw the passage of HB 200, which established a process for judicial appeal of desired future conditions made by Groundwater Conservation Districts. This is a needed step towards undoing previously legislated water policy, which obstructed beneficial use of appropriate use of water in Texas.

Other regulatory issues complicate water supply projects. The junior rights provision strips water rights of their seniority when surface water is transferred for use in a water basin different from the basin in which the water rights originated. This discourages interbasin transfers, a key strategy to meet future water demand. HB 1153, introduced during the 84th Legislature, called for a repeal of the junior rights provision, a much needed reform.

SB 1 stipulated that "voluntary redistribution" of existing water supply would create much of the water needed for growing demand. Such redistribution assumes a well-functioning water market, which facilitates change of use (e.g., from

irrigation to municipal use) and water transfers. Markets depend upon defined property rights and predictable regulatory decisions.

The Facts

- The 2017 SWP estimates Texas will need an additional 8.9 million acre-feet of water a year until 2070 to meet demand under drought conditions.
- Implementation of the water supply strategies in the 16 Regional Water Plans has an estimated capital cost of $62.6 billion.
- Voluntary redistribution of existing water supply through water marketing is constrained by state and local district regulations.
- Water management strategies could generate nearly 3.4 million acre-feet of additional supply per year by 2020, according to the SWP.
- Surface water strategies in the SWP are estimated to produce 3.8 million acre-feet of additional supply per year, approximately 45% of the total recommended strategy supplies in 2070.
- The 2017 SWP recommends construction of 26 new reservoirs, which would add 1.1 million acre-feet of new supply annually by 2070.

Recommendations

- Remove legal barriers to private investment in water supply projects.
- Amend Texas law to simplify TCEQ approval of water rights amendments.
- Simplify requirements for bed and banks authorization for indirect reuse of water and repeal the junior rights restrictions on interbasin water transfers.
- Amend SB 3 to clarify that the policy objectives for Environmental Flow Standards are critical flows during a drought of record.
- Clarify whether the TWDB's statutory authority in Regional Groundwater Management Areas to establish desired future conditions is consistent with the landowner's right to groundwater in place, as recognized by the Texas Supreme Court in *Edwards Aquifer Authority v. McDaniel*, and the Texas Legislature in SB 332.

Resources

Texas Water Policy Options by Josiah Neeley, Texas Public Policy Foundation (March 2013).

2012 State Water Plan, Texas Water Development Board (Jan. 2012).

Liquid Assets: The State of Texas' Water Resources, Texas Comptroller of Public Accounts (Feb. 2009).

Solving the Texas Water Puzzle: Market Based Allocation of Water by Ronald A. Kaiser, Texas Public Policy Foundation (March 2005).

Draft 2017 State Water Plan, Texas Water Development Board (March 2016).

Surface Water Rights

The Issue

Unlike groundwater, which is owned by the landowner as a real property right, surface water is legally owned by the state in Texas. Texas owns the corpus of the surface water but allocates this water through the issuance of rights for beneficial use of the water. Most Texas surface water rights are held in perpetuity and can only be cancelled for non-use over an extended period of time (TWC 11.0235(a)). Such usufructuary rights are recognized as private rights and entitle the appropriator of a given amount of water from a particular diversion point for a particular beneficial use enumerated in law. Such rights can be bought and sold with minimal state review if the purpose of use is not changed in the transaction.

Like most western states, Texas has adopted the prior appropriation system to allocate quantities of surface water for specific beneficial uses. Texas' prior appropriation system operates under the principle of "first in time, first in right," meaning that older or "senior" rights are given precedence over newer or "junior" rights in times of water shortage. An exception to the prior appropriation system is the landowner's qualified riparian rights for domestic and livestock use.

Surface water is the most significant source for the water supply strategies identified in the State Water Plan (SWP). It is the source of approximately 3.8 million acre-feet of water needed by water user groups, accounting for 45% of the total recommended strategy supplies in 2070 in the 2017 SWP draft. However, state and federal regulatory impediments, and legal questions about water right amendments, interbasin transfers, indirect reuse authorizations, environmental flows, and federal endangered species protection now delay and could preclude key surface water projects.

In 2007, SB 3 created a multi-layered process to protect environmental flows leading to the Texas Commission on Environmental Quality's (TCEQ) adoption of Environmental Flow Standards for instream flows (rivers) and freshwater inflows (bays and estuaries). The law stipulated a bottom-up process with five layers: (1) Bay/Basin Stakeholder Groups; (2) Bay/Basin Science Teams for each river basin; (3) an Environmental Flow Advisory Group appointed by the governor; (4) a statewide Science Advisory Group; and finally (5) TCEQ adoption of Environmental Flow standards in rule.

Some models used to estimate needed environmental flows would require greater volumes than anticipated in previous SWPs and existing law. For example, a key strategy for the Dallas-Fort Worth region involves a transfer of 600,000 acre-feet of water from Toledo Bend Reservoir on the Sabine River. The science team in the Sabine Bay/Basin group recommends environmental flow requirements, which would decrease water available for this transfer, undermining this source of new supply for DFW. Science team reports have prompted federal authorities to interfere with Texas water decisions. The 2017 update is the first SWP to include environmental flow standards in water availability models used for evaluating water management strategy supplies.

Environmental and human needs can both be met but should be legally integrated within the same process. In a state with widely varying rainfall and thus

flows in our rivers, streams, and estuaries, environmental flows should be estimated to protect critical flows under drought conditions.

Restrictions on interbasin transfers also pose obstacles to the completion of water supply projects. Interbasin transfers are a key strategy for certain regions of the state, particularly in the area surrounding Dallas-Fort Worth. SB 1, however, added a new section to the Texas Water Code providing that "any proposed transfer of all or a portion of a water right [in an interbasin transfer] is junior in priority to water rights granted before the time application for transfer is accepted for filing." The junior rights provision thus creates a situation where the act of transferring a water right from a seller to a buyer erases much of the value of that right. This can be a major disincentive to interbasin transfers. HB 1153 in the 84th Legislature called for the much-needed repeal of the junior rights provision but was not passed out of committee.

The Facts

- Texas surface water resources: 191,000 river miles running through 23 river basins, 9 major and 20 minor aquifers, 7 major and 5 minor bays and estuaries, and over 3,300 miles of shoreline.
- Most of the state's existing surface water supply is stored in reservoirs.
- Surface water strategies in the 2017 SWP need to provide 4 million acre-feet per year in additional water supplies to meet Texas' demand for water in 2070.

Recommendations

- Legally integrate the Regional Water Planning process with the now separate Bay/Basin Environmental Flow process. Assert the priority of human need for water.
- Establish policy objectives for environmental flow regimes to protect critical flows during drought and minimum standards for scientific rigor.
- Clarify the "Four Corners Provision" (TWC 11.122(b)) that a water right amendment for only a change or addition of use is not subject to administrative hearing.
- Simplify the requirements for indirect re-use of water in TWC 11.042 and 11.046.
- Articulate policy reinforcing the value of water marketing for efficient and timely implementation of water supply strategies in the SWP.
- Repeal the junior rights provision relating to interbasin transfers.

Resources

2012 State Water Plan, Texas Water Development Board (Jan. 2012).

Rights to Use Surface Water in Texas, Texas Commission on Environmental Quality, *GI-228.*

Solving the Texas Water Puzzle: Market Based Allocation of Water by Ronald A. Kaiser, Texas Public Policy Foundation (March 2005).

Draft 2017 State Water Plan, Texas Water Development Board (March 2016).

Groundwater Rights

The Issue

Groundwater has long provided a major part of the Texas water supply. Undeveloped groundwater can help meet growing demand for water in Texas. Texas has two distinct legal systems governing water: groundwater and surface water. Surface water is owned by the state, which grants water rights to use specific volumes of water for beneficial uses. The Texas Water Code recognizes surface water rights issued in perpetuity as private rights that can be bought and sold.

In contrast, under Texas common law and statute, landowners hold a vested private property right in the groundwater beneath their land. Both the Texas Legislature and courts have recently reaffirmed this principle. Passed in the 82nd Legislature, SB 332 stated that "a landowner owns the groundwater below the surface of the landowner's land as real property." HB 4112, which passed in the 84th Legislature, strengthened groundwater ownership rights by codifying common law. Still, further work is needed to clarify whether the Texas Water Development Board's (TWDB) statutory authority to approve Desired Future Conditions (DFCs) set by Regional Groundwater Management Areas (GMAs) is consistent with the landowner's right to groundwater in place.

In *Edwards Aquifer Authority v. Day*, the Supreme Court held that the rule of capture is not inconsistent with ownership of groundwater in place. Citing the opinion in Day, the Court of Appeals in *Edwards Aquifer Authority v. Bragg* rejected the Authority's argument that its enabling legislation in 1993 gave to the Braggs ownership over water, and its permits, which they did not own before. Therefore, the Authority's denial of water permits to the Braggs for beneficial use in their pecan orchards rose to the level of a taking.

The landowner's property right in groundwater is often confused with the rule of capture. The rule of capture is corollary to the landowner's ownership right; it does not define the groundwater rights but explains the means by which a landowner may exercise the property right.

Like fee title ownership of land, "absolute" ownership of groundwater is subject to reasonable regulation. Since 1949, local Groundwater Conservation Districts (GCDs) have been the main regulator of groundwater in Texas. In 1995, the powers of GCDs were expanded to include pumping limits on wells and tract size, and in 2001, SB 2 enlarged GCD authority including preservation of historic uses and creation of Groundwater Management Areas (GMAs) based on regionally shared aquifers. In 2005, HB 1763 significantly enlarged the scope of groundwater regulation through provisions about DFCs of an aquifer and Managed Available Groundwater (MAGs) determined and overseen by the TWDB. The regulatory authority created expands the state's role in groundwater regulation and is being used to limit or deny groundwater permits at GCDs.

Although GCDs are recognized in law as the state's "preferred method of groundwater regulation" (TWC 36:0015), the system does not always function optimally. GCDs sometimes lack the resources and scientific expertise to make informed permitting and regulatory decisions. District boundaries are often based more on politics than hydrology, resulting in actions in one GCD that affect landowners outside the district boundaries. GCDs are exempt from many of the conflict of

interest rules applicable to other government officials and regulators. In some cases, GCDs have imposed moratoria on groundwater development.

Beginning with the Day decision, Texas courts have begun to recognize that excessive regulation of groundwater can amount to a taking of property for which compensation is owed under the Texas and U.S. Constitutions. Several features of the law governing GCDs make it difficult to mount a successful challenge to burdensome regulation. GCDs are not subject to the record keeping requirements of the state's Administrative Procedures Act, which can complicate judicial review. And if a landowner's challenge to GCD regulation fails in court, he must pay the GCD's attorneys' fees in addition to his own.

The 84th Legislature passed HB 200 that allows judicial appeal of DFCs made by GMAs. This legislation helps undo previously legislated water policy that obstructs effective, efficient, and appropriate use of water in Texas. Despite the obstacles presented by current groundwater law, challenges to GCD authority are increasing.

The Facts

- By 2070, water demand in Texas is projected to increase by 17%, while groundwater supplies are expected to decrease by 24% between 2020 and 2070.
- Texas has abundant groundwater resources: 9 major aquifers and 21 minor aquifers. Total groundwater supplies were approximately 8 million acre-feet in 2010.
- Total groundwater in Texas aquifers is estimated at 17.1 billion acre-feet.
- Texas has 100 local groundwater districts covering all or part of 177 counties.

Recommendations

- Remove legal impediments to the private development of new groundwater supplies and to proper functioning water markets in Texas.
- Review the operations of Groundwater Conservation Districts and Groundwater Management Areas to see what progress has been made in securing proper groundwater regulation, and seek adjustments as needed.
- Reform the rules governing GCD record keeping and conflict of interest to promote greater uniformity of regulation.

Resources

2012 State Water Plan, Texas Water Development Board (Jan. 2012).

Edwards Aquifer Authority v. Day, 369 S.W.3d 814 (Tex. 2012).

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Criminal Justice

Overcriminalization

The Issue

In 1790, there were 23 federal crimes. By 2008, there were over 4,450 federal criminal offenses and over 300,000 regulatory offenses that carried a criminal penalty. These regulatory offenses, promulgated not by Congress, but by unelected bureaucrats, generally criminalize everyday business activity not traditionally left under the guise of the criminal justice system, but rather left for civil and administrative remedies. Many of these "crimes" do not require the actor to know he or she has committed an offense, also known as mens rea.

Texas is not immune to the growing tendency of using the criminal justice system to regulate non-fraudulent business activity. Texas has over 1,700 criminal offenses, of which roughly 300 are found within the Penal Code. This does not count the burdensome and often conflicting local ordinances that carry criminal penalties. The rest (without even counting "catch-all" provisions that make violations of certain sections of agency rules a criminal offense) originate outside the Penal Code and regulate traditionally non-criminal activities in areas such as health care, insurance, agriculture, and fishing. For example, it can be a felony to alter the weight or length of a fish in a fishing tournament.

Texas also has criminal and administrative procedural issues that need to be addressed in the 85th Texas Legislature. Defendants prosecuted for frivolous criminal charges have little recourse to terminate them prior to trial, as is afforded in civil proceedings via "motions to dismiss" and "summary judgments."

Administrative agencies act as quasi-judicial bodies capable of doling out harsh penalties and fines for ordinary business activity with few protections afforded individuals during a criminal or civil proceeding. Texas law generally requires that you exhaust all administrative remedies prior to receiving judicial review. Exhausting all remedies wastes time, money, and resources unnecessarily in certain situations when immediate judicial review is appropriate. Even when you are afforded judicial review, great deference is generally given to the administrative agency decision. Further, there are few provisions preventing criminal prosecution when administrative remedies would suffice.

Grand jury proceedings are ripe for abuse and inconsistent outcomes. Prior to the 84th Legislature, judges were allowed to use judicially appointed commissioners to assist the court in picking the juror pool, a rare process nationwide due to the threat of bias. Now, jurors can only be randomly selected from a "fair cross section of the population of the area served by the court." Further, the suspect is not (usually) present at the grand jury proceeding, nor does he or she have counsel present in the grand jury room. Additionally during a grand jury proceeding, prosecutors are under no obligation to present exculpatory evidence they have come across during their investigation and can bring multiple grand jury proceedings for the same charges if the grand jury does not indict the defendant.

The Facts

- HB 1396 established a committee to make recommendations on repealing all criminal laws outside the Penal Code that are "unnecessary, unclear, duplicative, overly broad, or otherwise insufficient to serve the intended purpose of the law." The bill also codified the Rule of Lenity for laws outside the Penal Code.

The Rule of Lenity is an age-old canon of law that requires an ambiguous criminal law to be interpreted in favor of the defendant.

- HB 2150 removed the method of court-appointed commissioners to pick grand jurors and expanded the cause for challenging a grand juror.

Recommendations

- Enact recommendations from the commission pursuant to HB 1396.
- Require sunset commissions to review criminal penalties for violations of statutes outside the Penal Code within the pertinent agency's purview.
- Preclude the state from bringing a case before the grand jury after a previous grand jury has declined to bring charges, unless there is new material evidence to be presented.
- Expand access for defense counsel in grand jury room to provide balance in the proceedings. For example, allow counsel to be present when a witness/accused is being questioned.
- Require witness testimony to be transcribed and automatically entitle an accused individual a copy of the proceedings following an indictment.
- Require prosecutors to disclose to the grand jury exculpatory information that they come across during their investigation.
- Reform the Code of Criminal Procedure to allow for "as applied" constitutional challenges to a penal statute in a pretrial *habeus corpus* proceeding.
- Allow for a "motion to dismiss" in criminal matters following an indictment.
- Allow a "mistake of law" affirmative defense for criminal statutes outside the Penal Code.
- Allow defense counsel to be subject to suit for legal malpractice arising from their representation of persons in criminal matters.
- Expand and codify exceptions for judicial review of administrative agency suits and alleged violations prior to exhausting all administrative remedies.
- Implement "safe harbor" provisions to all administrative agency codes.
- Require trial *de novo* for every administrative decision in a contested case.
- Establish state preemption of local criminal laws.

Resources

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Policing: Regaining Public Trust

The Issue

Liberty is a guiding principle for the Texas Public Policy Foundation. Protecting the pursuit of liberty and other constitutional freedoms is a critical mission for our nation's peace officers. But many outside the ranks assert confidence of the police in this role has fallen. Militarization, lack of transparency, and over-criminalization often surface as contributing to distrust.

Police are told they are at war—on crime, drugs and terrorism. This has fueled an increase in militarization. Chiefs and sheriffs have introduced armored personnel carriers, high-powered rifles, and combat-style uniforms to their ranks. Citizens could easily mistake their protectors for an invading army. Little transparency exists in the process for obtaining equipment, or in its use. Paramilitary-style SWAT teams have increased as a result. Training and tactics for these units is untethered unless by individual department policy. Statewide tracking of actual deployment of SWAT or the use of their military-style gear is nonexistent. Protective gear such as helmets and vests is not at question. Personnel carriers, grenade launchers and the like are where concern lies.

Situations occur requiring special weaponry and procedures, but a fine line exists that must be monitored where teams are otherwise deployed. Citizen liberties—those protected by our own Bill of Rights—can easily suffer collateral damage from roughshod "battle" tactics. Many police officers fashion themselves warriors. A "warrior mindset" represents a human survival drive and a will to win. This is important when lives are on the line. But the title must be worn with care because it also embodies an infringement to liberty our Founding Fathers fought against in revolutionary times. In fact, the oft-overshadowed Third Amendment represents more than a prohibition to quartering soldiers. To colonists it symbolized the aversion to soldiers with weapons of war policing their communities.

Excessive and unnecessary laws are coupled to militarization. Both lend to questionable police tactics and certainly alter public trust. Committing a traffic violation—any violation—can be grounds for citations and related fines. A police officer can also arrest for even the most minor of infractions if they so choose. State statute and case law affirm this latitude. A simple warning is allowed, but this is at the officer's discretion. Many assert traffic stops are a gateway to detecting other violations or for seizing property and money. An unbridled officer can stop car after car looking for drugs and cash, but only with a cost to those simply commuting from place to place.

Traffic enforcement is meant to educate the public, reduce accidents and save lives. Constant enforcement for simple infractions, however, fosters distrust and creates an atmosphere of animosity, especially in minority communities. Legitimacy of authority and acting justly can powerfully affect a citizen's choice to follow the law. Yet officers lacking capacity or desire to exercise good discretion can cause this to come crashing down.

Indisputably, a law enforcement focus—a mission—is necessary in our society. But "mission over liberty" should never pilot the course.

The Facts

- SWAT team formation, training, equipment procurement, and deployment criteria are not regulated or monitored by the state.
- Local law enforcement, including school district police departments, currently possess or can readily obtain military equipment such as armored personnel carriers and high-powered weapon systems. Requirements for transparency in its planned use, actual use, or costs for upkeep are few.
- Chapter 14 of the Texas Code of Criminal Procedure authorizes peace officers to arrest without a warrant for offenses within their presence or view. Offenders can be stopped and jailed for minor violations, including traffic infractions at the discretion of a police officer even if the category of the offense does not carry a custodial sanction.
- The Fourth Amendment clearly outlines a warrant preference for seizure of persons. An affidavit and prior judicial review is required for an arrest warrant, but not for warrant field arrests where the officer makes a probable cause decision.
- Broad arrest authority for peace officers was affirmed in the United States Supreme Court's ruling in *Atwater v. City of Lago Vista*.
- Most Texas police officers have little training in search and seizure law or in the exercise of discretion beyond that which is required in the basic police academy.

Recommendations

- Require greater transparency in the use of equipment procured from military sources, including the related costs for upkeep.
- Regulate SWAT team formation, training, and deployment criteria to comport with public liberties and constitutional protections.
- Require tracking of SWAT deployments by police agencies, including outcomes from the related situations.
- Require the Texas Commission on Law Enforcement establish more comprehensive training for basic police academy programs and for incumbent officers focused on the better understanding of the principles of liberty, the use of discretion, and the protections afforded citizens under the Fourth Amendment.

Resources

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Procedural Liberty and Asset Forfeiture

The Issue

Our western criminal justice system is, at its core, one of laws, not men. The supremacy of law is deliberate; man's passions are fickle, prone to capricious reaction, and oftentimes unmeasured during times of stress and uncertainty. Steadfastness in the rule of law allows society to weather such perilous times rather than careening from one crisis to another.

The rule of law—and by proxy the legitimacy of the criminal justice system—is rooted firmly in unflinching adherence to the formal procedure as a manifestation of our founding principles. The presumption of innocence, entitlement to a jury of one's peers, the state bearing the high burden of proof, and the sanctity of property rights are representative of our revolutionary inheritance; direct responses to the atrocities endured at the orders of George III and Santa Anna. These procedural elements ensure that the end result of the criminal process is just.

Today, this legitimacy is threatened. Whether by laziness, fear, or emphasis on clearance over correctness, procedural "shortcuts" have cropped up in routine practice, divesting the system of the requisite safeguards to be considered a neutral arbiter of guilt.

One example of this is civil asset forfeiture. Under this practice, police and prosecutors can take your property without ever charging you with a crime. Further, the protections you would have if you are accused of a crime (such as a lawyer or a jury of your peers, just to name a few) are not due during forfeiture proceedings, because it is the property itself that is alleged to be guilty of the criminal offense.

Texans are not even made aware of how much civil forfeiture is being conducted in the state, as there are no requirements to post such numbers, only to inform the attorney general of the aggregate amount of property forfeited.

Further, the original intent of the Fourth Amendment was to allow for police officers to conduct reasonable detentions, searches, and to seize evidence to be later used in a criminal prosecution without a warrant. What it is not intended for is to, failing to produce any evidence of wrongdoing, allow the detention to be extended indefinitely until more invasive warrantless measures can be employed, such as a canine search. Such detention is permissible only if there is a reasonable suspicion of wrongdoing, said six of the U.S. Supreme Court justices in *Rodriguez vs. United States*, including the late Antonin Scalia.

Procedural soundness is not about helping the guilty go free. Those that would do harm to our families and communities must be duly punished under the law, and we must be certain that the punishment is delivered to the correct person. By ensuring that criminal procedure adheres to the intent of our founding documents, we can buttress the legitimacy of our criminal justice system.

The Facts

- Texas law is among the most permissive of civil asset forfeiture, requiring only a preponderance of the evidence standard be met before the government can take property.

- This is more often than not done without any representation of the interests of the property owner.
- In 2012 alone, over $143 million was forfeited by agencies in Texas.
- Texas has a track record of enshrining procedural protections, such as with the codification of *Riley v. California* during the 84th Legislature.

Recommendations

- Wholly eliminate civil asset forfeiture by requiring a conviction before property can be forfeited by the government.
- Empower police and prosecutors by strengthening criminal forfeiture, allowing judges to declare property abandoned if the appropriate government entity has undertook its due diligence in trying to locate the owner and if no one has come forward to claim the property, thereby bypassing the conviction requirement.
- Bolster the "innocent owner defense" for property owners, requiring the state to prove via clear and convincing evidence that the owner knew their property was being used for illegal activities.
- Divert forfeited cash and property to the purview of the jurisdiction's elected body; e.g., the city council or commissioner's court—those with the authority to appropriate.
- Failing meaningful procedural reform, require forfeiting agencies to publicly report information on individual forfeiture proceedings including value of the property and whether a criminal conviction was obtained.
- Codify the standards established in *Rodriguez v. United States*, allowing Texas appellate courts to determine the legality of certain traffic stops under Texas law.

Resources

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Without Due Process of Law: The Conservative Case for Civil Asset Forfeiture Reform by Derek Cohen, Texas Public Policy Foundation (Sept. 2015).

Taking Contraband Without Taking Our Liberties: Civil Asset Forfeiture Reform in Texas by Derek Cohen, Texas Public Policy Foundation (March 2014).

Corrections Budget

The Issue

Texas has the sixth highest incarceration rate in the nation and the most prisoners (147,000) of any state, about half of whom are nonviolent offenders. However, since 2005 when the state began strengthening probation and other alternatives to incarceration, the state's incarceration rate has fallen more than 14%. During this same period, Texas' crime rate has dropped more than 29%, reaching its lowest level since 1968.

In 2007, the Texas Legislature approved a justice reinvestment plan that avoided the construction of more than 17,000 new prison beds, which the Legislative Budget Board (LBB) had projected would be needed by 2012. Instead of spending between $2 and $3 billion to build and operate the projected new beds, lawmakers appropriated $241 million for a package of prison alternatives from drug courts to treatment beds. Funds were also used to clear out parolees not being released because of waiting lists for in-prison treatment programs that must be completed as a condition of release and halfway houses (paroled inmates are not actually released until they have a valid home plan). The new capacity brought online in the 2008-09 budget included 4,000 new probation and parole treatment beds, 500 in-prison treatment beds, 1,200 halfway house beds, 1,500 mental health pretrial diversion beds, and 3,000 outpatient drug treatment slots.

Given that nearly all offenses can result in either probation or prison, sentencing trends may reflect the confidence that judges, juries, and prosecutors have in the effectiveness of probation. Although the LBB has traditionally assumed an annual 6% increase in the number of offenders sentenced to prison due to population growth and other factors, sentences to prison actually declined 6% in 2009 while more nonviolent offenders went on probation. Similarly, members of the Board of Pardons and Paroles have suggested inmates who complete treatment programs are more attractive candidates for parole, which likely explains significant increases in the parole rate over the last decade even as new crimes by parolees have fallen.

Capitalizing on Texas' recent success, the Legislature in 2011 ordered the closure of the Sugar Land Central Unit, the first such prison closure in Texas history, saving taxpayers approximately $20 million over the biennium in operating costs while yielding even more in one-time proceeds from the sale of the property. Moreover, two state jails were closed through the budget approved in the 2013 Legislature.

The Facts

- Prisons cost Texas taxpayers $54.89 per inmate per day, which is $20,034 per year.
- TDCJ's budget increased from $793 million in 1990 to $3.3 billion in 2016.

Recommendations

- **Implement Senate Bill 1055, which was unanimously enacted in 2011 to incentivize lower costs and less recidivism.** SB 1055 provides that counties

can use the share of the state's savings that they receive for community-based programs, which include drug courts, specialized probation caseloads, and residential programs, including short-term use of the county jail to promote compliance. A provision is needed in the next budget authorizing TDCJ to implement SB 1055.

- **Revise probation funding formula.** Currently, state basic adult probation funds are distributed based solely on the number of individuals under direct supervision in that department. Distributing funding based on the number of adult probationers provides an incentive to keep probationers who have been compliant for many years, pose no risk to public safety, and are fully paying their fees on probation longer than necessary. Also, because the current funding formula does not incorporate risk, there is a disincentive to put individuals on probation in lieu of prison who could be safely supervised but only with a lower caseload, specialized treatment, electronic monitoring, and/or other interventions that are costly, though far less so than prison. Furthermore, the current funding formula creates a disincentive for counties to offer pre-charge diversion to first-time, low-risk defendants from probation altogether, such as through the First Chance Intervention program spearheaded by the Harris County District Attorney. Adopting a funding mechanism similar to juvenile probation which incorporates the population of the county but not the number of individuals on probation would address this. The new formula could also incorporate an incentive for early termination of compliant probationers who have fulfilled all of their obligations and do not pose a risk to public safety, adjusted funding based on risk level of the caseload, and an incentive to reduce technical revocations so long as new crimes by probationers either remain the same or decline.
- **Enhance use of problem-solving courts.** Drug courts, mental health courts, DWI courts, and other problem-solving courts have been proven to reduce recidivism and lower costs by diverting appropriate offenders from incarceration while still holding them accountable. State funding should focus on felony offenders, and be based on guidelines that ensure the lowest-risk, low-level drug possession offenders who can succeed with basic probation do not take up slots that could be better used to divert offenders who might otherwise be incarcerated.

Resources

Texas Adult Corrections: A Model for the Rest of the Nation by Greg Glod, Texas Public Policy Foundation (Oct. 2015).

Unlocking the Key Elements of the Adult Corrections Budget by Marc Levin, Texas Public Policy Foundation (May 2011).

The Role of Parole in Texas: Achieving Public Safety and Efficiency by Marc Levin and Vikrant Reddy, Texas Public Policy Foundation (May 2011).

Incentivizing Lower Crime, Lower Costs to Taxpayers, and Increased Victim Restitution by Marc Levin, Texas Public Policy Foundation (April 2011).

Adult Probation and Parole

The Issue

More than 400,000 Texans are on probation, including approximately 218,000 felony probationers. Revoked probationers account for 37% of prison intakes and 41% of state jail intakes. The 22,980 probationers revoked in 2015, including 12,330 revoked for technical violations such as missed appointments, are projected to serve an average of 2.5 years at a cost of $54.89 a day, resulting in an annual cost of $460 million.

The 84th Texas Legislature continued incentive-oriented probation funding that was first authorized by the 79th Legislature in 2005. Departments are eligible for the incentive funding if they adopt graduated sanctions and pledge to reduce technical revocations. Graduated sanctions involve utilizing measures such as increased reporting, community service, curfews, electronic monitoring, mandatory treatment, and even shock-nights in county jail prior to revoking a probationer to prison for technical violations. A technical violation is conduct that contravenes the terms of probation (such as missing an appointment) but which is not a new crime.

Most of the $55 million in funding went towards reducing caseloads from approximately 150 to 110 probationers per officer in major metropolitan areas and expanding specialized, much smaller caseloads for subgroups such as mentally ill probationers. This facilitated closer supervision, and the consistent application of such sanctions. Participating probation departments have implemented graduated sanctions and reduced revocations, allowing the state to avoid at least $226 million in incarceration costs. While progress has been uneven as the minority of departments not participating have increased revocations, overall from 2005 to 2013 the share of probationers revoked to prison for technical violations—failure to comply with probation rules rather than conviction of a new offense—fell 8.7%.

However, recent results from parole have surpassed probation. Even as the parole rate has risen dramatically, the number of new convictions by parolees leading to revocation hearings has dropped from 7,439 in 2006 to 5,191 in 2014. Technical revocations of parolees have plummeted from 2,031 in 2006 to 843 in 2014. Now, the technical revocation rate for parolees is more than five times lower than that of probationers. This is likely attributable to many factors, including greater use of intermediate sanctions facility beds by the parole board which do not count as a revocation and the fact that parole is a statewide system with decisions made by one parole board, whereas there are 121 probation departments with revocation decisions shaped by countless probation officers, prosecutors, and ultimately elected judges.

The Facts

- Probation costs $3.20 per day, of which the offenders pay 54% of that in fees. Parole costs $4.04 per day.
- At a 2016 interim hearing before the House Corrections Committee, testimony offered by the head of the Texas Department of Criminal Justice Community Assistance Division indicated that while a state audit found that gradu-

ated sanctions were used in 60% of probation technical revocations, this still leaves 40% of cases where this evidence-based practice was not followed.

Recommendations

- **Require probation with mandatory treatment for first-time, low-level drug possession offenders.** SB 1909, passed by the Senate in 2007, would have made this change, applying only to offenders convicted of possessing less than four grams of drugs such as cocaine. Those convicted of drug delivery were excluded, as were drug possession offenders who had a previous conviction for any offense other than drug possession or a traffic violation. Those covered would be sentenced to mandatory probation and treatment. The judge would determine whether the offender would go to a residential facility, which could be the state's six month secure Substance Abuse Felony Punishment Facilities (SAFPFs), or day treatment, or a combination. The bill specifically included faith-based treatment programs that meet state standards. Under SB 1909, an offender could still be initially sent to prison upon a documented judicial finding of danger to the community. Furthermore, if the nonviolent drug user did not comply with the treatment program or otherwise violated their probation, they could be revoked to prison for up to ten years. The LBB estimated that SB 1909 would have saved taxpayers $500 million over five years.
- **Cap maximum time nonviolent revoked probationers can serve for technical violations.** Given that research shows that the swiftness and sureness of punishment is more important than the length of stay and that there is less of a need to incapacitate nonviolent offenders, technical revocations of nonviolent offenders who have not previously been revoked should be capped at nine months or less with eligibility for parole occurring at six months.
- **Reduce number of inmates discharged without supervision and eliminate practice of releasing inmates directly from solitary confinement.** Studies have found that both of these practices lead to higher recidivism rates. One study of similar inmates in New Jersey found those released on to parole were 36% less likely to commit a new crime. While the sentences of those already incarcerated cannot be constitutionally extended to include a post-release supervision period, those who are scheduled for release within six months and have already served at least three years could be given an option of leaving three months early in exchange for six months on supervision.

Resources

The Role of Mental Health Courts in Texas by Marc Levin, et. al, Texas Public Policy Foundation (April 2015).

Incentivizing Stronger Probation in the Texas Budget by Marc Levin, Texas Public Policy Foundation (March 2013).

Juvenile Justice

The Issue

Juvenile offenders are more impressionable than adult offenders, and have longer lives ahead of them. This raises the stakes for both success and failure for both future public safety and taxpayer costs when dealing with juveniles. Sentencing youth to ineffective, inappropriate programs and facilities could place a one-time nonviolent offender on a path of persistent wrongdoing; essentially making the youth a lifetime siphon of resources rather than contributor.

One of the simplest reforms for ensuring juvenile offenders are placed in the most appropriate setting would be to expand the limit of juvenile court jurisdiction from 16 to 17-year-olds for misdemeanants and give adult courts the discretion to transfer certain 17-year-old nonviolent felony offenders. Raising the age of juvenile jurisdiction would align Texas with the vast majority of other states in the country, who also set the cut-off age for juvenile jurisdiction at 17. These youths are likely to have committed a minor infraction that would warrant probation; juvenile probation is much better situated to engage parents, who have no right to participate in the adult system or even be informed that their child was arrested at all, strengthening the family's capacity to provide structure and discipline. Moreover, juvenile probation typically works with the youth's school to ensure the youth is attending school and exhibiting appropriate behavior. Further, if the situation warrants it, prosecutors can continue to ask that the court certify any youth to stand trial as an adult if charged with a violent or sex offense, and even some drug and property offenses.

Youths in Texas may reach the juvenile justice system in unexpected ways. Until 2013, students could receive tickets for misbehavior in their schools, and failure to respond or an accumulation of tickets sometimes resulted in arrest warrants and jail time. Further, truancy was a criminal offense, and until 2015 had many of the same issues. Today students still receive punishments disproportionately in certain districts which place them at a higher risk of later becoming involved in the criminal justice system.

It costs some $437.11 per youth per day to house youth in state lockups operated by the Texas Juvenile Justice Department (TJJD), the agency that was created in 2011 with the merger of the Texas Juvenile Probation Commission and Texas Youth Commission (TYC). Although this cost has been growing steadily, it stems in great part from successful efforts to reduce the population in these facilities from about 5,000 in 2005 to 1,100 in 2013. As fewer kids are being committed to TJJD residential facilities, the statewide system inherently becomes less efficient as economies of scale are lost.

However, as these trends continue, closing down more facilities may be possible, thereby representing wholesale reductions in system costs. In fact, recently, a regionalization plan was enacted, in order to downsize the state facilities by up to 80% in the coming years, diverting youth to regional facilities and further shrinking costs, similar in some respects to the successful Missouri Model, which keeps juveniles in localized settings for therapeutic treatment.

The Facts

- There were 141,734 juvenile arrests in Texas in 2005. In 2014, there were only 59,447 juvenile arrests. Arrests of juveniles for murder and manslaughter with a culpable mental state greater than negligence fell from 54 to 30.
- Largely due to a greater than two-thirds drop in the number of youths in TJJD lockups, the TJJD facilities budget for 2014-15 was $319 million, less than the $427 million appropriated to TYC in 2006-07.
- As seen in the Missouri Model of juvenile justice, localized and regional treatment of juvenile offenders can reduce cost and the recidivism rates of juvenile offenders.
- The crimes committed by 17-year-old offenders are more in line in substance with the crimes committed by 15- and 16-year-olds, and 17-year-olds also see a reduction in recidivism rates when sent through the juvenile system.

Recommendations

- Raise the jurisdiction of the juvenile court to cover 17-year-old misdemeanants. This will increase public safety due to the lower recidivism rates in the juvenile system and save taxpayer dollars. These savings will compound over time as fewer youth return to the criminal justice system in their adult years.
- Failing that, empower adult criminal court judges with the authority to transfer 17-year-old nonviolent felons to the juvenile court. This will allow courts to examine each case in light of factors such as the maturity of the 17-year-old, prior record (if any), and assessed risk level, all of which will help the court determine whether the more intensive rehabilitative programming and smaller caseloads in the juvenile system would benefit that offender.
- Expand use of specialized caseloads with specially trained supervision officers for medium to high-risk mentally ill youths on juvenile probation and parole, in light of evidence that such programs as the Front End Diversionary Initiative (FEDI) substantially reduce recidivism and revocations.

Resources

The Texas Model, Juvenile Justice by Dianna Muldrow and Derek Cohen, Texas Public Policy Foundation (Nov. 2015).

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A Critical Look at Juvenile Offenders with Mental Illnesses: What We Know, What We Don't, and Where We Go from Here by Jeanette Moll, Texas Public Policy Foundation (Jan. 2012).

Records and Reentry

The Issue

In 2014, 70,521 adult inmates were released from Texas prisons and state jails. Approximately 20% of released state prison inmates and 30% of jail inmates are re-incarcerated within three years, either for a new offense or for violating the rules of their parole supervision.

Many offenders—but not all—that are released are placed on parole. As of August 2014, 113,898 Texans were under parole supervision. In recent years, the number of parolees convicted of new crimes has been declining. This success may be due to recent strengthening of parole supervision and treatment, as well as graduated sanctions for technical violations.

Before 2011, state jail inmates served a flat sentence of up to two years. During the 82nd Legislature, however, the law was changed to award diligent participation credits to state jail offenders who make progress in educational, vocational, and treatment programs. This was further streamlined by HB 1546 in 2015 that allowed TDCJ to implement these credits, saving judicial time and resources.

Immediately upon reentering society, ex-inmates face challenges such as obtaining employment and housing and establishing positive associations. Evidence shows that ex-offenders who are employed are less likely to offend again, and those in higher-paying jobs, which are more likely to be licensed, re-offend at the lowest rate. There are several ways that the reentry process can be aided in order to maximize safety and employment. One key possibility is increasing the use of orders of nondisclosure. Orders of nondisclosure were expanded by the Legislature in 2015 for certain offenders after specific periods of time. These orders allow a first-time offender who committed a nonviolent crime to request that their record be sealed after they have completed their sentence and a specified time frame has elapsed. Sealing these records means that these offenders can accurately state that they have not been convicted of a crime on an employment form. However, law enforcement is still able to access these records, as well as sensitive employers, such as schools and hospitals.

Nondisclosure has provided an opportunity for a second chance for those with criminal records, but it is also important that those criminal records be accurate in the first place. Errors or incomplete records in state and local databases can lead to inaccuracies in private companies' aggregated databases and stick innocent citizens with erroneous criminal records for an unknown amount of time. Further, false positives can result when private databases do not provide sufficient detail to link a record to a name, seemingly giving individuals with common names a record, or when the databases are not updated after an arrest failed to result in charges, or a conviction was overturned.

The Facts

- In 2014, parole cost $4.04 per day per offender, compared to $54.89 a day per prison inmate.
- Finding employment after release reduces the likelihood of recidivating by around 20% according to a study by the Manhattan Institute.

- The FBI criminal database is estimated to have around 600,000 errors or incomplete records, which are then transferred to private databases, to which employers and landlords often subscribe.

Recommendations

- Continue to strengthen parole supervision and treatment programs that reduce recidivism and revocations.
- Expand orders of nondisclosure to cover first time convictions for nonviolent or nonsexual offenses.
- Increase accuracy standards in criminal record keeping to minimize the number of incomplete records that are disseminated.

Resources

The Role of Parole in Texas by Marc Levin and Vikrant Reddy, Texas Public Policy Foundation (May 2011).

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Texas Criminal Justice Reforms: Lower Crime, Lower Cost by Marc Levin, Texas Public Policy Foundation (Jan. 2010).

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Local Government

Property Tax

The Issue

Texas' local property tax is big and fast-growing. In fiscal 2013, local governments received in excess of $45 billion in property tax revenue, making it the single largest tax imposed in the Lone Star State. Of the total levy, school district taxes represented more than half of the overall burden, at $24.9 billion. The number of taxing jurisdictions levying a property tax grew to more than 4,000 statewide, an increase of 10.6% compared to a decade prior.

Property Taxes by Unit Type, Fiscal Year 2013

	# of Local Governmental Units	Property Tax Levy	% of Total Tax Levy	% Levy Change from 2012 to 2013
School Districts	1,020	$24,854,671,461	54.91%	+7.72%
Counties	254	$7,558,398,797	16.70%	+6.99%
Cities	1,066	$7,324,430,896	16.18%	+3.61%
Special Districts	1,756	$5,529,434,215	12.22%	-0.25%
Total	**4,096**	**$45,266,935,369**	**100%**	**+5.89%**

Source: Texas Comptroller

Compared to other major U.S. states, Texas' property tax burden rates among the worst. According to the Tax Foundation's latest survey of all states, local governments collected $1,559 in property tax revenue in 2012 from every man, woman, and child in the Lone Star State, ranking as the 14th worst for taxpayers.

Property taxes in Texas are not only substantial, but the burden is growing quickly. From 2000 to 2013, property taxes levied across the state grew by more than 101%. Over that same period, population and inflation—a commonly used metric that accounts for the rising cost of funding basic public goods and services along with economies of scale—increased by only 70.3%. This disparity suggests that local property taxes are growing faster than Texans' ability to afford them.

The consequences of high and fast-growing property taxes are numerous. Studies suggest that oppressive taxes can discourage economic growth and activity, distort investment decisions (especially among capital intensive industries), and depress job creation. It is critical that Texas lawmakers take steps to mitigate these negative effects with substantive policy reforms.

One such reform that could go far to protect and promote the Texas economy has to do with controlling the rate of growth of property taxes. Under the Foundation's proposal, political subdivisions should be required to seek voter approval for tax rates that allow property tax revenues to grow by 4% or population and inflation, whichever is less. In this way, the onus is placed on local governments to justify to voters why their property tax bills should continue to grow at such a rapid rate.

Structural reforms, like the one above, are key to creating a more predictable and sustainable tax environment that is necessary for ongoing economic growth and job creation. Without these kinds of long-term taxpayer protections in place, Texans will continue to struggle under the weight of an oppressive property tax system.

The Facts

- Texas' property tax is the single largest tax in the Lone Star State.
- In fiscal 2013, more than 4,000 local governments levied $45.3 billion in property taxes on Texas homeowners and businesses.
- From 2000 to 2013, Texas' property tax grew by 101.1%. Population and inflation increased just 70.3% over the same period.

Recommendation

- Require voter approval for property tax rates that result in property tax revenue increases of 4% or population growth plus inflation, whichever is less.

Resources

Texas Property Tax Reform Needed by Allegra Hill and James Quintero, Texas Public Policy Foundation (Dec. 2015).

The Freedom to Own Property: Reforming Texas' Local Property Tax by Kathleen Hunker, James Quintero, and Vance Ginn, Texas Public Policy Foundation (Oct. 2015).

Testimony: Ten Facts About Texas' Property Tax by James Quintero,Texas Public Policy Foundation (April 2015).

Local Control

The Issue

Local control is a policy preference favored by many in the Lone Star State, but its misuse and misapplication over the years has enabled the rise of a whole host of bad public policies.

This sentiment was echoed last year by then-Governor-elect Greg Abbott at the Texas Public Policy Foundation's 13th annual Policy Orientation for the Texas Legislature during his keynote address, at which he remarked:

> The truth is Texas is being California-ized and you may not even be noticing it. It's being done at the city level with bag bans, fracking bans, [and] tree-cutting bans. We are forming a patchwork quilt of bans and rules and regulations that is eroding the Texas Model.
>
> Now think about it—few things are more important in Texas than private property rights. Yet some cities are telling citizens that you don't own some of the things on your property that you have bought and purchased and owned for a long time. Things like trees. This is a form of collectivism.
>
> Some cities claim that the trees on private property belong to the community, not to the private property owner. Large cities that represent about 75% of the population in this state are doing this to us. **Unchecked over-regulation by cities will turn the Texas miracle into the California nightmare faster than you can spell TPPF.** (emphasis added)

As rightly suggested by the governor, a slew of onerous rules, restrictions, and regulations have been put in place locally that threaten to turn Texas into something unrecognizable. The glut of restrictive regulations run the gamut from the types of businesses allowed within a city limit to the kind of bags a person can use at the grocery store to the things a person can and cannot do in the privacy of their own vehicle. Indeed, there seems to be no nook or cranny too small to escape the growing regulatory reach of Texas' local governments.

More often than not, the justification given for these intrusions hinges upon "local control," or the state-afforded authority granted to communities to govern certain policy areas. Local governments know best how to solve their problems, or so the thinking goes. But where this rationale frequently goes off the rails is in its emphasis of local control over other, more important governing principles, such as liberty.

Liberty, not local control, is the overriding principle that should inform and direct our public policymakers. For without liberty, local control merely becomes a means toward the end of local tyranny.

It is through the lens of liberty that Texas' elected officials ought to be crafting public policies so as to protect and promote those inalienable rights of life, liberty, and property rights. To the extent that a law or regulation violates these core values, it should be held suspect by the state.

While some will seek to criticize this stance, local control is a preference that should neither be unlimited nor unchecked.

Like all government power, local control must be confined and monitored to avoid abuse and misapplication. Such checks are particularly important given local governments' peculiar vulnerability to persuasive leaders and factions. As Founding Father James Madison explains in the Federalist No. 10:

> The influence of factious leaders may kindle a flame within their particular States, but will be unable to spread a general conflagration through the other States. A religious sect may degenerate into a political faction in a part of the Confederacy; but the variety of sects dispersed over the entire face of it must secure the national councils against any danger from that source. A rage for paper money, for an abolition of debts, for an equal division of property, or for any other improper or wicked project, will be less apt to pervade the whole body of the Union than a particular member of it; in the same proportion as such a malady is more likely to taint a particular county or district, than an entire State.

Since the nation's founding, our leaders have recognized the vulnerabilities of local governmental structures and the need for proper supervision from state authorities. This view—that state government serves as a check on local government overreach—is not new.

The state's supervisory role operates as a safeguard for the sake of the citizenry, ensuring that there's at least some avenue to protect against local tyranny. Moreover, the state is, in many cases, ultimately responsible for local government actions, especially in matters of public finance. Thus, it has an inherent interest in making sure that local governments operate within the bounds of right and reason.

The Facts

- Texas is being California-nized with a patchwork quilt of bans, rules, and regulations enacted at the local level.
- Liberty, not local control, is the overriding principle that should inform and direct our public policymakers.

Recommendation

- Allow liberty, not local control, to be the overriding principle that informs and directs Texas' public policymaking process.

Resources

Laredo Merchants Association v. City of Laredo, Texas Amicus Brief by Robert Henneke, Allegra Hill, and Kathleen Hunker, Texas Public Policy Foundation (March 2016).

Involuntary Annexation

The Issue

Texas law allows cities to unilaterally expand their boundaries by annexing new territory without the consent of its residents. Cities can thus assert control over outlying areas without giving affected property owners a vote in the process.

Municipal annexation power dates back to the 1912 Home Rule Amendment to the Texas Constitution. In response to a nationwide debate about citizens' rights to local self-governance, Texans enshrined the concept into the state's formational document. Home rule cities are thus defined by what they cannot do; such municipalities have the authority to exercise any power that is given them by the people and not prohibited by the Constitution or laws of the state.

Since no limit on annexation was expressly stated in the 1912 amendment, cities wielded virtually unlimited authority to annex property. However, after watching cities abuse the annexation power throughout the 20th century, the Legislature began to enact reforms.

In the 1960s for example, a land battle between Houston and Friendswood prompted the Legislature to pass the Municipal Annexation Act of 1963. The Act limited cities' expansion to a confined buffer zone around the municipality known as the extraterritorial jurisdiction ("ETJ").

Similarly, in 1989, the Legislature created a requirement that cities prepare a municipal annexation plan to extend services to newly annexed areas within four and a half years after annexation.

Finally, the "mother of all annexation battles" occurred in 1996. Houston decided to quickly and unilaterally take control of the wealthy, politically active Kingwood community while ignoring the area's vocal protestations. Less than a month later, Kingwood residents found their way to the Capitol, and the Texas Legislature enacted heightened requirements for municipal annexation plans, public hearing timelines, and notice requirements.

These annexation reforms made a significant difference in limiting some of the more dangerous parts of annexation authority generally, but do not go far enough in addressing the fundamental flaws inherent in the system, such as the involuntary nature of the process.

Cities have used the annexation laws to gerrymander municipal boundaries for their benefit, leading to some strangely-shaped jurisdictions:

To overcome these flaws and better protect Texans' property rights, the Legislature should reform the system to allow affected property owners a chance to participate in the process through a popular election.

The Facts

- Citizens who prefer a smaller government and fewer central services live outside the city limits for a reason. Forcing citizens to become part of a city denies them the ability to vote with their feet.
- Cities view annexation as a way to expand their tax base and capture additional revenue, whether or not such annexation increases efficiencies. Wealthier suburbs are thus favored for annexation, although poorer areas outside of the city limits can oftentimes benefit more from municipal annexation since these communities frequently lack sufficient services.
- Cities often underestimate how much it will cost to expand their services to annexed areas, resulting in a dilution of services. Researchers Mary Edwards and Yu Xiao reported in the Urban Affairs Review that cities are typically required to take out debt and issue bonds to finance the costs of annexation. The San Antonio Police Officers Association vocalized this concern in opposition to the city's 2015 annexation plan, with the president of the union stating, "I think it's [annexation's] a horrible idea. We're barely covering what we've got right now."

Recommendations

- Require a vote of affected residents and property owners prior to a municipal annexation. If the vote does not pass, the city should not be permitted to annex the area.
- Review the disannexation process to ensure that previously annexed citizens can enforce municipal promises to extend services to annexed areas, without the necessary involvement and approval of the Texas attorney general.

Resources

Ending Forced Annexation in Texas by Jess Fields and James Quintero, Texas Public Policy Foundation (July 2015).

The Philosophical Case Against Forced Annexation by James Quintero and Jess Fields, Texas Public Policy Foundation (July 2015).

Municipal Annexation by Alan Bojorquez, Bojorquez Law Firm, PC (Dec. 2014).

Local Ordinance Integrity

The Issue

Local governments are held accountable for violations of civil law only when a group of injured Texans happen to have sufficient time, money, energy, and interest to challenge the violation in court.

Texas' local governments violate the law if they adopt a charter amendment or ordinance that is "inconsistent with the Constitution of the [Nation, or the] State, or of the general laws enacted by the Legislature," or if they transgress another established charter provision or ordinance. Currently however, enforcement of civil law against municipal overreach is almost exclusively handled by private parties. There is no general grant of statutory standing or authority that provides for public enforcement when local governments violate civil laws.

- **Violations of Federal Law:** The state cannot legally challenge cities that adopt their own policies in violation of federal law, e.g., "sanctuary cities."
- **Violations of State Law:** The state cannot intervene when municipal ordinances violate state laws. For example, Texas Health & Safety Code Section 361.0961 prohibits cities from enacting certain types of plastic bag restrictions. Many of the municipal plastic bag bans in place throughout the state run afoul of this statute. Yet, rather than allowing the state to step in and enforce its laws or resolve the interpretation issue, current statute requires private citizens and businessmen to challenge the cities' plastic bag bans one-by-one in court.
- **Violations of Local Law:** Individual Texans are required to wage legal battles to enforce municipal charters. In 2010, the Houston City Council used legally-insufficient language to misrepresent a drainage fee charter amendment to voters. Later, in 2014, the council refused to put the controversial "HERO" ordinance on the city's ballot, in violation of Houston's referendum procedures. In both instances, Houstonians had to pay tens—if not hundreds—of thousands of dollars to take the cases before the Texas Supreme Court and mandamus city officials to force them to comply with the law.

The rule of law is fundamental to our constitution-based society, and must be upheld. In America, this is largely accomplished through the separation of powers; if the legislative branch overreaches or enacts an illegal law, the judicial branch has the power and responsibility to strike it down. However, a court cannot act unless and until the case is before it. Thus, someone must bring suit, charging the city with a legal violation. Currently, Texas puts the burden on private citizens to find sufficient time, money, and energy to enforce the rule of law and hold their cities accountable. Another avenue is needed to ensure accountable governance.

The Facts

- Cities throughout the state are passing bag ban restrictions that arguably violate state law. Texas Health & Safety Code Section 361.0961(a) prohibits ordinances that "assess a fee or deposit on the sale or use of a container or package," or "prohibit or restrict, for solid waste management purposes, the sale or use of a container or package." In 2014, then-Attorney General Greg Abbott issued an official opinion regarding pnm Section 361.0961, stating that municipal

plastic bag bans were subject to the statute, and could not be enacted for waste management purposes. Despite this, many cities have plastic bag bans in place. Dallas repealed its ordinance in the face of private legal action, and the Laredo Merchants Association is currently paying extensive legal fees to hold their city accountable as well.

- Houstonians had to pay tens of thousands of dollars to force the city to comply with its own charter procedures and requirements. In 2014, Houstonians gathered approximately 30,000 signatures to challenge an Equal Rights Ordinance passed by the City Council. The city refused to recognize the legitimacy of the petition, or to put the ordinance on the ballot. Ultimately, residents challenged the city before the Texas Supreme Court in *In re Jared Woodfill*. The Court issued a *writ of mandamus* compelling city officials to either repeal the ordinance, or put it on the ballot.
- Houstonians had to fund a court case to challenge Houston's deceptive and misleading ballot language. The Houston City Council passed a drainage fee charter amendment in 2010, putting it before the voters for approval. However, the city's ballot description of the amendments failed to mention its key characteristic: the drainage fee. Reviewing the amendment in the 2015 case *Dacus v. Parker*, the Texas Supreme Court held that Houston failed to identify the measure for what it is, and thus misled voters as a matter of law.
- In October 2015, Dallas County Sheriff Lupe Valdez announced a new department policy to determine whether illegal immigrants should be detained for ICE on a "case-by-case" basis. Governor Greg Abbott chastised Sheriff Valdez for her policy, calling on her to comply with all ICE detainer requests, regardless of her "case-by-case" opinion. However, even the governor could not give teeth to his request; instead, he simply detailed the legislation he planned to advance to force the sheriff to comply with federal law.
- Per Article 4, Section 22 of the Texas Constitution, and Section 402.021 of the Texas Government Code, the attorney general has the power and responsibility to "represent the State in all suits and pleas," and to "prosecute and defend all actions in which the state is interested."

Recommendation

- Reaffirm and refine the attorney general's power to intervene in instances of local government overreach.

Resources

Local Ordinance Integrity: Written Testimony to the Senate Intergovernmental Relations Committee by James Quintero, Texas Public Policy Foundation (Dec. 2015).

Local Spending

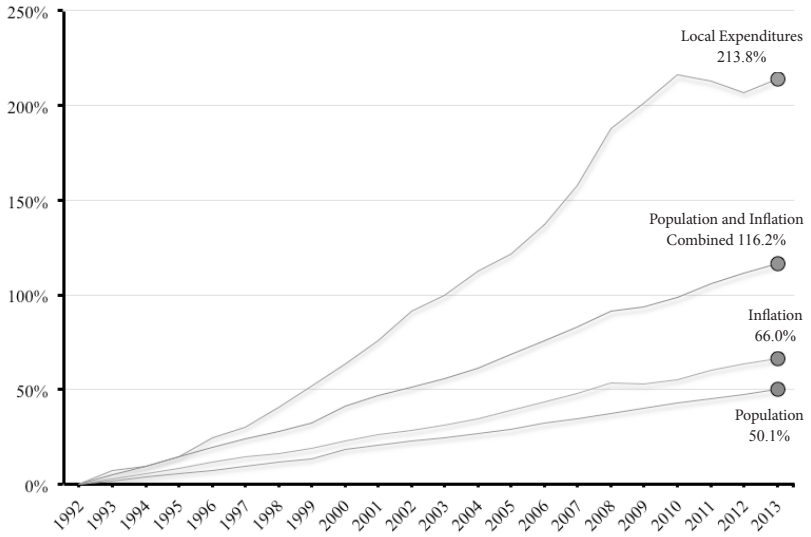
The Issue

For decades, local government spending has grown much faster than the ideal. According to the U.S. Census Bureau, local government spending in Texas totaled $40.3 billion in 1992. By 2013—the latest available data—aggregate local spending had risen to $126.4 billion, representing an increase of almost 215% over the period.

While some level of increase is to be expected—especially in a fast-growing state like Texas—the trajectory of local spending growth has been well in excess of traditional economic measures like population and inflation.

From 1992 to 2013, Texas' population grew from 17.7 million to 26.5 million, equating to an increase of 50.1%. Meanwhile, the Bureau of Labor Statistics' Consumer Price Index (U.S. All items, 1982-84) suggests that inflation simultaneously increased by 66%. Thus, population and inflation grew at a much more modest rate of 116.2%, suggesting a clear imbalance between the actual and ideal rates of growth.

Growth Comparison: Local Spending, Population, and Inflation



Note: Totals may not add due to rounding.
Source: U.S. Census Bureau, U.S. Bureau of Labor Statistics

Accelerated spending growth at the local level has not been without consequences. The most obvious of which has been the imposition of a high and fast-growing property tax on homeowners and businesses. Less visible are the inefficiencies that tend to accumulate in budget structures that have no stringent spending requirements.

If Texas is to remain the nation's economic engine, then it is critical that Texas policymakers get a handle on local governments' spending problem.

The solution to controlling spending is controlling revenue. The Texas Legislature should change the current rollback system to require voter approval for property tax rates that result in property tax revenue increases of 4% or population growth plus inflation, whichever is less.

Dr. Arthur Laffer, one of President Ronald Reagan's chief economic advisors, said it best: "Government spending is taxation." If the Texas Model of low taxes and limited government is to be maintained well into the future, then it is critical that policymakers contain the growth of local spending and the tax increases that necessarily come along with it.

The Facts

- There are few, if any, restrictions on the rate of growth of local government spending.
- Local government spending totaled $40.3 billion in fiscal 1992. By fiscal 2013, local spending had grown to $126.4 billion, representing an increase of 213.8%. Over the same period, population growth and inflation increased by just 116.2%.
- The accelerated rate of local spending growth helps, in part, to explain the high and fast-growing nature of property taxes in Texas.

Recommendation

- Require voter approval for property tax rates that result in property tax revenue increases of 4% or population growth plus inflation, whichever is less.

Resources

"Local government should follow state's lean budget lead" by James Quintero, *Austin American-Statesman* (Aug. 4, 2015).

Reforming Texas' Tax and Expenditure Limit by Talmadge Heflin and Vance Ginn, Texas Public Policy Foundation (Jan. 2015).

Shining a Light on Local Spending and Debt: Testimony to the House Appropriations Sub-Committee on Budget Transparency and Reform on House Bill 14 by James Quintero, Texas Public Policy Foundation (March 18, 2013).

Local Debt

The Issue

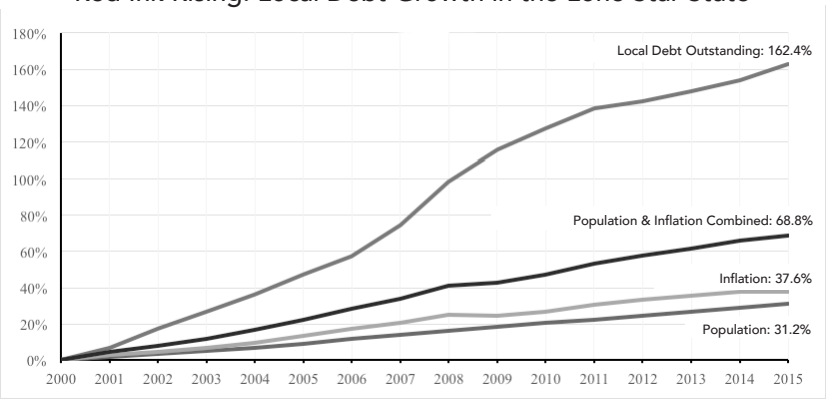
Texas' local governments are awash in red ink. In fiscal year 2015, the principal amount of debt owed by cities, counties, school districts, and special districts in Texas amounted to $212.4 billion, "an increase of $20.09 billion (10.4%) over the past five fiscal years," according to the Bond Review Board. On a per capita basis, that level of indebtedness translates into an obligation of $7,750 owed per person.

Of course, the burden is even greater when interest is accounted for. Texas' total local debt, including principal and interest, stood at more than $338 billion in fiscal year 2015. On a per capita basis, the tab for each Texan amounts to roughly $12,250 while the bill for a family of four is almost $50,000.

Most of Texas' local debt burden can be traced back to city and school district excess. City governments collectively owe $105.8 billion while ISDs owe a combined $117.7 billion, representing two-thirds of the overall total.

It's not just the size of local debt that is staggering, but also the rate at which it is accumulating. From 2000 to 2015, local government debt soared by more than 162%. Over the same period, traditional economic measures like population and inflation grew just 68.8%, proving that there's a significant delta between the actual and ideal rates of growth.

Red Ink Rising: Local Debt Growth in the Lone Star State



Source: Texas Bond Review Board, U.S. Census Bureau, U.S. Bureau of Labor Statistics

The girth and growth of local debt are among Texas' most pressing public policy problems. In the absence of meaningful reform, the status quo is sure to produce higher taxes, lower credit ratings, and slower economic growth.

While there's no silver bullet solution, there are several important reforms that can help get Texas back on firmer footing locally. And of those, ballot box transparency is perhaps the most important.

Upon entering the voting booth, a Texan has just two pieces of information in front of him or her for any given bond proposition: a short paragraph of legal-

ese that can usually be construed to mean anything and the principal amount to be borrowed. Absent is any detail on how the bond's passage might affect the average taxpayer or how much the bond is expected to fully cost.

With so little information available to voters at the point of decision-making, many Texans make million and billion dollar debt decisions without being fully informed. This is not a recipe for success.

Voters need more information to be in the best position possible to make prudent fiscal decisions. To ensure a more well-informed electorate, the Legislature should require all new debt propositions to include a short list of simple facts, including:

- The estimated combined principal and interest required to pay the proposed bonds on time and in full; and
- The estimated additional tax burden on the average area resident that would result from the passage of the measure.

Reforming the process to include just this little bit of extra information could have a profound impact on the state's fiscal future. Because without an informed electorate making prudent fiscal decisions, other reforms simply won't matter.

The Facts

- In fiscal 2015, local debt outstanding (principal only) was estimated at $212.4 billion, or approximately $7,750 owed per person.
- In fiscal 2015, local debt service outstanding (including principal and interest) was estimated at $338.4 billion, or approximately $12,250 owed per person.
- Among the top 10 most populous states, Texas' local debt per capita ranks as the 2nd highest total, behind only New York.
- Only two items of information are included with each proposed debt issuance: the principal amount that the governmental entity intends to borrow and a general description of the purpose.

Recommendation

- Require local governments seeking to issue bonds to provide voters with basic financial information about the proposition being decided upon.

Resources

Red Ink Rising in the Lone Star State by James Quintero, Texas Public Policy Foundation (May 2016).

Ensuring Debt Transparency, Accountability, and Fair Elections, Texas Public Policy Foundation (Sept. 2014).

Improving Financial Transparency at the Ballot Box by James Quintero, Texas Public Policy Foundation (Aug. 2014).

Special Purpose Districts

The Issue

Special purpose districts (SPDs) are the most numerous units of government in Texas, yet many people know relatively little about their function, structure, or governance, earning them the nickname: Invisible Governments.

SPDs are independent governmental entities that exist locally and provide infrastructure and deliver specific services, like firefighting, road construction, and water treatment. Districts can be created by local government bodies, the Texas Legislature, or the Texas Commission on Environmental Quality. Generally, SPDs are governed by the commissioners court of the county of their origin or by a board of directors.

The purpose and jurisdiction of SPDs tend to vary from district to district, but broadly speaking, they can include the power to:

- Impose a property tax;
- Impose a sales tax;
- Issue bonds and borrow money;
- Contract with other entities;
- Sue and be sued;
- Acquire, purchase, sell, or lease real or personal property; and/or
- Eminent domain.

Although SPDs have broad powers, they are not limitless. For example, district bonds must be approved by two-thirds of the voting public residing in the district, and may not exceed one-fourth of the assessed value of property in the SPD.

Today, there are approximately 3,350 special districts in Texas providing all manner of government goods and services. Of these thousands of districts, there are approximately 40 different types.

Types of Special Districts in Texas

Groundwater Management Area (GMA)	County Development District (CDD)
Sports and Community Venue District (SCVD)	Library District (LD)
Noxious Weed Control District (NWCD)	Levee Improvement District (LID)
Groundwater Conservation District (GCD)	County Assistance District (CAD)
Multijurisdictional Library District (MJLD)	Independent School District (ISD)
Road District (RdD)	Irrigation District (ID)
Water Control and Improvement District (WCID)	Hospital District (HD)
Public Improvement District (PID)	Regional District (RD)
Road Utility District (RUD)	Health Services District (HSD)
Fresh Water Supply District (FWSD)	Navigation District (ND)
Homestead Preservation District &	Mosquito Control District (MCD)
Reinvestment Zone (HPD)	Self-Liquidating Navigation District (SLND)
Wind Erosion District (WED)	Emergency Services District (ESD)
Municipal Utility District (MUD)	Special Utility District (SUD)
Municipal Management District (MMD)	Jail District (JD)
Arts and Entertainment District (A&E)	Stormwater Control District (SCD)
Water Improvement District (WID)	Crime Control and Prevention District (CCPD)
Municipal Development District (MDD)	Municipal Management District (MMD)
Sports Facility District (SFD)	Agricultural Development District (ADD)
Drainage District (DD)	

Source: Texas Senate Research Center

Because of the expansive nature and sheer quantity of special districts, there are common problems that have begun to arise in relation to these entities, including:

- **Layering of local governments.** Overlapping layers of governments servicing the same jurisdictional boundaries create the conditions necessary for inefficiency, redundancy, and waste.
- **Contribution to soaring property taxes.** A majority of special districts levy property taxes, which are fast outgrowing people's ability to pay. Consider that from 2000 to 2013 local property tax levies increased by 101.1%, well above population and inflation, which increased only a combined 70.3%.
- **Questions of accountability.** There is no comprehensive review mechanism in place to determine if these entities are providing value to the community.
- **Lack of transparency.** Few, if any, financial transparency requirements exist oftentimes meaning that the public has little or no idea about how their tax dollars are being spent.

Addressing these problem areas with targeted reforms will be a critical task for lawmakers next session.

The Facts

- As of 2014, there were more than 3,350 special purpose districts, including school districts, in Texas.
- Special purpose districts are taxing entities that can have the authority to levy a property tax, a sales tax, or both.
- There is no comprehensive review process for special districts.

Recommendations

- Require special districts to adhere to basic financial transparency standards, such as the public posting of budgets, financial statements, and a check register online.
- Create a comprehensive review process for SPDs to undergo a periodic assessment of its roles and responsibilities.
- For certain districts, include a "sunset" provision that automatically expires the district unless a public vote affirms the continuance of the SPD.
- Require SPDs to hold an election to approve a tax rate that increases annual property tax revenue by more than 4% or population growth plus inflation, whichever is less.

Resources

Your Money and the Taxing Facts, Texas Comptroller of Public Accounts (Aug. 2012).

Invisible Government: Special Purpose Districts in Texas, Texas Senate Research Center (Oct. 2014).

Local Pension Reform

The Issue

Over the years, more than one dozen local retirement systems have successfully petitioned the Legislature to codify certain aspects of their pension plans in state law, including provisions related to "contribution rates, benefit levels and the composition of their board of trustees." By establishing their plan provisions in state statute, these select systems have erected a major political barrier to local oversight and control.

Absent approval from the Texas Legislature, many critical features of these state-governed systems cannot be changed or modified locally. This is true even in instances where the long-term sustainability and reliability of these systems has been called into question.

Overview of Local Retirement Systems Under State Governance

	Active Members	Unfunded Liability	Liability Per Active Member	Amortization Period	Funded Ratio
Austin Employees' Retirement Fund	9,028	$900,174,491	$99,709	24.0	70.91%
Austin Fire Fighters Relief & Retirement	1,025	$78,713,151	$76,793	10.6	90.93%
Austin Police Retirement System	1,777	$315,148,059	$177,348	28.6	67.45%
Dallas Police & Fire Pension System--Combined	5,487	$2,096,942,149	$382,166	Infinite	63.80%
Dallas Police & Fire Pension System--Supplemental	39	$20,471,488	$524,910	10.0	51.15%
El Paso Firemen's Pension Fund	871	$114,707,333	$131,696	23.0	80.69%
El Paso Police Pension Fund	1,052	$193,755,713	$184,178	32.0	78.23%
Fort Worth Employees' Retirement Fund	6,198	$1,271,153,104	$205,091	55.7	62.23%
Galveston Employees' Retirement Plan for Police	450	$11,881,160	$26,403	31.5	79.50%
Houston Firefighters' Relief & Retirement Fund	3,745	$532,645,292	$142,228	30.0	86.56%
Houston Municipal Employees Pension Systems (HMEPS)	11,949	$1,798,058,000	$150,478	33.0	58.07%
Houston Police Officers' Pension System (HPOPS)	5,261	$1,155,510,000	$219,637	23.0	79.75%
San Antonio Fire & Police Pension Fund	3,944	$209,951,480	$53,233	6.2	92.91%
TOTAL/AVG.	50,826	$8,699,111,420	$171,155		74.01%

** Funded ratios in black denote systems that are below the 80% threshold, signifying a plan that may be considered actuarially unsound.*
Source: Texas Bond Review Board

Obtaining legislative approval of good government changes is no easy task either. The Texas Legislature only convenes a regular session for 140 days every other year, providing community stakeholders with a narrow window of time to achieve necessary reforms. This condensed timeframe can be an especially challenging hurdle for stakeholders who are either new to the legislative process or lack the right connections at the statehouse.

Generally speaking, making it difficult, if not impossible, to enact good government changes locally has not yielded positive fiscal results for these state-governed systems. The latest data from the Pension Review Board reveals that the health of many of these systems is lacking.

Combined, unfunded pension liabilities for these 13 state-governed systems, which have more than 50,000 active members, amount to $8.7 billion or $171,155 owed per active member. That is more than a $1 billion increase since June 2015's estimate of nearly $7.5 billion.

Among the plans, 4 of the 13 systems had unfunded liabilities in excess of $1 billion, while 6 of the systems' future pension debt was greater than $500 million. The Dallas Police & Fire Pension System—Combined has accumulated the highest total amount of unfunded liabilities at $2.1 billion.

What's more, 9 of the 13 systems have funded ratios that are below 80%. It is generally presumed that "a ratio below 80% may indicate a pension plan is not fiscally healthy," according to the Texas Comptroller. However, even the 80% ratio is forgiving; only a ratio of 100% or more would reflect a fully-funded plan. None of the state's protected plans have funded ratios of 100% or more.

Another measure of a plan's financial health—and the one favored by the Pension Review Board (PRB)—is the amortization period. Yet, looking at that measurement, almost two-thirds of Texas' state-governed systems still show the need for improvement. Whereas the PRB recommends that a plan's amortization period remain below 25 years, 7 of the 13 systems ingrained in state statute have amortization periods outside this guideline. Even the PRB's "maximum" recommended guideline of 40 years is exceeded by 2 systems: the Dallas Police & Fire Pension System—Combined (infinite) and the Fort Worth Employees' Retirement Fund (55.7 years).

In the absence of local control, the health and sustainability of some of Texas' largest local retirement systems have come into question. For this reason, it is critical that the Legislature move to restore local control of local retirement systems that are currently governed by state law. Policymakers should restore management and authority over these systems back to the community of their origin, so that stakeholders can implement necessary changes and ensure these systems' long-term viability and recovery.

The Facts

- More than one dozen local retirement systems in Texas have ingrained aspects of their plans in state law, including benefit levels, contribution rates, and the composition of their boards of trustees.

continued

Local Pension Reform (cont.)

- In the absence of local control, the soundness and sustainability of these pension plans have come into question.
- Unfunded liabilities among these 13 state-governed plans totals $8.7 billion or $171,155 owed per active member.

Recommendation

- The Legislature should restore local control of local retirement systems under state governance to allow for greater community oversight.

Resources

Restoring Local Control of State-Governed Pension Plans by James Quintero, Texas Public Policy Foundation (June 2016).

"A Solution to Our Public Pension Problem" by Vance Ginn and James Quintero, *Forbes* (May 2, 2016).

Property Rights

Property Rights and Texas Courts

The Issue

In the wake of the 2005 *Kelo v. New London* decision, Texas courts have made significant headway in the direction of protecting property rights, and correcting weaknesses in the protection thereof.

For example, in *Laws v. Texas*, a couple sought to prove that a tract of land condemned by the state was, in fact, capable of being divided into several self-sustainable economic subunits, whose value collectively was greater than the value viewed in the greater unit by the state. The Supreme Court, examining this situation, agreed that the Lawses, and by extension anyone else whose land is under government scrutiny, could provide evidence in court that their property is more valuable than the state estimates. The courts still make final decisions, but the state cannot constrain evidence in such proceedings.

In another important case, the city of Dallas declared Heather Stewart's long-vacant home a public nuisance, demolished it, and refused to pay compensation due to its prior declaration. However, the courts determined that she was, in fact, due compensation because the condemnation was based only on facts presented by the city exercising its taking powers. The Supreme Court determined that the "protection of property rights … cannot be charged to the same people who seek to take those rights away."

In another case, the Supreme Court continued to re-emphasize the importance of private rights to property over supposedly public interest. In *Texas Rice Land Partners v. Denbury*, Denbury received permission from the Railroad Commission to claim land for a CO_2 pipeline as a common carrier, and argued that such permission precluded a court case. However, the Supreme Court disagreed, saying that, in fact, just "checking the right boxes" to become a common carrier doesn't provide protection from suits to determine if the use is public rather than private.

More recently, the Texas Supreme Court issued its decision in *Severance v. Patterson*, in which the state of Texas was claiming that a rolling easement to beach access can eliminate a property owners right to use her own property in the case of a rapid erosion event, such as a hurricane. However, the Court determined there was simply no evidence in the record of an easement by prescription or dedication on such land, nor has the public had a "continuous right" to use it. Based on this, the Court ruled (twice) that while the public has acquired the right to access many beaches over time, it does not suddenly acquire the right to access private property that becomes the beach because of a major storm. Unfortunately, the Texas Legislature changed the law in 2013 to reduce the protection of property rights under *Severance*. This might ultimately lead to another lawsuit in time.

A more recent property rights action by the court involves the seizure of property though civil asset forfeiture. In *El-Ali v. Texas*, the Court denied a petition for review from a citizen whose Chevrolet pickup truck had been seized because someone else had used it in a crime. The truck owner, Zaher El-Ali, claimed that honest property owners should not be burdened with proving

their innocence to recover property used by others in the commission of a crime.

There is still much more to be done in the sphere of property rights. However, these decisions help protect those rights from executive and legislative abuse of takings powers, and the discussion of these rights and the threats to them —such as takings powers and taxation—is essential for moving our state and country forward economically.

The Facts

- Property rights are essential for economic prosperity and development.
- The Supreme Court of Texas has made many strides of late in protecting property rights from abuse by executive agencies and legislative acts, and has turned away from strict deference to the Legislature.

Recommendations

- Amend statute to shift the burden of proof in all property rights cases from the land owner to the condemnor.
- Reduce judicial deference to the decisions of executive agencies and local governments.
- Restore the constitutional right to both own and use property. Current case law, as held by the Texas Supreme, says, "Property owners do not acquire a constitutionally protected vested right in property uses."

Resources

Amicus Letter in Support of Texas Property Rights by Kathleen Hunker, Texas Public Policy Foundation (Oct. 2014).

Senate Bill 18: Presumption by Ryan Brannan and Bill Peacock, Texas Public Policy Foundation (Feb. 2011).

Amicus Brief in Beach Access Case by Vikrant P. Reddy, Texas Public Policy Foundation (June 2011).

Property Rights in Texas: Heading in the Right Direction by Bill Peacock, Texas Public Policy Foundation (Oct. 2011).

Regulatory Takings

The Issue

In 1995, the Legislature passed the Texas Real Private Property Rights Preservation Act (RPPRPA), providing compensation to property owners for loss of value due to new regulations on land use. Authors sought a method of protection and a deterrent against local government regulations that would damage the value of someone's property. Unfortunately, the act exempts municipalities. Since cities, due to re-zoning activities, are the largest condemnors, this exemption practically renders the act ineffective.

Additionally, even when a condemnor is not a municipality, the condemnor does not have to compensate a private real property owner for the taking, unless a court decides that the land has been devalued by at least 25% of its original fair market value. This tells property owners to expect losses of almost a quarter of the value of their property due to regulatory impacts. For the last three legislative sessions, bills have been filed attempting to address some of the above issues. However, the bills have stalled in committee. The problems remain.

The Facts

- Article I, Section 17, of the Texas Constitution states, "No person's property shall be taken, damaged or destroyed for or applied to public use without adequate compensation being made, unless by the consent of such person."
- The Texas Real Private Property Rights Preservation Act does not apply this constitutional protection to actions by municipalities—like zoning—that result in a reduction of property value, i.e., a taking. Section 2007.003(a) exempts the actions of municipalities from the provisions of the Act.
- The Texas Real Private Property Rights Preservation Act, in Section 2007.002, excludes from the compensation requirement any government action that reduces the market value of private property up to 25%.
- Texas case law also makes it very difficult for property owners to receive compensation for regulatory takings. The Texas Supreme Court has stated that property owners do not acquire a constitutionally protected vested right in property uses.
- Dallas opted to re-zone around Ross Avenue to increase the number of luxury condominiums and improve the aesthetic beauty of its eastern gateway to downtown. The practical effect was to prevent many of the property owners already working on Ross from continuing to operate their businesses. One operator was allowed to continue operating his auto body shop, but at a cost of close to $100,000 in legal fees and property modifications. Another was sued by the city when he resisted and is being threatened with hundreds of thousands of dollars in fines.

Recommendations

- The Texas Real Private Property Rights Preservation Act should be amended to apply to municipalities.
- The numerical threshold of what qualifies as a taking under the Act—a 25% reduction of the market value of the affected private real property—is an arbitrary number that should be reduced or eliminated.
- Condemnors should have the ability to issue waivers as an alternative to financial compensation. Those waivers should specifically mention which property rights are being reinstated per the waiver. Doing so will allow the waiver to "run with the land" for future owners, as well as prevent municipalities from spending more.

Resources

Private Property Interrupted by Kathleen Hunker, Texas Public Policy Foundation (July 2014).

"The Story of Texas Begins with Respecting Private Property" by Kathleen Hunker, *Austin American-Statesman* (July 2014).

Regulatory Takings: The Next Step in Protecting Property Rights in Texas by Ryan Brannan, Jay Wiley, and Bill Peacock, Texas Public Policy Foundation (July 2010).

Private Real Property Rights Preservation Act Guidelines, Attorney General of Texas.

Article 1, Section 17, Texas Constitution

Texas Real Private Property Rights Preservation Act.

City of University Park v. Benners, 485 S.W.2d 773 (Tex. 1972).

Housing Affordability

The Issue

Residents in Texas have an easier time realizing the American Dream. This includes having the opportunity to rent or buy a place to call their own. A combination of low taxes and minimal regulations encourage the economic efficiency that keeps housing costs low but salaries high. As a consequence, the Real Estate Center at Texas A&M observes that the state's housing market is historically among the most affordable in the nation. It scored an average affordability index value of about 20% higher than the nation as a whole from 1999 to 2014. More recently, in second quarter 2015, the Real Estate Center calculated that the state's median income was 1.71 times higher than the income required to qualify for a mortgage on a median-priced home.

Although safe and adequate housing is within the reach of most Texans, state and local governments have promulgated several policies, which make securing and maintaining a place to live much more difficult than it otherwise need be. These policies fall into two main camps.

The first are the regulations and restrictions that artificially tighten the supply of available units, driving up demand and subsequently the price. Zoning codes represent a good example. Over the last few years, Texas cities have reacted to population growth by enacting a number of detailed ordinances that strictly control development and construction within their borders. Research shows that overzealous zoning codes can have a damaging effect on a city's housing market, specifically because they remove tracts of land from prospective development and because they can add delay and expense for the project to come into compliance. There is therefore wide acceptance of the fact that many of the increased housing costs seen in major urban centers in Texas are a direct result of that city's land-use policies.

The second camp, in contrast, pertains to those regulations that add, post construction, to the purchaser's burden in procuring and maintaining a residence. These policies do not touch the housing supply per se but instead act as a barrier between prospective residents and their desired unit. Property taxes, for example, are an inescapable part of owning real estate, but they can also put an otherwise affordable unit out of reach. Another example is the overregulation of Texas' title insurance market, which artificially inflates the cost of closing on a piece of real property. State law forces residents to pay a fixed rate for the most comprehensive type of coverage regardless of need; as a consequence, Texans pay among the highest rates in the country for title insurance. The extra burden may seem trivial on its own, but when considered in the context of all the "regulatory taxes" imposed on residents, the miscellaneous bars and weights can prove too much to carry.

The Facts

- Adequate accommodations represent a basic human necessity, whose absence has a documented, corrosive effect on mental, physical, and emotional health.
- The National Association of Homebuilders (NAHB) surveyed hundreds of single-family home builders nationwide. It found that government regulations represented 25% of a unit's final sales price.

- Two academic studies scrutinizing the California and New York markets corroborated NAHB's conclusions, observing that stringent restrictions inflated housing costs by as much as 50%.
- The breadth of land-use regulations in Texas extends far beyond what is needed to defend against nuisances. Frisco's zoning ordinance, for instance, spans 336 pages and includes, among other constraints, a masonry requirement, landscaping standards, a set procedure for tree removals, and specified minimums for the dwelling area as well as the front, side, and rear yards.
- As the only major U.S. city without a formal zoning regime, Houston consistently ranks as among the most affordable metropolitan markets in the country.
- The U.S. Census Bureau notes that the 2011 to 2013 average annual tax paid by an owner-occupied dwelling in Texas was $2,493. Households forfeited 9.8% of their median income to meet their property tax.
- According to a LBJ School of Public Affairs report, Texas has the highest title insurance rates for a $200,000 home among states that require comprehensive coverage.

Recommendations

- Have Texas cities respect the right to use private property and roll back the number and complexity of their land use restrictions. Zoning codes should only be used in the event of a genuine public nuisance.
- Provide a clear and final appeals process when local ordinances contradict as well as when public actors offer conflicting interpretations.
- Ensure that all impact fees share a close and rational relationship to the burden the government seeks to avoid.
- Keep Texas' property tax burden to a minimum by reining in public spending and granting taxpayers more control over their tax obligation either through a rollback provision, greater transparency, and/or unrestricted access to tax lien transfers. Ultimately, the state should replace the property tax with a broad-based consumption tax.
- Relax the regulatory scheme governing title insurance by introducing a file-and-use system similar to that of the one used to determine home insurance rate.

Resources

Bringing Down the Housing Restrictions by Kathleen Hunker, Texas Public Policy Foundation (May 2016).

Do Property Rights Help the Poor? Affordable Housing in Texas, policy panel, Texas Public Policy Foundation (Jan. 2016).

The Freedom to Own Property: Reforming Texas' Local Property Tax by Vance Ginn, Kathleen Hunker, and James Quintero, Texas Public Policy Foundation (Oct. 2015).

Government Reform

Unions and Labor Policy

The Issue

Texas is a Right to Work state, meaning Texans cannot be forced to join a union to get a job. Unlike states that do not have this employee protection, Texas employees and employers have not seen control of wages, work standards, and other labor-management policy shift almost entirely to unions. However, Texas' growing influence on national policy has made it a target for Big Labor in recent years, and there are still problems that need to be addressed.

In the private sector, unions like the Service Employees International Union, National Nurses United, and the Communications Workers of America have used federal law or pressure tactics, such as "corporate campaigns," to make significant inroads into Texas. A number of union officials have either tacitly or explicitly asserted they and their agents have a right under federal labor law to stalk employees and supervisors of targeted businesses, even if that causes them to fear for their persons or property.

One tactic often used is negative publicity to push companies into "neutrality agreements," under which companies might provide personal contact information for employees, give unions access to employees in the workplace, and prevent employees from voting in secret-ballot elections. Neutrality agreements often prevent employers from disseminating information to employees about the downsides of unionization. At the Providence Memorial Hospital and Sierra Medical Center in El Paso, a putative "neutrality" policy actually denied nurses opposed to unionization access to non-work areas at the hospital to make their case to their fellow employees, while giving preferential access to union organizers.

Section 617.002 of the Texas Government Code states that an official of the state or a political subdivision of the state may not enter into a collective bargaining contract with a labor organization regarding wages, hours, or conditions of employment of public employees. However, a number of legal loopholes allow public employers to break this law and make special deals with labor organizations. One example is Sec. 174.023, also known as the "Fire and Police Employment Relations Act," which excludes firefighters and police officers from Texas' collective bargaining ban. Furthermore, the state boosts public employee membership for unions by acting as the agent for the payment of employee dues by deducting them from paychecks.

Public school districts have their own loophole: adopting "exclusive consultation" policies that allow only one designated organization to meet and confer with the school board about educational issues and employment conditions. As a result, Texas school board decisions often closely resemble what union officials advocate, and their employment policies impose the same "single salary schedules" that are pervasive in states where teachers are overwhelmingly unionized.

Unions have recently increased their influence over labor policy in Texas hospitals, airlines, janitorial companies, and government. Unfortunately, many employees never receive the benefits they expect from unionization due to the fact that benefits are allocated according to union standards, such as seniority or level of education. The fact is there is no magic formula through which firms can

promptly and sharply raise the pay and benefits of their employees, without cutting jobs and/or hours, while continuing to offer their clients a competitive price for their services and turn a profit. Unions do not offer stable economic solutions, nor do they offer balanced relationships in the workplace.

Texas has led the nation in economic growth for the last 15 years, not by handing employer and employee rights over to Big Labor but by protecting their rights to communicate directly and create mutually beneficial arrangements. In the public and private sectors, employers have had more flexibility to innovate, generate better levels of production, and pay productive employees more. Texas legislators can maintain this effect by closing the loopholes in Texas' ban on collective bargaining in the public sector, and limiting unions' coercive practices in the private sector.

The Facts

- Texas' government unionization rate is roughly 20%.
- The current "meet and confer" agreement between the city of Houston and the Houston Organization of Public Employees union is more than 100 pages.
- There are 17 Texas cities that have passed referenda allowing exclusive union bargaining in fire departments.
- Thirty cities have allowed exclusive union bargaining in police departments.

Recommendations

- Prohibit automatic deduction of union dues from public workers' paychecks.
- Eliminate all practices and repeal all provisions that are inconsistent with Texas' ban on exclusive union bargaining for public employees (Sec. 617.002).
- Empower employees to seek injunctive relief against union officials and employers who violate Texas' Right to Work law.
- Prohibit employers from handing over employees' names, addresses, and other personal information to union organizers.
- Prohibit employers from entering into neutrality agreements with unions.
- Prevent union representatives from participating in government inspections of non-union worksites without employer consent.

Resources

State Labor–Management Policy and the Texas Model by Stanley Greer, Texas Public Policy Foundation (Feb. 2015).

The Texas Miracle and Labor Policy by Bill Peacock, Texas Public Policy Foundation (April 2015).

Corporate Welfare

The Issue

Corporate welfare is when the government favors certain businesses in the form of direct subsidies, tax credits, or favorable regulatory schemes. Sometimes this practice is referred to as "economic development." This label creates a dangerous misconception about corporate welfare, which is known to hinder, if not reverse, economic growth.

Corporate welfare is abundant in Texas, and so are its negative economic effects. Direct subsidies are paid to politically adept corporations through the Texas Enterprise Fund, the Texas Emissions Reduction Plan, and the Texas Film Commission. The Property Tax Abatement Act and the Texas Economic Development Act give preferential tax treatments to corporations through tax abatements and credits. Other forms of special treatment include grants, loans, sales tax funds, and even regulatory privileges; biased policies such as those relating to title insurance regulation and condemnation compensation are buried in Texas' legal framework.

Corporate welfare is economically harmful for a number of reasons. It attempts to grow the economy through monetary handouts, but it takes money from taxpayers in order to do so. Because corporate welfare disrupts natural market processes, it shifts money from productive hands into those which are less productive and more politically connected. This method creates inefficiency in the economy and stunts competition. Unconnected businesses struggle to compete with the welfare recipients, and they are unable to reap the just rewards of their merit. Additionally, corporate welfare undermines consumer choice: it overturns the decisions of millions of Texans, and redirects the outcomes in the marketplace through subsidies and regulations. Finally, corporate welfare fails to achieve its stated goal. It cannot compete with the free-market approach in terms of economic growth.

Despite its challenges with corporate welfare, Texas has generally had a more free-market approach to economic development than other states. Sometimes referred to as the Texas Model, the approach is really simple: lower taxes, less regulation, fewer frivolous lawsuits, and reduced reliance on the federal government. It's also very successful. The results speak for themselves, with Texas leading the nation in just about every economic category. Since the beginning of the Great Recession, Texas has added 1.3 million jobs, far more than any other state and 39% of all non-farm U.S. jobs created during that time. Texas has also become the nation's top exporting state. Its $289 billion in exports in 2014 accounted for more than 17% of the U.S. total. And Texas' poverty rate is second lowest among the 12 largest states. Texas' free-market approach works.

Corporate welfare turns profit seekers into rent seekers and businesses' market-oriented focus on consumer satisfaction into a government-oriented focus on corporate welfare. Creating a conflict of interest between businesses and consumers does not benefit the economy.

The Facts

- In Texas corporate welfare spending totals more than $2 billion annually.

- Texas ranks 37th in the nation in per capita spending on state economic development spending, much of this at the local level.
- States that spend a lot on economic develop programs tend to have lower job growth, lower income growth, and lower population growth.
- Four of the top five states in overall spending are also in the top five when it comes to economic development spending.

Recommendations

- Establish a select or joint committee, or adopt an interim charge, to examine the effectiveness and costs of the Property Tax Abatement Act (Chap. 312) and the Texas Economic Development Act (Chap. 313) in advance of the September 1, 2019 sunset date for Chap. 312.
- Repeal existing exceptions to transparency laws for economic development located in sections 551.087 (Open Meetings) and 552.131 (Public Information) of the Government Code.
- Reduce direct and indirect economic development programs and use the savings from the direct programs to repeal the margin tax.
- Eliminate or modify regulatory regimes and agencies designed to benefit specific industries or workers at the expense of most Texas consumers, workers, and businesses and increase freedom to work:
  - introduce competition into the title insurance market,
  - reduce excessive occupational licensing, including scope of practice issues in health care,
  - adopt paycheck protection and ensure secret ballots in union elections, and
  - reduce local economic regulation of the economy by removing excessive restrictions on the sharing economy and requiring voter approval for annexation.
- Reduce taxes and spending:
  - adopt a Conservative Texas Budget for 2018-19 that increases spending by less than population growth plus inflation,
  - eliminate the margins tax, and
  - require local government entities to get voter approval for increasing property tax revenue more than 4% or population growth plus inflation, whichever is less

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Resources

Liberty or Economic Growth? Texas Can Have Both if We Rely on the Free Market by Bill Peacock, Texas Public Policy Foundation (April 2016).

"Rivalry Helps Drive Florida and Texas to Economic Success" by Bill Peacock, *Orlando Sentinel* (May 24, 2016).

Economic Development–Texas Style by Bill Peacock, Texas Public Policy Foundation (March 2010).

Sunset Review

The Issue

In 1977, Texas created the Sunset Advisory Commission (SAC) to make government more efficient.

As part of this process, each state agency has a sunset date, or a date whereby they are automatically "sunsetted" unless extended by the Texas Legislature. This was designed to eliminate unnecessary or outdated regulatory bodies, and streamlining regulatory processes.

In Texas, the 12-member SAC includes five members from the Senate, five members of the House, and two public members, appointed by the lieutenant governor and the Speaker of the House, respectively. This commission meets in every two-year cycle to review the agencies up for sunset and to conduct public hearings. After examining a particular agency, the Commission recommends to the Legislature whether the agency should be renewed, abolished, merged with another, or in some way made more efficient.

However, while early on the SAC was able to eliminate a lot of archaic or duplicative agencies, today few agencies are eliminated, or streamlined for that matter. Instead, the process is generally to grow government. The "must pass" nature of Sunset bills make them ripe for special interests to include provisions to increase government that never could pass on their own.

The Facts

- Since 1977, 78 agencies have been dissolved. Of these, 37 were completely abolished and 41 were abolished and transferred to existing or newly created agencies.
- More recently, the Sunset process has led to special interests being able to increase the size and scope of government, rather than make it more efficient.

Recommendations

- Eliminate the "must pass" provision of the statute by repealing Section 325.013 and Section 325.015 of the Texas Government Code. This will help reduce the special interest policy initiatives and allow the Commission to concentrate on reducing the size, scope, reach, and cost of government.
- The SAC should conduct its evaluation of an agency once every 12 years, focusing on abolishing/eliminating agencies, committees, boards, and statutes. Reducing the Commission's ability to change the scope of agencies will make their mission more about whether or not to eliminate or consolidate agency functions.
- Every six years the relevant jurisdictional standing committees within the Legislature should review the regulations and policies of agencies, committees, boards, and statutes. Regulations have the potential to substantially diminish the freedom of citizens and businesses in their everyday activities. A regulatory

review process would allow the Commission to get rid of outdated, redundant, or "ultra vires" regulations.

- Every two years, agencies should undergo operational reviews through the appropriations process to determine whether specific programs should continue to exist. To facilitate this, the appropriations bill should be changed to a program-based bill pattern to allow appropriators to identify individual programs within each agency.
- Require all sunset legislation to go through the substantive, jurisdictional legislative committees. This would also allow the SAC staff and members to focus on reducing the size, scope, reach and cost of state agencies, as well as eliminate the access point for those interested in subverting due legislative process.
- Consider assigning the Sunset review process of smaller agencies to the Senate Committee on Government Organization and House Committee on Government Efficiency & Reform.

Resources

Improving the Effectiveness and Efficiency of Texas Government by Maurice P. McTigue, Texas Public Policy Foundation (March 2015).

Sunset in Texas, Texas Sunset Advisory Commission (Jan. 2012).

Gambling

The Issue

It has often been suggested that Texas expand state-controlled gambling to increase state revenue in order to address the funding priorities *du jour.*

For instance, one group in 2012 suggested that gambling is a good way to "generat[e] more tax revenue for the state" in order to "rectify the anticipated budget imbalance."

However, this approach is wrong on two counts.

First, raising revenue to keep up with calls for increased spending is not the right answer. Instead, Texas should restrain government spending at a level to keep it within available revenue. This approach of "living within one's means" is simple, and is very similar to the practice that most Texas families put into practice every day.

Yet even this seemingly fiscally conservative approach to spending doesn't leave any room for savings. So while Texas has restrained the growth of spending better than most other large states, it still has plenty of room for improvement.

For instance, between 1990 and 2010, the sum of population growth plus inflation in Texas totaled 115%. During the same time, however, state spending increased by more than 300%, roughly two-and-a-half times that amount.

The same is true when it comes to public education spending. Total Texas public school expenditures increased 334% from 1987 to 2007, an increase of 142% when adjusting for inflation. On a per-pupil basis, Texas' costs increased from $3,659 in 1987 to $11,024 in 2007, a 66% increase per-pupil when adjusted for inflation.

Whether the increased revenue in these examples comes from expanding an existing tax like the margin tax, from instituting a new tax like a tax on gambling, or from expanded economic growth, the result is the same: more government.

The ultimate measure of government's ability to regulate the industrious pursuits of its citizens is how much it spends. The more it spends, the more it must tax. The more it spends, the more it can regulate. We will not have a "wise and frugal Government" if our default is to spend every penny we can squeeze out of the economy.

The Texas Model, i.e., low spending and taxes; a predictable, low level of regulation and strong property rights protection; a sound civil justice system; and minimal dependence on/interference from the federal government, has helped make Texas the nation's runaway leader in job creation over the last decade. It has also helped us successfully meet past budget shortfalls without increasing taxes on hardworking Texans.

Second, a significant body of research has shown that gambling expansion does not increase state revenues to the level suggested by proponents. As the Foundation noted in a 2005 study:

> The economic impacts of gambling have been examined by a large body of national and international research; however, the research findings are mixed. While there is general agreement that gambling can provide large state revenues and that there are socioeconomic costs attached to these revenues, researchers disagree about the dollar value assigned to these costs and whether the net fiscal impact is positive or negative. …
>
> Costs associated with gambling include: (1) a reduction of approximately 10% in state lottery revenues; (2) an investment of approximately 10% of revenues in regulatory costs for gambling; (3) criminal justice costs underwriting an 8 to 13% increase in crime; (4) lost state and local revenue resulting from diversion of spending from goods and services to gambling; and (5) lost jobs resulting from decreased spending on non-gambling goods and services. …
>
> According to some research, the economic impact of gambling is positive—however, most of these studies acknowledge limited or no calculation of costs…. Other research, however, indicates the economic costs associated with gambling cancel out the revenues with net-zero financial gains or result in an overall financial loss at the end of the day. For example, research conducted by Florida's Office of Planning and Budgeting concluded in 1994 that Florida would experience a significant deficit if the state expanded gambling; although tax revenues were projected to reach almost $500 million annually, gambling costs were projected to total at least $2 billion annually.

Rather than turn to gambling or other sources for new revenue, Texas should instead address whatever budget shortfall we may face through reducing wasteful or unnecessary government spending.

The Facts

- Many researchers have found that the economic costs associated with gambling cancel out the revenues with net-zero financial gains or result in an overall financial loss.
- Costs associated with gambling include:
  - reduction of state lottery revenues,
  - increased regulatory costs for gambling,
  - criminal justice spending to counter an 8% to 13% increase in crime,
  - lost state and local revenue resulting from diversion of spending from goods and services to gambling, and
  - lost jobs resulting from decreased spending on non-gambling goods and services.

continued

Gambling (cont.)

Recommendations

- Do not expand or further legalize gambling in Texas.
- To address any potential budget shortfalls, Texas policy makers should reduce wasteful or unnecessary government spending.

Resources

VLTs—What Are The Odds Of Texas Winning? by Chris Patterson, Texas Public Policy Foundation (2005).

Gambling in America: Costs and Benefits by Professor Earl L. Grinols, Cambridge University Press (2009).

Gambling Economics: Summary Facts by Professor Earl L. Grinols, Baylor University (2004).

Health Care

Medicaid Expansion

The Issue

In recent years, state lawmakers have experienced pressure to expand Medicaid under the Affordable Care Act (ACA), however they have yet to do so. Expansion would add an estimated 1.5 million Texans to the program, extending eligibility to non-disabled adults, both with and without dependents. The groups pushing for expansion hope to pull down billions in federal funding, which would reimburse the state at 100% of the cost of coverage for the expansion population until 2017, then gradually reduce the rate to 90% by 2020.

Proponents argue that expansion would be an economic boon for the state by helping to reduce uncompensated care costs for hospitals that treat uninsured and underinsured patients. These costs are paid primarily through local property taxes, and many hospitals claim that Medicaid expansion would alleviate this tax burden by shifting the cost of covering the uninsured to the federal government.

Opponents of expansion, including TPPF, argue that previous Medicaid expansions in other states did not reduce uncompensated care costs, but instead exceeded cost and enrollment projections, and increased uncompensated care costs. TPPF and others instead push for reform of the current Medicaid program, arguing that program spending is on an unsustainable trajectory and has already overwhelmed other budget priorities such as education.

Expanding the program would exacerbate this problem and also strain an already fragile safety net of Medicaid providers in the state, making it more difficult for current Medicaid enrollees—whom the program was originally meant to serve—to access care. By adding 1.5 million Texans to the Medicaid rolls, lawmakers would expand coverage without providing adequate access to care, thereby weakening an already dysfunctional program with sub-standard health outcomes.

Some lawmakers argued for a "Texas Solution" that would expand Medicaid in exchange for certain reforms to the program such as requiring cost-sharing on a sliding scale based on income, the use of health savings accounts, and a trigger to opt out of expansion if federal funding drops off. However, none of these reforms are possible under current federal law or under the terms of a waiver from the Centers for Medicare and Medicaid Services (CMS). Furthermore, the proposed bill would have directed state officials to abandon them if it was necessary to secure federal expansion dollars. TPPF therefore opposes the "Texas Solution" as nothing more than Medicaid expansion under the ACA disguised to look like conservative Medicaid reform.

The Facts

- According to the Congressional Budget Office, federal spending on Medicaid will more than double over the next decade, increasing from $265 billion to $572 billion. The CBO estimate confirms TPPF 2010 projections that show Medicaid spending will double every decade on the state and federal levels.
- The Medicaid program now consumes 25% of General Revenue appropriations, an increase of the share by 42% in just over a decade.

- In the 2016-17 All Funds (AF) budget, the Medicaid program accounts for nearly 80% of all health and human services spending, and nearly 30% of the total state budget.
- In the current biennium, the program's growth has caused total state spending on health and human services to exceed total education spending for the first time in Texas history.
- Medicaid expansion is estimated to cost the state $8.8 billion over 10 years. According to projections from expansion proponents, expansion would cost $3.74 billion in state matching funds for the years 2014-17.
- Nearly 70% of Texas physicians will not accept new Medicaid patients, thus forcing them to seek primary care in hospital emergency rooms or forego needed treatment altogether.
- Numerous studies show that Medicaid patients have worse outcomes than those with private health insurance and often worse outcomes than the uninsured.

Recommendations

- Lawmakers should resist calls to expand Medicaid under the ACA and instead focus on improving the existing program.
- Lawmakers should be skeptical of the "Texas Solution" or similar proposals for Medicaid expansion as they are typically disguised as Medicaid reform.

Resources

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Medicaid Block Grants

The Issue

Medicaid was created by Congress in 1965 and came to Texas two years later, a program designed to provide health benefits to specific groups—initially, to recipients of certain cash assistance programs. Since then, eligibility has gradually expanded and caseload growth has made Medicaid the single largest program in the state budget. In 2001, Medicaid consumed 20% of the All Funds (AF) budget but now accounts for nearly 30% of the 2016-17 budget.

Medicaid spending in Texas is experiencing steady, long-term growth. In the 2014-15 budget, for the first time in Texas history, spending on all health and human services (HHS) exceeded spending on education. The Medicaid program accounts for almost 80% of all HHS spending, or $61.2 billion of the $77.2 billion budget. This is a large increase from just a few years ago; in 2010-11 the total HHS budget was only $65.5 billion with Medicaid accounting for $45 billion of that.

The Medicaid program is unsustainable financially for the state. Access is a problem as 70% of physicians in the state will no longer accept new Medicaid patients. Further, numerous studies indicate that Medicaid delivers worse health outcomes than private insurance, and in some cases, than being uninsured. The answer is to reform the program, which states cannot do effectively under current federal law. Regardless of the promise that waivers can be utilized to reform the program, the restrictions of benefit and entitlement requirements prevent real reform. Unless exempted from the federal requirements of mandatory benefits and mandatory eligibility, reforms that change behavior cannot be implemented. Such reforms would include:

1. Sliding scale cost sharing, as utilized by Federally Qualified Health Centers and the more innovative public hospital indigent care programs like Carelink in San Antonio. Cost sharing would include participation in the state-funded health savings account (HSA) and/or co-pays.

2. Personal responsibility for managing the HSA, which would be restricted to medical services, equipment, insurance premiums, etc. Additional co-pays would be required for inappropriately accessing the emergency room. The recipient could be suspended from the program for six months if they failed to carry out their responsibilities.

3. Personal freedom to choose a health plan, available in the private market, that fits the needs of the recipient rather than the one-size-fits-all entitlement benefits.

Economic modeling such common sense reforms demonstrated cost savings of $4 billion per year or $8 billion per biennium to the cost of Medicaid in Texas, growing to $12 billion per biennium in 2022-23. The modeling considered HHSC data for only three cohorts—pregnant women, Texas Temporary Assistance for Needy Families (TANF) adults, and children.

The Facts

- For the 2012-13 biennium, the Legislature appropriated $39 billion in All Funds for the Medicaid program alone. In the current biennium, that figure is about $61.2 billion—a 57% increase.
- Children have increased as a percentage of total Medicaid enrollment due to economic factors and provisions of the ACA that are causing children to move from the Children's Health Insurance Program (CHIP) into Medicaid. The Aged, Blind, and Disabled (ABD) population in Medicaid is also expected to increase consistently as the Baby Boom generation ages.
- The 84th Legislature approved $180 million in All Funds supplemental Medicaid spending for the 2014-15 biennium that caused estimated spending for HHS to exceed estimated spending for Education for the first time in Texas history.
- States must adhere to strict federal rules about how much Medicaid enrollees are allowed to contribute to the cost of care and what benefits they are entitled to receive. As long as the state participates in the program, Texas must provide medically necessary care to all eligible individuals, regardless of whether the enrollee needs or wants those benefits.
- States are not allowed to use federal Medicaid dollars to pay for private coverage for Medicaid-eligible individuals unless the state pays for wrap-around benefits not covered by the private plan.

Recommendations

- The state should continue to pursue a block grant for Medicaid in order to give the state greater flexibility to reform the program and greater certainty in the Medicaid budget from year to year. This includes petitioning the state's congressional delegation to pursue block grant legislation in Washington, D.C.
- The Legislature should pass a contingency Medicaid block grant act that would go into effect if and when block grant funding is passed by Congress. Such a bill would send a strong message nationwide that Texas has developed a detailed plan for how to amend its state plan and enact fundamental Medicaid reform if it were given the opportunity to do so.

Resources

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"Studies Show: Medicaid Patients Have Worse Access and Outcomes than the Privately Insured" by Kevin D. Dayaratna, Heritage Foundation (Nov. 2012).

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State Supported Living Centers

The Issue

State Supported Living Centers (SSLC) are an increasingly inefficient and ineffective system of care for those with intellectual disability and/or developmental disabilities (ID/DD). The current state-run, institutional system is a Medicaid-funded program that suffers from higher provider rates, but lower quality of care than privately-run community-based facilities. While the regulating agency, the Department of Aging and Disability Services (DADS), has made tremendous progress in moving individuals from SSLCs to community care, consolidation of the facilities has yet to occur in Texas. The resulting lower census per facility has increased costs per resident and the aging structures require high maintenance costs. Overall, the SSLC system is failing financially and failing their patients.

Reports of deaths in the Lubbock SSLC and abuse in other facilities led to an investigation by the U.S. Department of Justice (DOJ) in 2005. The state of Texas entered into a settlement with the DOJ in 2009 that would ensure the standards in the SSLCs adhered to generally accepted standards of care, that protections were in place, and that residents would be given the choice to transition to community services. Despite significant reforms and increased expenditures, currently none of the 13 facilities have yet to achieve substantial compliance with the provisions of the settlement.

Past proposals to help resolve these issues by closing and consolidating Texas SSLCs have not produced any significant result. A coalition of interests—families that may have institutionalized their loved ones decades ago and do not want the SSLCs closed, lawmakers with SSLCs in their districts who are concerned about the loss of jobs, and those employed at SSLCs—have blocked reform in the past and will attempt to block future reform. For instance, during the 84th Legislature, these issues were highlighted in SB 204. This bill was based on the Sunset Advisory Commission's recommendations for the Legislature to reduce the number of SSLCs and aid in the transition to community-based services. Although the bill passed separately through both houses, the conference committee members could not come to agreement and the bill died in the last days of the session, leaving no course for reform. This is an issue because regardless of code violations or low quality of care, an SSLC cannot be closed without action by the Legislature.

Simply put, state-operated institutions cannot be relied on to police themselves or enact needed reforms, and inaction has come at the expense of Texans with ID/DD. It is long past time for Texans to join the long-term trend of deinstitutionalization and carefully, deliberately begin the process of closure and consolidation. SSLCs are closing by default as those with ID/DD and their families increasingly choose to live in the community. The only question for the lawmakers is whether they will manage the gradual decline of SSLCs, or allow them to languish at the expense of those who remain trapped in a failing system.

The Facts

- Texas has not closed an SSLC since 1996, despite a long-term decline in the average monthly census, sub-standard care, and sharply rising costs.
- The average daily population of state-run IDD facilities nationwide declined

78% between 1965 and 2011, while the share of those receiving care in the community increased 85% between 1977 and 2011.

- Community is what Texans want. There are 25,000 people eligible for placement in SSLCs who currently chose to live in the community.
- One year of services for a person in an SSLC costs about $113,000 more than serving that same person in an equivalent program in the community.
- As of 2013, 14 states report having no state institutions for people with ID/DD, while Texas operates the most in the nation, currently with 13 SSLCs.
- During the 84th Texas Legislature, SB 200 required that the current agency in charge of regulating SSLCs, DADS, be absorbed by the Health and Human Services Commission (HHSC) by September 1, 2017.
- Texas is currently ranked 50th in a study reporting the Best Performing States for ID/DD services.

Recommendations

- The state must begin the process of closing and consolidating its SSLCs and in turn help manage the transition into a community-based system.
- Lawmakers should direct DADS/HHSC to begin closing and consolidating SSLCs, beginning with the Austin Facility, while implementing reforms to ease transition of SSLC residents into the community.
- Effective SSLC reform should include community placement for all who want it, guaranteed institutional care when families prefer that option, and appropriate assistance for displaced workers.
- Once the facilities have begun to close, DADS/HHSC should focus on improving quality of life for residents and staff at the remaining SSLCs.
- Ultimately, community-based solutions will improve accountability and in turn improve quality.

Resources

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Scope of Practice

The Issue

In November 2013, New Mexico Governor Susana Martinez launched a campaign to recruit nurse practitioners (NPs) to her state as part of an effort to deal with a shortage of primary care physicians. In New Mexico, NPs are allowed independent practice and prescriptive authority; Gov. Martinez highlighted neighboring states with more restrictive scope of practice laws, including Texas.

Texas is among a dozen states with relatively restrictive scope of practice regulations for advanced-practice registered nurses (APRNs), under which NPs is one of the four specialties. Texas requires NPs and most other APRNs to practice with some form of supervision, delegation, or team management by a physician (this varies based on the site and type of practice). Currently, 21 states and Washington, D.C. allow APRNs to evaluate patients, diagnose, initiate and manage treatments, and prescribe medications.

For years, Texas has struggled with physician shortages, especially in rural areas. The 2013 Texas Legislature approved two new medical schools in Austin and the Rio Grande Valley. However, simply graduating more physicians will not necessarily increase access to primary care in Texas as only 2% of medical students plan to pursue careers in primary internal medicine. The 2013 Legislature passed SB 406 which was designed to expand prescriptive authority for APRNs, but it also kept in place numerous state regulations including a prohibition on NPs collecting reimbursement by Medicaid managed care organizations (MCOs) if the supervising physician does not accept Medicaid or have a contract with the patient's MCO. In the 2015 Legislature, efforts were made again, however not a single bill regarding the scope of practice of APRNs made it to the floor of either chamber.

Physician shortages will likely continue to worsen as long as the Patient Protection and Affordable Care Act is in place. These services expand access to care by subsidizing coverage for low-income Texans and subsequently increase demand for primary care. Without an expansion and greater utilization of providers throughout the state, many of the newly insured will face difficulties accessing care—just as those who currently have coverage face access problems in many areas of the state.

The Facts

- According to the U.S. Department of Health and Human Services (HHS), 126 of Texas' 254 counties do not have enough primary care physicians and are designated Health Professional Shortage Areas (HPSA), roughly defined as areas with a doctor-patient ratio of about one per 3,000 residents.
- Texas has 295 Medically Underserved Areas (MUA), more than any other state in the country.
- The utilization of nurses as primary care providers is an emerging trend nationwide. The number of Medicare patients who received primary care from NPs rose fifteenfold between 1998 and 2010.
- A survey of 37 articles published between 1990 and 2009 on the quality, safety, and effectiveness of primary care provided by NPs compared to physicians

found that outcomes were comparable across all categories.

- Basic health care services provided by NPs in retail clinics have been shown to be associated with lower costs per visit, and eliminating barriers to practice could have a large effect on cost savings that NP-operated clinics are able to achieve.

Recommendations

- To remain competitive with other states and fill persistent gaps in health care delivery, Texas lawmakers should expand scope of practice laws for all APRNs—nurse practitioners, certified registered nurse anesthetists, certified nurse midwives, and clinical nurse specialists.
- Texas law should mirror the most generous scope of practice laws in the country, similar to those in New Mexico, such that APRNs are given prescriptive and diagnostic authority, the ability to operate independent on-site clinics, and serve as primary care providers.
- If full practice authority is not granted, SB 406 should be revisited and legislation passed to enable NPs to be reimbursed by MCOs regardless of whether the supervising physician is contracted with the MCO.

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Telemedicine

The Issue

The state of Texas defines telemedicine as a remote health care service in which a physician may assess, diagnose, consult, treat, or transfer medical data using technology. It is a convenient, affordable way to access health care services, and recent advances in audio-visual communications technology are enlarging the potential of telemedicine to reach more people and address a growing number of health care needs. More importantly, this service could increase access to health care in more than 90% of Texas counties that are designated health professional shortage areas or medically underserved areas.

In rural communities in Texas, people travel an average of 31 miles to see a healthcare provider. If you live in a smaller community, you're likely to travel much farther. Once you get to the doctor, if you're uninsured you can expect to pay about $50 to $200 per clinic visit and $2,000 at an emergency room. These prices can be devastating for a family. Telemedicine can provide access at a lower cost.

Telemedicine uses technology, like smartphones or Skype, to provide health care to people in their homes. Especially for people traveling over 30 miles for health care, being able to access care for basic ailments, like urinary tract infections, pink eye, or strep throat, from home would vastly increase access and potentially prevent more serious conditions from developing. In addition to travel expenses avoided, there are significant cost saving opportunities as typical telemedicine costs closer to $40 per encounter.

Telemedicine is affordable and convenient, but its accessibility is limited in Texas. The Texas Medical Board (TMB) passed a rule in April 2015, which made it harder for people to access telemedicine in Texas than in any other state except Arkansas. A person using telemedicine services in Texas must first see the doctor in person or travel to a healthcare site where a medical provider can facilitate the call. This burdensome process creates several of the initial barriers that keep people from getting care in the first place. This process must be completed each year in order to continue telemedicine services.

The Texas Medical Board passed these rules stating health and safety concerns, but 48 other states have decided that these types of regulations are not necessary to protect patients. In fact, even in Texas, the State Board of Examiners of Professional Counselors rejected similar rules for mental health treatment specifically because there had been no complaints about or problems with telehealth services.

This anticompetitive ruling from the TMB might violate antitrust law according to a new precedent set in a case decided by the Supreme Court in 2015, *North Carolina State Board of Dental Examiners v. F.T.C.* State licensing boards comprised of a majority of market participants, such as the TMB, are vulnerable to federal antitrust lawsuits.

Telemedicine is safe and could help to deliver better healthcare in Texas if these rules were to be rescinded or overturned. Barriers to expanding telemedicine in Texas should be removed.

The Facts

- The American Telemedicine Association declared Texas tied for last place in their state telemedicine rankings.
- Texas and Arkansas are the only states that require an in-person or face-to-face video conference visit with a physician prior to using telemedicine.
- Texas is one of the only states that requires an in-office follow-up visit after using telemedicine.
- The University of Texas-Medical Branch has been providing telemedicine to state prisons improving health outcomes and saving taxpayers about $780 million.
- The new telemedicine regulations hurt Texas' health care market by limiting competition.
- The unchecked authority of licensing boards to make rules and regulations, like the new telemedicine rules, leave Texas vulnerable to federal antitrust lawsuits that undermine state sovereignty.

Recommendations

- State lawmakers should remove unnecessary regulations that stymie the use of telemedicine in Texas.
- The Texas Legislature should take active steps to guard against the anticompetitive conduct of its licensing boards that also leave the state vulnerable to federal lawsuits.

Resources

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Consumers

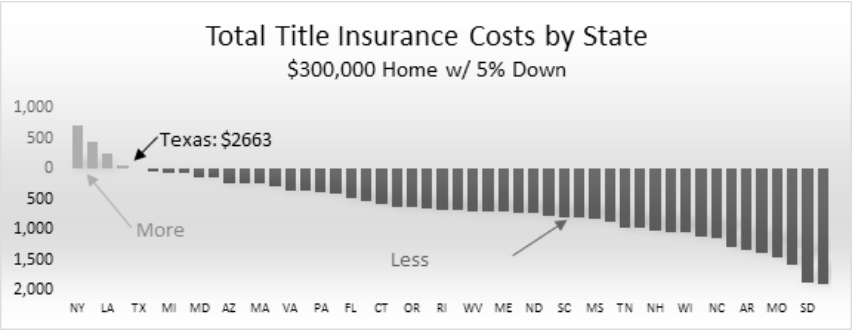
Title Insurance

The Issue

Texas has the most heavily regulated title insurance market in the country. The Texas Department of Insurance sets the price and coverage of residential and commercial title insurance. The TDI also promulgates the division of premiums between title companies and agents. As a result, competition is eliminated from the title insurance market and costs are increased for both consumers and businesses.

There is nothing unique about title insurance that warrants its exclusion from the forces of competition. In fact, just the opposite is true. Whereas competition forces companies to be customer-focused and conscious of quality, title insurance companies that are relatively insulated from competition are instead largely focused on manipulating regulations. Consumers understand this; a recent poll found that 91% of Texans agree that since they can shop around for auto and home insurance, they should be able to shop around for the best deals on title insurance.

Texas has some of the highest title insurance rates in the nation. According to a study by the LBJ School of Public Affairs (2011), Texas has the highest title insurance premium for a $200,000 home among states that require comprehensive coverage. The Foundation's research shows that Texas has the fifth highest total title insurance cost for a $300,000 home.



Consumers are not only burdened by high prices, they are also deprived of choice. Since the government sets coverage, many Texans must pay for things they do not want—and what they do get is often of inferior quality. So long as the government regulates their business, title insurance companies have no incentive to meet the needs of their customers.

The current regulatory system not only adds significant costs for homeowners but also for businesses engaging in real estate transactions. While high residential rates discourage homeownership in Texas, high commercial rates burden businesses and can negatively impact their relocation and expansion.

The current system is far removed from the Texas Model of low taxes and regulations, which has made Texas the nation's economic leader for the last 15 years. Texas can easily introduce competition and choice into title insurance by applying the same file-and-use system that is used for auto and home insurance. Making

title insurance consistent with the Texas Model will lead to lower rates, higher quality coverage, and more consumer choice. Additionally, it will lower the cost of business in Texas which can lead to more jobs and a stronger economy.

The Facts

- Texas has the most heavily regulated title insurance market in the country.
- Texas has the highest title insurance premium for a $200,000 home among states that require comprehensive coverage and has the fifth highest all-in cost for a $300,000 home.
- A study by the LBJ School of Public Affairs (2011) found that "when a state promulgates rates, the cost of title insurance will on average be significantly higher than the title prices where states use other regulation styles."
- 91% of Texans agree that they should have choice in title insurance market.

Recommendations

- Increase competition and consumer choice in the title insurance market by adopting the same file-and-use system that is used for auto and home insurance for both rates and forms.
- Eliminate the authority of the TDI to promulgate or approve the split of premiums between title insurance companies and agents.

Resources

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Title Insurance Regulation in Texas: Challenges and Opportunities, Lyndon B. Johnson School of Public Affairs (2011).

Homeowners' Insurance

The Issue

Reform of the Texas homeowners' insurance market in 2003 called for a file-and-use regulatory system. However, in 2009, the Sunset Review Commission's Staff Report on the Texas Department of Insurance (TDI) rightly concluded that the "Legislature cannot judge the success of the shift to file-and-use rate regulation because the system has not been fully implemented." Conditions have little improved since the report was issued.

One reason for the incomplete implementation is TDI's use of both pre-market and post-market regulatory tools—the Insurance Code grants TDI authority to reject rates both before and after being used in the marketplace. Failure to implement file-and-use is a problem because pre-market regulation hinders timely entry of rates into the marketplace and disrupts market pricing.

The price disruption is aggravated by Texas' non-renewal law, which prohibits insurers from non-renewing high claims policies, even when the damage was a product of the policyholders' own negligence. This forces insurers to base their coverage and rates on non-actuarial principles and discourages insurers from establishing specialized markets to cover high-risk areas.

A related problem is TDI's focus on "affordability." Ultimately, a regulatory stance focused on affordability reduces investment, hinders competition, and puts insurers at risk of insolvency. An example of the danger of focusing on affordability—rather than solvency—is the failure of Texas Select Lloyds in 2006, at a time when TDI was committing significant resources to pursuing legal actions against two major insurance companies for excessive rates.

Furthermore, statutory calls for rates neither "excessive" nor "inadequate" are at odds with each other, creating regulatory uncertainty. This conflicting statutory guidance stands in the way of true file-and-use rate regulation in the Texas homeowners' insurance market.

The Facts

- Senate Bill 14 (2003) called for a transition to a file-and-use regulatory system for homeowners' insurance, with the intention of having a file-and-use system in place as of December 1, 2004.
- Texas' system of rate regulation for homeowners insurance includes pre-market and post-market regulatory tools, where rates can be rejected before or after they are first used in the marketplace. This prevents insurers from basing rates on actuarial principles and reduces competition in the marketplace.
- TDI's belated implementation of a 1997 provision allowing insurers to use national forms, along with lawsuit abuse, caused premiums to rise dramatically. This delay ultimately cost consumers more than $900 million. After TDI allowed insurers to use non-standard forms in 2002, mold claims plummeted and rates stabilized.

Recommendations

- Adopt a true file-and-use system allowing the Commissioner to disapprove only rates in use.
- Shift the focus from blocking "excessive" rates to guarding against inadequate or discriminatory rates.
- Implement a true file-and-use system for policy forms, and focus policy-form regulation on the wording and clarity of an insurance form rather than the content of a form.
- Allow the Commissioner to place under prior approval only those companies whose financial positions warrant increased supervision in order to maintain solvency.
- Permit insurers to non-renew, or add a premium surcharge to, high claim policies, especially where those claims were a product of negligence or misuse of the claims process.

Resources

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Short-term Consumer Lending

The Issue

In the wake of the 2008 financial crisis, lenders and consumers alike have had many concerns regarding the state of the credit market. Traditional banks have tightened restrictions on lending, making it more difficult to obtain credit, especially when the need arises very suddenly and unexpectedly.

For consumers who don't meet banks' lending criteria, options are limited, especially when the necessary funds are too "small" for the bank, and when borrowers don't have proper credit ratings and can't obtain credit cards. One option for these individuals is payday lending, especially after being rejected by a traditional bank. Contrary to popular opinion, the individuals seeking such lending are not undereducated or unemployed; rather, they are normal individuals who needed a short-term loan to tie them over after an unexpected expense. Often, these individuals are renters, and thus aren't able to use home equity to help them cover their needs.

Oftentimes, credit service organizations (CSOs) will help loan-seekers locate third-party lenders for a fee; the lenders in turn deposit money in an individual's account against a future paycheck. However, these fees, and payday lending in general, are often targeted by governments. In the last session, at least 13 bills targeted the practice, including one that would institute restrictions on charging fees.

The bills in question would have likely driven many payday lenders out of the business, as happened when New Hampshire created new regulations. Rather than protecting consumers, it likely would have dried up their last attempts at credit, making it more difficult for those with sudden needs from meeting those needs, often at great personal cost.

Fortunately, no major regulatory bill passed. However, 34 Texas cities have adopted strong local payday and auto title ordinances in the last 5 years, restricting the practice. Advocates have pledged to encourage more communities to do the same. New regulations are bound to harm the market, and are unnecessary; consumers are able to make their own decisions as to whether the fees and costs are worth the utility of the loan. Calls for regulation also incorrectly assume that CSOs are unregulated, which is simply not true.

Those who need access to credit already face a hard challenge. New regulations of the market would make that challenge even more difficult, and in some cases could make it impossible. On the other hand, consumers benefit when they are able to secure credit in a timely fashion. Keeping short-term lenders open extends credit to all those who need it.

The Facts

- An estimated 40% of payday loan recipients seek such loans only after rejection by traditional lenders.
- Payday borrowers, contrary to popular belief, are educated and employed.
- Regulations in other states have forced many such lenders out of business,

limiting credit options for those that the laws supposedly were designed to protect.

- Thirty-four Texas cities have adopted ordinances that restrict payday lending, creating a patchwork of inconsistent financial regulation throughout the state.

Recommendation

- No attempts should be made to add further barriers to payday lending and restrict access to capital for those in need of short-term loans.

Resources

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Tax Lien Lending

The Issue

Every year thousands of Texas property owners find themselves in the unenviable position of falling behind on their property taxes either because of a temporary financial setback or some other lack in liquid capital.

Fortunately, the competitive market has stepped in to offer these property owners a way to satisfy their tax debt without having to trek through the delinquency process, whose penalties, fees, and interest can add close to 50% onto a property owner's final tax bill after just one year.

Called a tax lien transfer, this specialized lending practice offers Texas property owners a reasonable means to take control of their outstanding tax debt by negotiating a short-term loan with a licensed tax lender and then transferring the tax lien that the government automatically attaches to the property as collateral for the loan. This allows property owners to spread out their tax obligation over several years rather than paying in a lump sum as is typically demanded by state law.

Over the past few years, Texas taxpayers have expressed a strong demand for property tax lending services, driven in large part by sharp increases in Texas property taxes, which have risen almost three-times faster than household income. That demand will not dissipate so long as property taxes continue to overburden Texas taxpayers.

Nevertheless, despite the high demand for tax lien transfers, and despite their appreciable benefit to Texas taxpayers, an ensemble of special interests have incited fears over business practices within the tax lending market and have pushed for legislation that restricts, if not eliminates, taxpayers' access to much needed tax assistance.

The effort has had some success. The Texas Tax Code already puts up extra barriers for Texans with mortgaged properties, demanding that they wait until their taxes turn delinquent before initiating a tax lien transfer. Put differently, these Texans can only take action to resolve their tax debt after they start accumulating penalties and interest.

In addition, the Texas Legislature considered no less than eight bills last session aimed at curtailing tax lien loans, all of which failed. Proposed changes in HB 3222 and SB 1956 would have eliminated the tax lien's superior priority over other secured interests. Had it been enacted, the amendment would have effectively ended tax lien lending as a sustainable commercial practice, denying Texas property owners a cost-effective means of rectifying their tax debt. Such legislation would not help Texas property owners; it would simply force them to confront the penalties and foreclosure proceedings that accompany delinquency with no prospect for relief.

The Facts

- The Office of Consumer Credit Commissioner reports that 72 licensed lenders issued 14,526 property tax loans in 2012.

- Property taxes climbed 205% statewide from 1991 to 2010 or an average of 6.3% per year. Conversely, personal income increased by only 70% or an average of 2.7% per year.
- The delinquency rate in Travis County has jumped from 5.1% in 2000 to 10.6% in 2013.
- After one year of delinquency, a property owner will have added 12% in interest, 12% in late penalties, and somewhere between 15-20% in collection fees onto their original tax bill.
- The Finance Commission reports that a tax lien transfer could cost a taxpayer significantly less than remaining in delinquency, $13,156 as compared to $16,608 over five years.

Recommendations

- Amend §32.06(a-2) of the Texas Tax Code to eliminate its two tier treatment of Texans with mortgaged properties, specifically the requirement that these property owners wait until their taxes have become delinquent before initiating a tax lien transfer.
- Make no attempt to eliminate or alter the tax lien's high priority status after it's been transferred to a third party.
- Refrain from enacting any additional barriers to tax lien lending that restricts and/or denies Texas property owners access to market-based tax relief.

Resources

Tax Lien Transfers: A Reasonable Means of Rectifying Property Tax Obligations by Kathleen Hunker, Texas Public Policy Foundation (Dec. 2014).

Tax Lien Lending is a Cost-Effective Way to Manage Property Tax Debt by Bill Peacock, Texas Public Policy Foundation (May 2014).

Telecommunications

The Issue

Texas has recently been one step ahead of the rest of the country in telecommunications, passing major telecom reform legislation in both 1995 and 2005. Thanks to a bill passed by the 79th Legislature—SB 5—local telephone service for more than 15 million Texans was significantly deregulated as of January 1, 2006. This was a major step forward in reducing costs and bringing new technologies and services to millions of Texans.

Texas again took the lead in 2011. The Legislature passed SB 980, an omnibus telecommunications deregulation bill. This legislation allows new technology and innovation such as VOIP, broadband, and cable to compete in the market. The law ended specific tariffing requirements and removed monopoly relic regulation. Ultimately, it will increase competition in the marketplace and lower costs for Texas consumers.

There is nevertheless still room for improvement. Texas consumers are particularly burdened with high tax rates on telecommunications services. The taxes and fees that consumers pay include state and local sales taxes, municipal franchise fees, and charges for the Texas Universal Service Fund (USF). In fact, Texans pay higher rates on the purchase of most telecommunications services (except satellite) than they do on fireworks and hard liquor. Only cigarettes are taxed at a higher rate.

During the 84th Legislature, the House State Affairs Committee considered legislation that would have expanded the USF to include broadband. Had it been enacted, the bill would have reversed the current glide path phasing out the USF as improvements in technology make accessibility easier and cheaper. The federal government has already begun subsidizing broadband access in rural areas. Expanding the state USF would be an unneeded and expensive redundancy that stands in sharp contrast with the state's decade-long commitment to a freer telecommunications market.

The Facts

- The current Texas Universal Service Fund is 3.3% of taxable communications receipts. It funds a collection of programs, including Tel-Assistance, Lifeline, the Small Local Exchange Carriers Universal Service Fund, and the Texas High-Cost Universal Service Plan.
- Upon deregulation, interstate long distance rates fell 68% from 1984 to 2003, while intrastate rates fell 56%. The slower decline of intrastate rates is due largely to state regulators who have kept intrastate access charges artificially high in order to maintain subsidies of local phone rates.
- Texas has slowly been phasing out the Universal Service Fund. Total expenditures in FY 2013 amounted to $335.9 million. By FY 2015, that number had been reduced to $251.4 million.

Recommendations

- Do not expand Universal Service Fund subsidies or fees to new services or technologies, e.g., broadband. Examine ways to further reduce the Universal Service Fund.
- Eliminate the "tax on a tax" aspect of the state and local sales taxes.
- Restructure Municipal Franchise Fees to reflect the marginal costs of providing services through the right-of-way.

Resources

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Testimony Presented to the House Committee on Regulated Industries: Regarding Telecommunications Taxes and Technology Deployment by Bill Peacock, Texas Public Policy Foundation (June 2008).

Taxes and Fees on Telecommunications Services in Texas by Paul Bachman, Sarah Glassman, and David G. Tuerck, Texas Public Policy Foundation (April 2007).

Q&A on the Texas Universal Service Fund by Bill Peacock, Texas Public Policy Foundation (Aug. 2006).

Texas Telecommunications Taxes: An Overview by Bill Peacock, Texas Public Policy Foundation (Feb. 2006).

Texas Telecommunications: Everything Is Dynamic Except the Pricing by Robert W. Crandall and Jerry Ellig, Texas Public Policy Foundation (Jan. 2005).

Consumer Choice and Telecommunication Contracts by Chris Robertson, Texas Public Policy Foundation (April 2009).

Testimony Regarding the NFL Network Dispute by Bill Peacock, Texas Public Policy Foundation (Dec. 2007).

Texas Telecom Deregulation: Seeking a Level Playing Field by Bill Peacock, Texas Public Policy Foundation (April 2006).

Texas Telecommunications: The Road Ahead by Bill Peacock, Texas Public Policy Foundation (Oct. 2005).

A Telecommunications Policy Primer by Dianne Katz, Texas Public Policy Foundation (Jan. 2005).

Windstorm Insurance

The Issue

The Texas Windstorm Insurance Association (TWIA) provides windstorm and hail coverage in the 14 coastal counties and a few other specially-designated areas. All property insurers in Texas must participate in TWIA and must help pay losses. Although TWIA was intended to provide windstorm insurance coverage only to those who could not purchase insurance in the voluntary market, it is no longer an insurer of last resort.

While TWIA may have been intended as a residual provider, it has become anything but that. Its unrealistically low rates have made TWIA an unbeatable competitor and are crowding out the private market. TWIA's market share along the coast grew from 17.9% in 2001 to 69.5% in 2014. By March 2016, TWIA had over 268,832 policies in force.

Yet the artificially low rates that make TWIA an unbeatable competitor do not result in sufficient reserves to pay for the most likely claims caused by a major hurricane. At the start of the 2016 hurricane season, TWIA had somewhere around $581.3 million in the Catastrophe Reserve Trust Fund to pay claims. Average claims along the coast could range from $5.3 billion in Galveston County and $4 billion in Nueces County to $588 million in Cameron County. Altogether, TWIA's direct liability exposure was $ 77.9 billion.

This inefficient and woefully inadequate funding scheme presents a grave risk to all Texans in the event of a catastrophe, from TWIA policyholders whose policies have no definite funding source, to private insurers who remain vulnerable to unlimited assessments, and average taxpayers who could see a potential impact on the general revenue fund.

The Facts

- TWIA's market share along the coast grew from 17.9% in 2001 to 69.5% in 2014.
- Here is the exposure for TWIA in three areas of the coast:
  - Galveston County: $23.8 billion
  - Nueces County: $14.5 billion
  - Cameron County: $5 billion
- In the case of a strike by a Class 4 hurricane, here is the average projected loss in each area:
  - Galveston County: $5.3 billion
  - Nueces County: $4 billion
  - Cameron County: $588 million
- At the start of the 2016 hurricane season, TWIA had somewhere around $581.3 million in the Catastrophe Reserve Trust Fund to pay claims.
- The number of TWIA policyholders increased from 68,756 in 2001 to 268,832 at the end of March 2016.

Recommendations

- Eliminate the Texas Windstorm Insurance Association.
- Replace TWIA with a true provider of last resort, much like the Texas FAIR plan for automobile insurance policies.
- Require that the new windstorm rates be actuarially sound.
- Require that the new windstorm rates be higher than any competing private sector offers.

Resources

The Great Windstorm Divide: Isolating the Texas Coast by Bill Peacock, Texas Public Policy Foundation (May 2015).

Texas' Windstorm Insurance System Still Does Not Work by Bill Peacock, Texas Public Policy Foundation (March 2013).

Next Steps to Reforming Texas Windstorm Insurance by Bill Peacock and Ryan Brannan (Nov. 2010).

Consumers, Competition, and Homeowners' Insurance: A Sunset Report on the Texas Department of Insurance and the Office of Public Insurance Counsel by Drew Thornley and Bill Peacock, Texas Public Policy Foundation (Aug. 2008).

Texas' Windstorm Challenge: Unprepared for the Worst by Bill Peacock, Drew Thornley, and Machir Stull, Texas Public Policy Foundation (Dec. 2007).

A Better Homeowners' Insurance Market Awaits by Drew Thornley, Texas Public Policy Foundation (June 2008).

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Missing the Big Picture in Homeowners' Insurance Debate by Drew Thornley, Texas Public Policy Foundation (March 2008).

Tort Reform

Mesothelioma

The Issue

In 1973, the standard for causation in asbestos-related cases was lowered and Texas became the number one state for asbestos-related litigation. Eventually, the Texas Legislature responded by enacting litigation reform legislation that established medical criteria for filing asbestos and silica cases. The result was to help restore fairness to the system.

In its 2007 *Borg-Warner* decision, the Texas Supreme Court established that plaintiffs claiming an asbestos-related injury must provide scientifically reliable evidence regarding the dose—or amount—of the product that allegedly caused their disease. The Court noted that "substantial factor" tests alone were insufficient to eliminate guesswork in court rooms, showing that different courts have come to wildly different conclusions when dose is not the determining factor. The Borg-Warner test merely clarifies the "substantial factor" test just like it is used in other Texas tort cases, and provides guidance about what is necessary to fulfill existing evidence standards.

Scientific studies agree that mesothelioma is a dose-responsive disease and that not every dose causes disease. Without requiring a dose standard, any exposure to asbestos will be sufficient for liability. Asbestos is in the air. We all breathe it every day. If the standard for causation of mesothelioma was simply any exposure, the number of asbestos-related cases would rise again, and our court rooms would be as full and unpredictable as they were prior to Texas' 2003 tort reform laws.

The implications of including defendants who do not belong in litigation reach farther than the immediate parties involved—when businesses are financially burdened by multi-million dollar verdicts, employees are affected in the form of job losses, and consumers are affected by higher prices. There is no sound reason for exempting asbestos-related claims from the same standard of causation and exposure thresholds required in every other toxic exposure case in Texas.

The Facts

- Asbestos inhalation has been linked to mesothelioma, a form of malignant cancer that develops, over time, in the tissue surrounding the lungs.
- The amount of asbestos exposure determines whether the defendant's product caused the disease.
- In 1973, the standard for causation in asbestos-related cases was lowered.
- By the 1990s, plaintiff's attorneys were beginning to re-tool the asbestos litigation practice in response to growing efforts by Congress to stem the tide of costly judgments.
- Asbestos litigation has remained a profitable venture for many plaintiff's attorneys, costing the United States more than $800 billion annually, or greater than 2% of our GDP.

- From 1988 to 2000, Texas was home to more asbestos-related claims than any other state.
- In *Borg-Warner Corp. v. Flores*, the Texas Supreme Court established the evidentiary standard plaintiffs must meet in asbestos-related claims. Plaintiffs must show that the defendant's asbestos-related product was a "substantial factor" in their illness, and that mere exposure to asbestos should not be enough to establish a valid claim for awards.
- The Borg-Warner test does not require mathematical precision. A plaintiff merely needs to show defendant-specific evidence relating to the approximate dose to which the plaintiff was exposed, and evidence that the dose was a substantial factor in causing the asbestos-related disease.
- Asbestos and related fibers are among the most studied toxins worldwide. Scientists have reported extensively on the dosage necessary to cause asbestos-related disease, including mesothelioma.
- Legislation was introduced in the 81st Legislature lowering the causation threshold in asbestos-related litigation so that more defendants could be held civilly liable for enormous sums without plaintiffs firmly linking their illness to the defendant's product.
- Additional legal research into the previous versions of law, as well as legislative activities, would result in skyrocketing attorney fees and make Texas law less accessible to average citizens.

Recommendations

- The current causation standards for asbestos-related claims should remain at the same level as all other toxic exposure claims.
- A measurable standard for how plaintiffs prove negligence is key to preventing needless strain on our economy.

Resources

Borel v. Fibreboard Paper Prods. Corp., 493 F.2d 1076 (5th Cir. 1973).

Borg-Warner Corp. v. Flores, 232 S.W. 3d 765 (Tex. 2007).

Agency for Toxic Substances and Disease Registry, "Asbestos: Health Effects," WebMD (10 April 2009).

Asbestos Exposure and Cancer Risk, National Cancer Institute Fact Sheet.

Multi-district Litigation

The Issue

In 2003, the Texas Legislature passed significant civil justice reforms designed to improve the efficiency and effectiveness of our state courts. The Multi-District Litigation (MDL) system was a key part of that reform and has generally proven successful. The purpose of the MDL system is to improve the efficient administration of justice and promote settlement.

The 81st Legislature saw the introduction of legislation designed to limit the application of multi-district litigation to product liability cases involving pharmaceutical products, and tort claims involving asbestos and silica cases. This legislation would narrow the kind of cases the MDL system would handle, undermining the entire system and returning more mass tort litigation cases back to the complex and inefficient previous system.

When lawsuits involving products with widespread use are consolidated, efforts to resolve the dispute are less likely to be duplicated, and the application of the law is more likely to be consistent. This consistency reduces the risk of judicial error at the trial court level and, consequently, reduces the number of appeals that weigh down our appellate courts. Additionally, removing pretrial matters to an MDL judge in a different geographical location also ensures a fair application of the law by removing local biases.

The Facts

- In 2003, the Texas Legislature instituted the Texas MDL system as part of a package of strong civil justice reforms. Prior to the 2003 reforms, plaintiff's attorneys often sought to keep federal mass tort suits in state courts—free from federal MDL jurisdiction.
- The 2003 Texas MDL system consists of a five-judge panel that consolidates lawsuits involving the same basic facts and assigns them to one judge for the purpose of handling pretrial matters such as discovery and other motions.
- The Texas MDL panel has remained true to the Act, which specifies that transfers are only to be made by the MDL panel when the determination is made that the transfer serves the "convenience of the parties and witnesses; and promote(s) the just and efficient conduct of the actions."
- In 1968, the U.S. Congress enacted MDL for federal cases, chiefly in response to a massive government antitrust prosecution involving more than 25,000 individual claims.
- The Federal MDL system showed immediate results, consolidating the nearly 2,000 separate suits filed in 36 different courts down to nine trials, only five of which went all the way to judgment. As U.S. Chief Justice Earl Warren stated in 1967, if not for consolidation, "the district court calendars throughout the country could well have broken down."

- Since 1967, more than 179,000 separate federal civil actions have been consolidated in pretrial proceedings.

Recommendations

- Do not narrow the scope of litigation managed through the Multi-District Litigation system in Texas.
- The system prior to MDLs is not a good fit for these kinds of mass tort cases because it scatters litigants across the state and saddles parties seeking justice with unnecessarily costly and burdensome pretrial maneuvering. A return to such a system for mass tort cases does not serve the interests of justice and is not an efficient use of taxpayers' dollars.
- The MDL system is efficient and effective. To limit its scope is at odds with the interests of justice. Slowing down Texas' civil justice system is exactly the wrong course.

Resources

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"Is Multidistrict Litigation a Just and Efficient Consolidation Technique? Using Diet Drug Litigation as a Model to Answer this Question" by Danielle Oakley, 6 *NVLJ* 494 (2005).

"Unsettling Efficiency: When Non-Class Aggregation of Mass Torts Creates Second-Class Settlements" by Elizabeth Chamblee Burch, 65 *Louisiana Law Review* 157, 209 (2004).

The Next Step: Strengthening Texas Courts by Texans for Lawsuit Reform (Nov. 2005).

"Federal Jurisdiction Expanded For Mass Tort Litigation by the Multiparty, Multiforum Trial Jurisdiction Act of 2002," a presentation by Carlton Fields, Attorney At Law.

In re Delta Lloyds Ins. Co. of Houston, 2008 WL 5786888 (5 Sept. 2008) [Unpublished opinion available on Westlaw.] Sec.74.162, Government Code.

Statutory Construction

The Issue

In 1963, the Texas Legislature directed the Texas Legislative Council to effect a permanent statutory revision of state law to "clarify and simplify the statutes and to make the statutes more accessible, understandable, and usable." The Council was instructed not to "alter the sense, meaning, or effect of [a] statute." In *Fleming Foods v. Rylander*, it was deemed that one of these non-substantive changes in fact did alter the intent of the statute. The Texas Supreme Court determined that in those instances, the newly re-written version of the statute controls.

In Fleming Foods, the Texas Supreme Court held that prior law and legislative history cannot be used to modify the express terms of a statute when the meaning is clear. The Court understood the law should be clear, certain, and accessible to ordinary citizens. They reasoned that if a prior law were supplanted by the codification process—yet still given effect—no provision could be relied upon by citizens to clearly understand what the law actually is, and "anyone wanting to know what the law of Texas required would have to consult not only the existing law, but the former, repealed law and then compare the new with the old." In other words, the law ought to mean what the law says today, not what it said 50 years ago.

Because the law's effect on citizens is often determined by how courts interpret lawmakers' intent, it is important that the intent be based on clear statutory language. If the courts are forced to review multiple versions of statutory provisions, they will be tempted to divine the "true" intention from a variety of sources outside the actual text of the law. For instance, they may rely on legislative history. However, the legislative history of many statutes is so extensive that support could be found for any of the competing interpretations of its meaning.

The Facts

- The 1999 Fleming Foods decision was based on Texas legal precedent. The Texas Supreme Court has held since 1922 that "to say that the citizen, in order to know that law by which his rights are to be determined, must go through the many volumes of session laws … and examine the original acts, including the captions and repealing acts and clauses, is not to be seriously considered … The session laws are for all practical purposes inaccessible to the average citizen, and the task of searching through them to ascertain the law an insurmountable one."
- In 2001, the 77th Legislature passed HB 2809, which provided for statutory revision and construction in giving non-substantively codified statutes the same meaning that was given the statute before its codification. That legislation effectively gave courts the authority to interpret statutes outside of their purview of interpreting and applying the plain meaning of the statute. Governor Perry vetoed the bill.

- In 2009, the 81st Legislature passed nearly identical legislation which was again vetoed by Governor Perry.
- Under the vetoed legislation, citizens seeking to understand their rights and responsibilities under Texas law would be consigned to long-defunct regulations and obscure floor debates between legislators to discern the lawmakers' intentions.
- Additional legal research into the previous versions of law, as well as legislative activities, would result in skyrocketing attorney fees and make Texas law less accessible to average citizens.

Recommendations

- Avoid legislation that complicates the plain meaning of statutes. The very purpose of the codification process is to solidify public policy and make Texas law more accessible to its citizens.
- Prevent legislation that gives non-substantively codified statutes the same effect and meaning that was or would have been given the statute before its codification.

Resources

Tex. Govt. Code Annotated Sec. 323.007.

Fleming Foods of Texas, Inc. v. Rylander, 6 S.W. 3d 278 (Tex. 1999).

American Indemnity Co. v. City of Austin, 112 Tex. 239, 246 S.W. 1019 (1922).

"The Rise and Fall of Textualism" by Jonathan T. Molot, 106 *Columbia Law Review* 1, 3 (2006).

Paid or Incurred

The Issue

Limiting medical and health care expense recovery in a civil action to the amount actually paid or incurred, by or on behalf of the claimant, was one of the significant civil justice reforms passed in 2003. Prior to 2003, plaintiffs were allowed to recover the full billed amount, including the "phantom" charges that were never paid because the bills were reduced—a common practice in medical care.

However, the 81st Legislature introduced a pair of bills aimed at allowing a plaintiff to recover the entire billed amount, whether or not the amount was actually incurred or intended to be paid. In other words, the proposed legislation would have required taxpayers to reimburse phantom medical expenses in personal injury lawsuits that were never paid.

Under Section 41.0105 of the Texas Civil Practice and Remedies Code, plaintiffs are entitled to recover only medical expenses "actually paid or incurred." Thus, not only must the fees at issue be reasonable and necessary to be recovered, they must also have been actually paid or incurred by the plaintiff—not just billed. In determining what expenses were incurred, the issue is whether or not "discounts" such as "write-offs" and/or contractual "adjustments" constitute medical expenses "incurred" by the plaintiff.

Medical billing is unique to other types of billing. Medical providers commonly bill patients at higher rates than what is actually paid or owed by the patient. The charges are never fully paid, and amount to a "markup" within the health care industry. The reasoning is that doctors often agree with insurers to reduce the cost of procedures in exchange for being an "in-plan provider." The full billing amount is used for negotiation with doctors and insurance providers, and is never intended to be fully paid.

The legislation proposed in the 81st Legislature applied only to recovery for medical expenses, so it creates a double standard whereby lawsuits regarding medical care would be subject to greater damage awards while other kinds of suits would still be restricted by the "paid or incurred" limitation in the Act.

If plaintiffs are allowed to recover damages for medical costs they did not actually incur, settlements would be inflated and windfall damage awards would result. Businesses and health care providers would pass those additional litigation costs on to consumers, patients, and taxpayers. Unraveling Texas' successful tort reform measures would be done at the expense of patients, medical providers, and taxpayers.

The Facts

- The Texas Supreme Court has ruled that medical expenses are incurred at the time the services are rendered to the patient. *Black's Law Dictionary* defines the term "incurred" to mean "when one suffers or brings on oneself a liability or expense."

- Section 41.0105 of the Texas Civil Practice and Remedies Code has been interpreted to "trump" the Collateral Source Rule in that it allows the court to look at evidence to determine what has actually been paid or incurred in medical or health care expense recovery cases.
- This interpretation has become accepted as good legal precedent. In *Mills v. Fletcher*, the 4th Court of Appeals found that plaintiffs cannot recover medical bills that have been adjusted or written off. A federal district court in Houston agreed, holding that the Mills opinion "is a reasonable interpretation of the statute and [we] will follow [it]." The "paid or incurred" provision assures that plaintiffs recover actual out-of-pocket medical expenses.
- In 2012, The Texas Supreme Court accepted the lower courts' interpretation that Section 41.0105 "limits recovery, and consequently the evidence at trial, to expenses that the provider has a legal right to be paid." In other words, a claimant may not recover or introduce evidence of medical bills that the provider later writes off.

Recommendation

- The "paid or incurred" provision in the Act should remain intact. Unraveling Texas' successful tort reform measures would be done at the expense of patients, medical providers, and taxpayers.

Resources

Texas Civil Practices & Remedies Code, §41.0105.

Haygood v. De Escabedo, 356 S.W.3d 390 (Tex. 2012).

Garza de Escabedo v. Haygood, 283 S.W.3d 3 (Tex. App.—Tyler 2009).

Mills v. Fletcher, 229 S.W. 3d 765 (Tex. App.—San Antonio 2007).

Goryews v. Murphy Exploration & Production Co., 2007 WL 2274400 (S. D. Tex. 2007).

Black's Law Dictionary, p. 782 (8th ed. 2004).

Black v. American Bankers Ins. Co., 478 S.W. 2d 434 (Tex. 1972).

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Experts

DEREK COHEN, Deputy Director, Center for Effective Justice
AREAS OF EXPERTISE: Juvenile Justice Reform, Victims' Rights, Constitutional Limitations on Corrections, Overcriminalization
dcohen@texaspolicy.com

THE HON. CHUCK DEVORE, VP of Policy; Senior Fellow for Fiscal Policy
AREAS OF EXPERTISE: Tax & Fiscal Policy, Elections, Foreign Affairs, Military Affairs, Energy and Environmental Policy
cdevore@texaspolicy.com

VANCE GINN, PH.D., Economist, Center for Fiscal Policy
AREAS OF EXPERTISE: State Budget & Tax Reform, National & State Labor Market Trends, Tax & Expenditure Limits, Energy Markets & Policy
vginn@texaspolicy.com

GREG GLOD, Policy Analyst, Center for Effective Justice; Right on Crime
AREAS OF EXPERTISE: Civil & Criminal Justice, Law Enforcement, Prisons, Overcriminalization
gglod@texaspolicy.com

THE HON. KENT GRUSENDORF, Director, Center for Education Freedom
AREAS OF EXPERTISE: K-12 Education Growth, Increasing Public School Efficiency, Education Choice
kgrusendorf@texaspolicy.com

THE HON. TALMADGE HEFLIN, Director, Center for Fiscal Policy
AREAS OF EXPERTISE: State Budget & Taxation, Economic Stabilization Fund, Local Government Spending, Pension Reform, Federal Funds
theflin@texaspolicy.com

KATHLEEN HUNKER, Senior Policy Analyst, Center for Economic Freedom
AREAS OF EXPERTISE: Electricity Markets & Renewable Energy, Insurance, Tort Reform, Property Rights, Economic Development, Consumer Issues
khunker@texaspolicy.com

MEGAN INGRAM, Research Assistant, Center for Energy & the Environment
AREAS OF EXPERTISE: Environment, Energy
mingram@texaspolicy.com

MARC LEVIN, Director, Center for Effective Justice & Right on Crime
AREAS OF EXPERTISE: Adult Corrections, Juvenile Justice, Law Enforcement, Overcriminalization, Victim Empowerment & Restitution, School Discipline
mlevin@texaspolicy.com

THOMAS LINDSAY, PH.D., Director, Center for Higher Education; Director, Center for Tenth Amendment Action
AREAS OF EXPERTISE: Higher Education, Culture Wars (political correctness, cultural decline, etc.), America's Founding Principles, Online Learning, Federalism, Tenth Amendment, Interstate Compacts
tlindsay@texaspolicy.com

TREVOR MCGUIRE, Policy Analyst, Center for Higher Education; Center for Tenth Amendment Action
AREAS OF EXPERTISE: Tenth Amendment, Higher Education, Federalism, For-Profit Education
tmcguire@texaspolicy.com

DIANNA MULDROW, Policy Analyst, Center for Effective Justice; Right on Crime
AREAS OF EXPERTISE: Juvenile Justice, Civil & Criminal Justice, Prisons
dmuldrow@texaspolicy.com

BILL PEACOCK, VP of Research; Director, Center for Economic Freedom
AREAS OF EXPERTISE: Electricity Markets & Renewable Energy, Insurance, Technology & Telecommunications, Tort Reform, Property Rights, Economic Development, Consumer Issues
bpeacock@texaspolicy.com

JAMES QUINTERO, Director, Center for Local Governance
AREAS OF EXPERTISE: Budgets, State & Local Spending, Debt, Taxes, Transparency, Pensions
jquintero@texaspolicy.com

KEVIN D. ROBERTS, PH.D., Executive Vice President
AREAS OF EXPERTISE: K-12 Education Growth, Increasing Public School Efficiency, Education Choice, Higher Education, Tenth Amendment
kroberts@texaspolicy.com

DEANE WALDMAN, PH.D., Director, Center for Health Care Policy
AREAS OF EXPERTISE: Health Care, Medicaid, Telemedicine, Scope of Practice, Regulatory Issues
dwaldman@texaspolicy.com

THE HON. KATHLEEN HARTNETT WHITE, Distinguished Senior Fellow-in-Residence; Director, Center for Energy & the Environment
AREAS OF EXPERTISE: EPA Regulation, Energy & Environmental Policy, Endangered Species Act, Water Rights, Free Market Environmental Policies
khwhite@texaspolicy.com

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901 Congress Avenue, Austin, Texas 78701
512.472.2700 phone 512.472.2728 fax
www.TexasPolicy.com