Keeping Texas Competitive

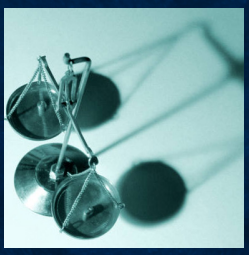
A Legislator's Guide to the Issues

2013-2014







The Texas Public Policy Foundation is a 501(c)3 non-profit, non-partisan research institute.

The Foundation's mission is to promote and defend liberty, personal responsibility, and free enterprise in Texas and the nation by educating and affecting policymakers and the Texas public policy debate with academically sound research and outreach.

Funded by hundreds of individuals, foundations, and corporations, the Foundation does not accept government funds or contributions to influence the outcomes of its research.

The public is demanding a different direction for their government, and the Texas Public Policy Foundation is providing the ideas that enable policymakers to chart that new course.

TEXAS PUBLIC POLICY FOUNDATION
900 Congress Ave., Suite 400
Austin, TX 78701
(512) 472-2700 Fax (512) 472-2728
www.TexasPolicy.com

Keeping Texas Competitive

A Legislator's Guide to the Issues

2013-2014

Edited by Bill Peacock & Nancy Druart
Texas Public Policy Foundation

Texas Public Policy
FOUNDATION

Table of Contents

★ Keeping Texas Competitive Priority

Texans are blessed that the Lone Star State is as much a land of opportunity today as it was almost 200 years ago when Stephen F. Austin and the "Old Three Hundred" arrived here seeking prosperity.

There are many reasons for this, but perhaps the most important is that Texans still walk in the footsteps of those early Texians who left everything behind to establish their homes far out into the American West. As a result, our laws and institutions today embody the spirit of liberty of our early years and make it possible for Texans to live out the American Dream.

As the Texas Legislature approaches its 83rd Session in 2013, we must continue our efforts to keep the Dream alive. Thus we have published the 2013-14 edition of our biennial Legislator's Guide to the Issues. This year, however, it has a new title: Keeping Texas Competitive. We've added the new title for two reasons.

First, to remind us that it is competition in free markets and a system of federalism that made America great and will continue to make Texas the leader of the national economy.

Second, to highlight several of the policy recommendations in the Legislator's Guide that we consider the most important and timely for policymakers to address. These priority recommendations are at the front of each section and marked with the Keeping Texas Competitive logo. In addition, we've released a second publication, *Keeping Texas Competitive 2013: A Roadmap to Keep Texas at the Forefront of Prosperity, Job Creation, and Economic Growth*, which contains only the highlighted recommendations.

We look forward to working with policymakers and all Texans seeking to further liberty and building a strong future for our state.

Budget

State Budget

The Issue

In January 2013, the next legislative session will convene amid a period of great budget difficulties.

Current estimates suggest that the state will have to contend with an estimated $3 billion to $4.5 billion budget deficit for the current biennium, and a $10 billion to $13 billion projected budget shortfall for the next. Virtually all of the deficit and shortfall are the result of a surge in obligations under the Medicaid program.

If Texas' economy hopes to continue creating jobs and growing the economy over the next few years, it is imperative that the Legislature close these two budget gaps with existing revenues and avoid any job-killing tax increases.

By implementing reforms needed to make this happen, Texas lawmakers will get the state's budget challenges under control and ensure that Texas stays on the path to prosperity.

The Facts

- Incoming lawmakers are likely to face two major budget hurdles: 1) an estimated $3 billion to $4.5 billion deficit for the 2012-13 biennium; and 2) a projected budget shortfall of $10 billion to $13 billion for the 2012-15 biennium.
- The bulk of the state's deficit and shortfall is attributable to a surge in obligations under the Medicaid program.
- An improving economy and rebounding revenues may soften the blow some, but the state's budget challenges are still thought to be significant, growing more so by fiscal 2014-15.
- Effectively solving the state's budgeting difficulties will require bold leadership and vision guided by a principled approach, similar to the approach outlined in *Real Texas Budget Solutions: 2013 and Beyond.*

Recommendations

- **Revamp Public & Higher Education.** While public education spending needs to be accountable to taxpayers, the top-down approach of running classrooms from Austin isn't working. We need to scrap many state mandates, burdensome education programs, and the school funding system so we can start from scratch to increase efficiency, capture cost savings, and most importantly, improve educational achievement. One way to do this is to make Home Rule Districts and Campus Charters easier to create, give them more freedom from state mandates, to pursue blended learning models, and to give parents more control over their creation and operation. When it comes to higher education, funding should be shifted toward student-centered funding.

- **Reduce Social Welfare Spending.** Social welfare spending is exploding as new Federal mandates and caseloads increase each year. Spending on Medicaid alone in 2014-15 could increase by over $10 billion. Texas needs to decrease these costs and get out from under federal health care and other welfare mandates. However, federal mandates for Medicaid and other programs dramatically limit the ability to save in this area.

- **Cut Overregulation, Unnecessary Programs, and Subsidies.** Overregulation, unnecessary programs, and subsidies to businesses and consumers cost Texans billions of dollars each year while reducing economic growth. Eliminating or reducing these will reduce taxes, cut prices, and increase economic growth.

- **Prioritize Transportation Spending on Relieving Congestion.** Shift scarce resources toward reducing congestion and away from areas and uses—like rail—that fail to address the state's congestion problems.

- **Move Future State Employees into Defined-contribution Retirement Plans.** To protect taxpayers and state employees, future state employees should be incentivized to move into a defined-contribution 401(k) plan, the same plan the vast majority of non-government workers use.

- **Strengthen Texas' Tax and Expenditure Limitation.** Allow all state and local spending to increase only by the sum of population growth plus inflation, the growth in gross state product or the growth personal income, whichever is less.

- **Shift to Program-based Budgeting.** The general appropriations bill each session should specify the amount of the proposed appropriation for each program which is being funded, rather than the current practice of appropriating funds based on "strategies." Letting taxpayers know what programs are funded and for what amount is commonsense.

- **End the Practice of Using Special Fund Balances to Certify the Budget.** There are many government funds, like the System Benefit Fund, that hide money from taxpayers in order to certify the budget. But the money cannot be spent for general purposes, so this practice essentially results in deficit spending.

Resources

Real Texas Budget Solutions: 2013 and Beyond by Texans for a Conservative Budget (Mar. 2013).

Budget Transparency

The Issue

The Texas budget will be a focal point next session as lawmakers work to bring spending in line with revenues. As lawmakers go about the task of writing a budget within available revenue while preserving essential services, they need budget transparency to insure their success. It is equally important that taxpayers have an understanding of what programs are funded and where reductions are made.

Today, the General Appropriations Act (GAA), the bill that creates the state budget, is laid out in such a way that it's almost impossible for anyone—legislator and taxpayer alike—to track state spending by program. In order to hold the state accountable for its spending practices and to promote good governance, it is critical that lawmakers move from a strategic planning and budgeting system to a program-based budgeting system.

Currently, appropriations in the state budget are listed by strategy and goal, not by program. These funds are tied to arbitrary, and sometimes nebulous, performance measures which are then used to measure the agency's progress and goals over time. However, this kind of layout leaves much to be desired.

For instance, in the 1989 appropriations bill, one could easily find that the Comptroller of Public Accounts spent $3.3 million on legal services in central administration and $20.7 million on the enforcement of the tax compliance in field operations. In the 1993 bill, however, that information is impossible to determine. One can determine that the comptroller spent $177 million dollars on tax compliance and $97 million of that on "Ongoing Audit Activities," but that is the extent of the detail available in the appropriations bill.

While some agencies may or may not keep track of spending at the program level, this figure isn't shown in the GAA and, in many instances, requires a person to request the information from the agency via the Public Information Act. Moreover, since the GAA leaves out program-specific information, taxpayers don't know how certain programs are funded, whether it be through federal or state monies, or wether it is required by state law. There is simply a lack of information here.

That's why legislation is needed to change the layout of the budget so that revenues and expenditures for each program are easily identifiable, the source of funding is identified, and the statutory authorization provided.

This is an essential step in the state's continuing march to educate and empower taxpayers through greater government transparency. As our third President Thomas Jefferson said: "We might hope to see the finances of the Union as clear and intelligible as a merchant's books, so that every member of Congress and every man of any mind in the Union should be able to comprehend them, to investigate abuses, and consequently to control them."

The Facts

- The state's budget is currently prepared using a strategic planning and budgeting system.
- The current budgeting system, which links appropriations to strategies and goals rather than programs, obscures how government agencies are spending money and why.
- House Bill 2804, proposed during the 82nd Regular Session, would have moved the state to a program-based budgeting system. However, the bill was unsuccessful.
- On February 21, 2012, Legislative Budget Board Director John O'Brien testified before the House of Appropriations committee that the LBB was in the process of developing a way to offer program-specific budget detail along with its legislative recommendations. This initiative is set to be unveiled early next year.

Recommendation

- The Legislature should move from a strategic planning and budgeting system to a program-based budgeting system. In this way, the layout of the budget will become more intelligible for legislators and taxpayers, making it easier for all to understand how state money is spent and for what purpose.

Resources

Bill Analysis: House Bill 2804 by the Honorable Talmadge Heflin and Bill Peacock, Texas Public Policy Foundation (Apr. 2011).

Make the Budget Process More Transparent: HB 2804 and SB 1653 by the Honorable Talmadge Heflin and James Quintero, Texas Public Policy Foundation (Mar. 2011).

House Bill 2804 by Rep. Erwin Cain et. al , 82nd Regular Legislative Session, Texas Legislature Online (Mar. 2011).

Reforming Texas' Public Pension Systems

The Issue

Not long ago, efforts to reform Texas' public pension systems into something more sustainable went largely unnoticed. But ongoing turmoil in the market and a series of recent analyses documenting the imminent threat posed by unfunded liabilities to state and local governments have caused many to reconsider just how necessary pension reforms really are.

Historically, the public sector used the promise of a comfortable retirement as a way to draw skilled workers away from higher-paying private sector jobs. Lucrative retirement benefits and ironclad job security made up for the lower wages.

However, the wage gap between the two sectors has closed with government workers usually earning more than non-government. Taxpayers providing state employees with generous retirement benefits have now become a questionable expense.

According to the U.S. Bureau of Labor Statistics, the average state or local government employee in Texas earned an annual salary of $40,024 in 2010, while the average private sector worker earned $39,832.

In Texas, the aggregate funding ratio for public pension funds have dropped to near 83%, down from 103.6% in 1999, and just 3% above what is considered actuarially sound or adequately funded. As governments continue to fall short of their overly optimistic 8% projected rates of return, declining funding ratios will inevitably result in more taxpayer money being allocated to pensions at the expense of other, more critical government services.

Texas estimates its total unfunded pension liability to be around $54 billion, which will continue to grow without substantial reform. Supporting this are other studies, including one by Joshua Rauh of Northwestern University, which estimates that when using more realistic accounting practices, total unfunded liabilities are closer to $188 billion.

During the past several years, state and municipal pension systems have implemented changes designed to rein in excessive liabilities. Modifications such as an increased minimum retirement age and readjusted benefit calculations 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 and keep the state's pension systems above water.

Such changes could include:

- Freezing the current defined benefit pension plan to all new and unvested employees.
- Enrolling newly hired or unvested employees in a 401(k)-style defined contribution pension plan.
- Implementing either a hard or soft freeze of the system for vested employees.
- Replacing current employee health care plans with Health Savings Accounts (HSAs).

Moving Texas' public pension systems away from the defined benefit system and into a defined contribution model would go a long way to restoring sustainability in the system—a benefit for both for taxpayers and state employees.

The Facts

- The state's two major retirement systems, the Employees Retirement System (ERS) and the Teacher Retirement System (TRS), are considered to be adequately-funded—though just barely. Both funds were above the 80% threshold in fiscal 2011, with ERS' funding ratio at 82.8% and TRS' funding ratio at 82.7%.
- The Texas retirement system, while fairly well-funded compared to other states, is still legally liable to pay defined benefits totaling 10 to 20 times what state employees paid into the system—if investment returns drop or benefits are increased (as was done in California in 1999), taxpayers would be on the hook for the added exposure.
- The tendency in the private sector, unlike government, has been to move away from the defined benefit system and transition into defined contribution plans.
- Defined contribution systems are more sustainable than defined benefit plans since they are, by definition, fully-funded.
- Private sector taxpayers receive about 30.6% of their compensation in benefits, including deferred compensation, whereas Texas state employees receive about 40% of their compensation in benefits.

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 HSAs.

Resources

Reforming Texas' State and Local Pension Systems for the 21st Century, by Arduin, Laffer, & Moore Econometrics, Texas Public Policy Foundation (Apr. 2012).

Reforming Texas' Public Pension Systems: Testimony before the Committee on Pensions, Investments, and Financial Services, by The Honorable Talmadge Heflin, Texas Public Policy Foundation (Apr. 2012).

Changing Public Pensions from Defined Benefit to Defined Contribution: Testimony before the Committee on Pensions, Investments, and Financial Services, by Donna Arduin, Texas Public Policy Foundation (Apr. 2012).

Zero-based Budgeting

The Issue

Only with great effort is the constant growth in government checked. Zero-based budgeting is a discipline that, if applied correctly and judiciously, allows lawmakers to exercise greater control when developing a budget.

There are five basic approaches to budgeting in the realm of government: current-services; traditional/incremental; program-based; performance-based; and zero-based. It's common to see a blend of these budget approaches used within a governmental entity.

Current-services budgeting is often used for entitlement programs or public safety. It presumes that a certain level of "service" is needed to be met by government. Often left unchallenged are underlying assumptions that government should be providing services to a group of people or that the method of providing those services should remain the same as it is scaled up or down or as technology changes.

Traditional or incremental budgeting uses the previous budget as its starting point on top of which an automatic increase in spending is layered. As with current-services budgeting, it assumes that all previous expenditures are justified and necessary going forward.

Program-based budgeting builds a budget around programs, maintaining government for its own sake. However, coupled with zero-based budgeting, it can provide more transparency in budgeting.

Performance-based budgeting requires agencies and programs to meet performance criteria. It looks at how much can be obtained from a tax dollar, requiring detailed or measurable justification from the agency seeking to spend money. It is a necessary tool used in zero-based budgeting.

Zero-based budgeting starts a budget from zero. This method takes more work and time as budget line items are scrutinized and their justifications are verified and considered.

In 2003 Texas faced a projected $10 billion shortfall. Governor Perry sent the Legislature a budget with zeros next to each agency's line item. This set the tone that, rather than hike taxes or borrow to finance higher levels of spending, the Legislature would be asked to do the hard work of taking a detailed examination at what had become traditional spending patterns. This zero-based budget put Texas on a path of government restraint and lower taxes that set the stage for Texas' remarkable economic success over the past 10 years.

Zero-based budgeting isn't easy, however, and has not been used by the State of Texas for the last nine years.

While the process of zero-based budgeting provides the people's elected legislative representatives with a thorough understanding of how and why every taxpayer dollar is spent, this understanding comes at the cost of a strenuous investment of time from both agency administrators and lawmakers. A key part

of making zero-based budgeting a success includes reviewing all aspects of an agency or program, including its purpose and goals as well as the metrics used to gauge success or effectiveness. Lastly, it is important to avoid the common pitfall of putting the same people or interests who might be impacted by program changes, consolidations or eliminations in charge of their own review.

The Facts

- Zero-based budgeting is one of five basic types of budgeting processes.
- Texas last used zero-based budgeting in its truest form in 2003.
- Zero-based budgeting results in a more thorough analysis of the entire budget, rather than just consideration of the amount of spending above or below the baseline.
- Zero-based budgeting is hard and time-consuming for both lawmakers and budget administrators.

Recommendations

- The State of Texas should adopt zero-based budgeting to ensure taxpayers get the most value for the programs and departments they fund.
- Because zero-based budgeting is more difficult than traditional budgeting, it is hard to sustain; therefore lawmakers may want to consider applying this comprehensive budget tool to about one-third of the budget every biennium. For instance, education in one session, health and welfare in the next, and then all other budget items.

Resources

"Zero-Based Budgeting Resurfaces," Georgia Public Broadcasting News. The State of Georgia used zero-based budgeting in the 1970s, but abandoned it as too hard to use every year. They are now employing zero-based budgeting for a portion of the budget ever year (Jan. 17, 2012).

H.R. 821, a bill to bring zero-based budgeting to the Federal government, proposed by U.S. Representative Dennis Ross (R-FL).

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

Keep Saving for a Rainy Day

The Issue

With a challenging fiscal environment expected in 2013, the use or conservation of the Economic Stabilization Fund (ESF), broadly thought of as the state's "savings account," will likely prove to be a major flashpoint in lawmakers' upcoming budget deliberations—especially considering that the fund's balance is projected to reach a near all-time high of $7.3 billion by the end of fiscal 2013.

Given what a critical one-time resource this is to the state, it is vital that lawmakers come down on the right side of this issue.

While it would be relatively easy for the Legislature to bridge the state's expected budget deficit with some or all of the ESF, this decision would ultimately leave the state worse off financially. That's because using one-time funds to pay for ongoing expenditures would only delay and compound the difficult decisions needed, while simultaneously depleting one-time monies that should be saved for future emergencies, like natural disasters, or tax relief.

Thought of in a slightly different way, no reasonable person would advise a household who is spending more than they make every month to tap their savings account in order 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?

The Facts

- The rainy day fund is expected to grow to $7.3 billion by the end of fiscal 2013.
- If the fund reaches $7.3 billion as projected, the ending balance would be the 2nd highest in the history of the ESF.
- Using one-time monies to pay for ongoing expenses is poor public policy.

Recommendations

- The ESF should only be spent on one-time emergency items or tax relief. The fund should not be spent to support ongoing expenses.
- At a minimum, even in the face of one-time emergencies, lawmakers should preserve an ESF balance equal to 5% of the general revenue and general revenue dedicated funds in the 2012-13 budget. This figure amounts to approximately $4.4 billion.

Resources

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

Real Texas Budget Solutions: 2013 and Beyond, Texans for a Conservative Budget (Mar. 2013).

Texas' 2012–13 Budget: The Good, the Bad, and the Ugly by Talmadge Heflin and James Quintero, Texas Public Policy Foundation (Feb. 2012).

Taxes

Texas' Tax and Expenditure Limit

The Issue

In 1978, 84% of Texans voted in favor of the Texas Tax Relief Act, a constitutional amendment they thought would put reasonable limits on the growth of government spending. Since its ratification, however, Texas' constitutional tax and expenditure limit (TEL) has done little to curb the trajectory of state spending.

Consider that between fiscal years 1990 and 2012, total state spending has grown by 310%. By contrast, the sum of population growth plus inflation has risen just 132% over the same period. A driving force behind this level of imbalance has been ineffectiveness of the state's TEL, which can be traced back to several design flaws.

One of the most obvious flaws has to do with the kind of spending that is limited under the TEL. In Article VIII, Section 22(a) of the state's Constitution, the only appropriations subject to the spending limit are those derived from "state tax revenues not dedicated by this constitution," which generally make up about half the budget. The other half consists of funds appropriated from other revenue sources—i.e., federal funds and non-tax proceeds, such as fees and fines—which are not subject to the TEL, leaving open the window of opportunity for excessive growth.

Another flaw has to do with the measure used to establish the spending limit—personal income. Personal income is a poor measure to serve as a basis for restricting the growth of government spending because it stands to reason that as the state's residents become wealthier and their share of personal income grows, they should require less government assistance, not more. However, in this instance, the wealthier Texans become, the more money is redistributed away from them to the state via taxes and fees.

Political will also represents another stumbling block for an effective Texas TEL. With just a simple majority vote of each chamber, the Legislature can declare an "emergency" and bypass the appropriations limit altogether.

With so many hindrances to budgetary prudence, it is easy to understand why Texas' TEL has failed to live up to expectations. However, with just a handful of modest changes, legislators can vastly improve and entrench this important safeguard.

The Facts

- In 1978, 84% of Texas voters approved the Texas Tax Relief Act, demanding that government control its spending.
- Despite such overwhelming support, Texas' TEL has failed to meaningfully rein in the growth of government spending. Between fiscal 1990 and 2012, state spending has risen 310%, while the sum of population growth plus inflation has grown just 132%.

- The reasons that the TEL is ineffective are many: its exclusion of certain appropriations; the measure used to restrict the growth of government spending; and the ease with which lawmakers can get around the TEL, etc.
- Texas' TEL fails to adequately limit expenditures because it can be easily avoided with enabling legislation.

Recommendations

- Ensure that the TEL is self-contained within the state's Constitution and does not require any enabling legislation.
- Apply Texas' tax and expenditure limit to expenditures made from all types of revenue.
- Limit the growth of state spending to population growth plus inflation, the growth in personal income, or the growth in gross state product, whichever is less.
- Require a supermajority to override the TEL's provisions.
- Apply the TEL's provisions to both state and local governments.

Resources

Real Texas Budget Solutions: 2013 and Beyond by Texans for a Conservative Budget (Mar. 2013).

Texas' Constitutional Tax and Expenditure Limit: Testimony before the House Appropriations Committee by James Quintero, Texas Public Policy Foundation (Apr. 2011).

Strengthening Texas' Tax and Expenditure Limit by The Honorable Talmadge Heflin and Katy Hawkins, Texas Public Policy Foundation (Oct. 2010).

Trends in Texas Government: State Government Spending by The Honorable Talmadge Heflin and Katy Hawkins, Texas Public Policy Foundation (Oct. 2010).

The Margin Tax

The Issue

In 2006, the Texas Legislature—under pressure from a Texas Supreme Court ruling declaring the state's school finance system unconstitutional—overhauled the state's corporate franchise tax and created the revised franchise tax, or "margin tax."

Under this new taxing scheme, the base was expanded to include a greater number of Texas businesses enjoying state liability protection and an entirely new method for calculating an entity's tax liability was introduced, one based on the concept of an entity's "taxable margin."

Initially, it was hoped that these sweeping reforms would boost state revenues while also providing a mechanism to deliver meaningful property tax relief to businesses and homeowners. But in the few short years that the tax has been in place, it's failed to meet expectations.

In terms of performance, the tax has consistently failed to meet expectations. In fiscal 2008—the tax's first full year of collections—the margin tax generated $1.4 billion less than expected. In fiscal 2009, the revenue shortfall grew to $1.6 billion. And in both fiscal years 2010 and 2011, collections fell short of projections by $500 million annually.

For fiscal year 2012, collections exceeded expectations for the first time because of the improving economy.

Beyond its performance issues, the idea of a franchise tax is contradictory with the concept of a limited liability entity. Essentially, business owners are being punished for forming a limited liability entity—an option that encourages entrepreneurs to take necessary business risks.

In addition, the margin tax is a form of a gross receipts tax, so the tax is applicable regardless of the profitability of a business. For obvious reasons, this can have a particularly damaging effect on small businesses.

All things considered, the state's newly revised franchise tax is a poor and inefficient mechanism for generating state revenues, posing a tremendous burden for entrepreneurs and small businesses.

The Facts

- Texas' margin tax is complex, costly, and difficult to comply with, giving rise to a less competitive business climate in the state.
- The margin tax has consistently underperformed. With the exception of the current fiscal year, collections have fallen below expectations every year since its inception, partially resulting from legal tax avoidance strategies, a common issue with complex tax schemes.

- The state's business tax is contradictory to the idea of a limited liability entity.
- The margin tax is collected irrespective of a business' profitability.
- Texas does not have a revenue problem. From fiscal 1990 to fiscal 2010, the state's total revenue grew by 270.3%, much faster than inflation increases, 66.8%, or population growth, 48%, over the same period.

Recommendations

- Phase out the margin tax by 2018 by extending and increasing the amount of total revenue below which a taxable entity would owe no tax up to $10 million in 2013 and $50 million in 2015, and then eliminating the tax altogether after 2017;
- Require any increase in the margin tax rate to be approved by two-thirds of all members of each house of the Legislature.

Resources

The Margin Tax Debunked: Dispelling Three Common Myths About Texas' Restructured Business Tax by The Honorable Talmadge Heflin, James Quintero, and Lauron Fischer, Texas Public Policy Foundation (Nov. 2011).

The Texas Margin Tax & Its Impact on the State's Economic Competitiveness by The Honorable Talmadge Heflin, James Quintero, and Robert McDowall, Texas Public Policy Foundation (Sept. 2012).

"Fixing" the Texas Margin Tax by The Honorable Talmadge Heflin, The Honorable Chuck DeVore, and James Quintero, Texas Public Policy Foundation (Oct. 2012).

Property Tax Reform

The Issue

Texas' property tax burden—ranked 14th highest nationally by the Tax Foundation—continues to weigh heavily on homeowners and businesses around the state; but ongoing research suggests that relief may only be a few modest reforms away.

According to the Texas Public Policy Foundation's updated study, *Enhancing Texas' Economic Growth through Tax Reform*, Texas can eliminate its property tax burden entirely by replacing the revenue with a reformed sales tax. The Foundation's study identifies two scenarios in which the sales tax base and rate could be reasonably adjusted to produce a revenue neutral swap:

- 15.7%, if the current sales tax base is used including real estate; and
- 11%, if all services that are taxed in at least one state are taxed in Texas including real estate.

Repealing all property taxes and replacing the revenues with one of the proposed sales tax reforms would go far in providing meaningful tax relief for property owners, and it would also have the added benefit of strengthening the state's economy by encouraging capital investment.

If the property tax swap were to become a reality, personal income in the state of Texas could potentially increase in the range of $3.6 billion to $3.68 billion in the first year. Over a five-year period, if property taxes were replaced dollar-for-dollar with a higher sales tax burden, personal income could, on a cumulative basis, increase between $22.85 billion and $63 billion—or an increase of 1.8% to 4.7% higher than it would have been otherwise.

Spurred by stronger economic growth, the number of jobs created in the state would also increase. Over a five-year time horizon, it is estimated that Texas would benefit from a net gain of between 124,900 to 337,400 new jobs, as compared to if no tax reform were implemented.

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 man or woman who owns a home, operates a business, or has property of any kind, will ever truly own what they possess. Right now, all of us effectively rent from the government, indefinitely.

The evidence supports the case for repealing property taxes and replacing them with a broad-based sales tax; now all that is left to do is to find the political will to enact such reform.

The Facts

- Repealing 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.
- In the first year after tax reform is implemented, personal income in Texas would increase $3.6 billion to $3.68 billion. After a five-year period, personal income would increase by an estimated $22.85 billion to $63 billion—a rate of approximately 1.8% to 4.7% higher than under the current tax structure.
- Over a five-year period, the Foundation's property tax reform proposal would help create between 124,900 to 337,400 net new jobs as compared to if no tax reform were implemented.

Recommendations

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

Resources

Enhancing Texas' Economic Growth through Tax Reform by Arduin, Laffer & Moore Econometrics, LLC, Texas Public Policy Foundation (Apr. 2009).

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

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

Strengths of the Sales Tax

The Issue

Not all taxes are created equal. Some, like the income tax, discourage work and productivity; others, like the property tax, negatively impact building and improving property; while still others, like the sales tax, adversely affect consumption.

In each instance, the type of tax levied yields a different economic outcome depending on the activity being targeted as well as the design and structure of the tax.

Knowing this, the challenge for conservatives then is to develop a tax system that generates an adequate amount of revenue while doing minimal damage to the economy and without influencing consumer behavior on a grand scale.

So what does a system such as this look like? One that relies heavily on consumption taxes.

Of all the major forms of taxation, consumption taxes, or sales taxes, are one of the most preferable for three reasons: they are simple, transparent, and levied only on the end-user.

In terms of simplicity, the 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 is a unique feature that sets the sales tax apart from most other taxes laden with time-consuming paperwork and other compliance costs.

Transparency is another important feature of the sales tax. After each purchase, every consumer is provided with a receipt clearly showing the amount of sales tax paid in addition to the price of the actual good. Since the sales tax is acknowledged after every purchase, it is almost impossible to manipulate the tax rate without public knowledge, making this an important safeguard against back-door tax hikes and other stealth maneuvers to raise taxes.

Finally, a conventional sales tax applies only to the end-user, meaning that the person consuming the final product bears the tax's ultimate cost. Consequently, the tax can be administered in a relatively simple manner. The seller need only add the cost of the tax to the final product and collect it on the government's behalf. Such simplicity avoids the need for many of the big bureaucratic organizations associated with other forms of taxes—i.e., appraisal districts, appraisal review boards, income tax departments (in all their various incarnations), etc.—and the need for taxpayers to support them.

As compared to the other major forms of taxation, the sales tax has shown that it is the least intrusive, the easiest to understand and pay, and is generally well-guarded against manipulation. For these reasons, the sales tax is by far the most preferable form of taxation.

The Facts

- Consumption taxes or sales taxes are generally simple, transparent, and levied only on the end-user.
- Since the sales tax only affects personal consumption, income, investment, and job creation are not penalized.
- At the state level, Texas levies a 6.25% sales tax rate on consumers, slightly above the national median of 6%.
- In addition, local governments are also allowed to add a 2% levy to the sales tax rate for a maximum combined rate of 8.25%.
- Texas' heavy reliance on consumption taxes is an attractive feature of its tax system for businesses and entrepreneurs.
- As of August 2012, the Texas economy had helped produce 28 consecutive months of increased state sales tax revenues, according to the Texas Comptroller of Public Accounts.

Recommendations

- State and local governments should continue to rely on consumption taxes as their main revenue generators.
- Any increase in the sales tax base or the sales tax rate should be accompanied by reductions in other taxes.

Resources

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

Tax Policy and Economic Growth in the States by Barry W. Poulson and Jules G. Kaplan, Texas Public Policy Foundation (Oct. 2007).

All Taxes Are Not Created Equal by Byron Schlomach, Texas Public Policy Foundation (Mar. 2006).

Income Tax

The Issue

Texas boasts one of the best tax climates in the country. According to the latest Tax Foundation data, Texas' state and local tax burden ranks 45th nationally, placing it among the very best states for taxpayers.

As a result of the state's comparatively friendly tax environment, Texas' private sector economy is surging forward, outperforming the nation as a whole in a number of key areas. Consider that:

- Texas' economy is growing faster than the national average. In 2011, Texas' gross domestic product grew by 2.4%, much faster than the national economy which grew by just 1.6%;
- Texas' labor market is adding jobs at a faster rate than the rest of the nation. From August 2011 to August 2012, Texas nonfarm employment increased by 2.5%, whereas between August 2011 and August 2012, U.S. total nonfarm employment increased 1.4%.
- Texas replaced all of the jobs it lost during the recession by December 2011, putting it well ahead of the national recovery. At that same point, the nation had recovered just 30% of the jobs lost.
- Texas' unemployment rate is markedly lower than the national average. Texas' unemployment rate, 7.1% in August 2012, has been at or below the national average, 8.1% in August 2012, for 68 consecutive months or more than five years straight.

In spite of these impressive achievements, however, some argue that a broad-based personal income tax is needed to improve the state's overall outlook, raising the question: Is Texas better or worse off with an income tax?

To help answer that question, let's examine some recent data.

In *Competitive States 2010: Texas vs. California*, the Foundation compares the past economic performance of "the nine states without a personal income tax (including Texas) to the nine with the highest marginal income tax rates (including California)." The study's results show a clear difference between the two groups.

In every category analyzed—including Gross State Product Growth, Personal Income Growth, Population Growth, Net Domestic In-Migration as a Percentage of Population, and Non-Farm Payroll Employment Growth—the states without a personal income tax fared much better economically than the states with the highest marginal personal income tax rates. Not only that, but the nine states without an income tax also outperformed the national average in every category, often by a wide margin (*see chart on next page*).

Based on this empirical data, it is reasonable to conclude that creating an income tax in Texas would be a detriment for the state's economy. Texas'

The Nine States with the Lowest and Highest Marginal Personal Income Tax Rates
10-Year Economic Performance, 1999 to 2009

	Top PIT Rate*	Gross State Product Growth**	Personal Income Growth***	Population Growth	Net Domestic In-Migration as a % of Population	Non-Farm Payroll Employment Growth****
Alaska	0.00%	106.8%	69.0%	11.8%	-2.0%	15.8%
Florida	0.00%	78.4%	65.5%	17.6%	6.5%	8.7%
Nevada	0.00%	106.2%	81.3%	36.6%	14.1%	21.4%
New Hampshire	0.00%	53.5%	52.6%	8.4%	2.5%	4.4%
South Dakota	0.00%	77.9%	63.9%	8.3%	0.8%	9.7%
Tennessee	0.00%	56.7%	55.1%	11.7%	4.2%	-0.7%
Texas	**0.00%**	**94.5%**	**67.6%**	**20.5%**	**3.4%**	**13.7%**
Washington	0.00%	64.9%	58.8%	14.1%	3.4%	8.2%
Wyoming	0.00%	137.6%	91.6%	10.7%	4.3%	24.8%
9 States with No PIT*****	0.00%	86.28%	67.26%	15.52%	4.12%	11.76%
U.S. Average*****		66.34%	65.54%	10.08%	0.80%	10.42%
9 States with Highest Marginal PIT Rate*****	9.92%	59.81%	53.36%	6.10%	-1.91%	2.48%
Ohio	8.24%	35.2%	34.4%	1.8%	-3.1%	-7.7%
Maine	8.50%	56.7%	55.3%	4.1%	2.3%	1.9%
Maryland	9.30%	68.8%	66.0%	8.5%	-1.5%	6.4%
Vermont	9.40%	59.7%	52.5%	2.8%	-0.1%	1.2%
New York	10.50%	66.6%	48.0%	3.5%	-8.3%	1.9%
California	**10.55%**	**70.1%**	**56.6%**	**10.3%**	**-3.9%**	**2.5%**
New Jersey	10.75%	51.2%	48.7%	4.2%	-4.8%	1.0%
Hawaii	11.00%	70.0%	66.6%	7.0%	-2.2%	12.0%
Oregon	11.00%	60.1%	52.3%	12.7%	4.5%	3.0%

Source: "Competitive States 2010: Texas vs. California"

economic prospects as well as its citizens are best served by its current low tax, pro-growth approach rather than a new income tax.

The Facts

- Texas is one of nine states without an income tax.
- Income taxes damage a state's economy more than any other tax because they disincentivize capital investment, productivity, job creation, wages, and economic expansion.

continued

Income Tax (cont.)

- Short-term revenue gains from a new personal income tax are outweighed by the long-term economic damage the tax creates.
- The nine states without an income tax outperformed the nine states with the highest marginal income tax rates in nearly every important economic area from 1999 to 2009 including in such measures as Gross State Product Growth, Personal Income Growth, Population Growth, Net Domestic In-Migration as a Percentage of Population, and Non-Farm Payroll Employment Growth.
- In addition, the nine states without an income tax also outperformed the national average in every metric above.

Recommendations

- Do not create a personal income tax in Texas.
- Encourage economic growth by keeping taxes low and adopting pro-growth reforms.

Resources

Competitive States 2010: Texas vs. California by Arduin, Laffer, & Moore Econometrics, Texas Public Policy Foundation (Oct. 2010).

Gambling

The Issue

In recent years, it has often been suggested that Texas address possible budget shortfalls by increasing revenues rather than reducing spending.

As we approach 2013, this is true once again. This time, the efforts to increase state revenue seem to be focused in two areas: "fixing" the state's margin tax and expanding state-controlled gambling.

One group earlier this year 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 spending is not the right answer. Instead, Texas should keep government spending at the level necessary to match available revenue.

This approach of "living within one's means" is simple and commonsense, and is in fact the same one that each Texas family puts into practice every day.

Though Texas has accomplished this better than most other states, we still have plenty of room for improvement.

For instance, between 1990 and 2010, the sum of population growth plus inflation 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 this increased revenue comes from expanding an existing tax like the margin tax or from instituting a new tax like a tax on gambling, 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 response to budget shortfalls is more revenue.

The Texas Model consists of: 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.

continued

Second, a significant body of research has shown that gambling 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.

Recommendations

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

Resources

VLTs — What Are The Odds Of Texas Winning? by Chris Patterson, Texas Public Policy Foundation (Mar. 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 (Mar. 2004).

Health Care

Medicaid

The Issue

When Medicaid, created by Congress in 1965, arrived in Texas two years later, it focused on providing health care benefits to recipients of certain cash assistance programs. More than four decades of incremental policy expansion have made it the largest government health program and our biggest budgetary headache. In 2001, Medicaid consumed 14% of our state budget, but by 2011 the amount consumed had grown to over 20%. By comparison, over the same period public education spending fell from almost 45% of the budget to 41.3% of the budget.

Texas Medicaid did not exceed $2 billion in annual expenditures until 1987; it now costs $20 billion a year. Much of this growth was driven by caseload increases resulting from eligibility expansions enacted both in Washington, D.C., and Austin.

According to the Texas Health and Human Services Commission, Medicaid added around one million clients between 1999 and 2005, and then grew by roughly another million by 2010. The Commission projects that 2.7 million non-disabled children will be on Medicaid in FY 2013. Non-disabled children make up a majority of the caseload, but the aged, blind, and disabled (ABD) account for most of the spending.

Recent growth in Medicaid costs can be attributed to caseload growth driven by the economic downturn and lack of state flexibility in administering the program. The program is projected to experience significant growth in the future due to an aging population and pressures from the federal health care law. The cost growth from the health care law will result from a higher enrollment rate of individuals that are currently eligible but not enrolled. Even if the health care law is repealed, the ABD population will continue increasing as the Baby Boom generation enters retirement. Medicaid expenditures will increase due to higher costs associated with care for the elderly.

The Facts

- Medicaid is an entitlement program—Texas must provide medically necessary care to all eligible individuals who seek services as long as the state participates in the program.
- Health and human services spending, some 70% of which goes to Medicaid, represents roughly 22% of the state budget.
- For the 2012-13 biennium, the Legislature appropriated approximately $39 billion in All Funds for the Medicaid program alone, making it the second largest single item in the state budget.
- Medicaid is jointly financed with federal tax revenue and state tax revenues according to the Federal Medical Assistance Percentages (FMAP), which varies between states and usually changes from year to year. Historically,

Texas pays roughly 40% of Medicaid costs and the federal government roughly 60%. But even small fractions of change in the FMAP result in significant losses or gains in the amount of federal funding that comes to the state as a result.

- In 2009, Medicaid covered almost 3.7 million Texans, including 2.7 million children.
- Children have increased as a percentage of total Medicaid enrollment due to the economic downturn, but the ABD population is expected to increase consistently with the aging of the Baby Boom generation.
- In 2007, 56% of live births in Texas were paid for by Medicaid.
- Never, in the history of the Texas Medicaid program, has state spending (general revenue) on Medicaid declined from one year to the next. Only in 1982 did total Medicaid spending decline from the previous year as the result of reductions at the federal level.

Recommendations

- The state should continue to pursue Medicaid funding block grants, in order to give the state greater certainty in the Medicaid budget from year-to-year, as well as greater flexibility to run the program. This includes petitioning the state's Congressional delegation to represent these needs in the U.S. Congress.
- Texas should submit a new state plan to allow for greater flexibility in the program.
- The state should also reject efforts to extend the period of Medicaid eligibility—including eligibility for children's Medicaid benefits.

Resources

Letter to Commissioner Albert Hawkins commenting on Medicaid reform proposal from Mary Katherine Stout, Texas Public Policy Foundation (Nov. 2007).

Medicaid: Yesterday, Today, and Tomorrow: A Short History of Medicaid Policy and Its Impact on Texas by Mary Katherine Stout, Texas Public Policy Foundation (Mar. 2006).

Final Notice: Medicaid Crisis by Dr. Jagadeesh Gokhale, Texas Public Policy Foundation (Dec. 2010).

Medicaid Reform: Constructive Alternatives to a Failed Program by Arlene Wohlgemuth, Brittani Miller, and Spencer Harris (Feb. 2011).

Fiscal Size-Up: 2012-2013 Biennium Legislative Budget Board (Dec. 2009).

CHIP

The Issue

Congress established the Children's Health Insurance Program (CHIP) in 1997, in response to mounting pressure to address the number of uninsured children. Proponents argued that CHIP would deliver health insurance coverage to half the nation's 10 million uninsured children by 2000. Through Federal Fiscal Year 2005, however, the program had never enrolled even 4 million children at any given time. To take advantage of federal funds available under the federal program, the Texas Legislature established the CHIP program in 1999, though the new program did not begin to enroll children until June 2000.

Texas CHIP is limited to children under age 18, in families whose incomes fall below 200% of the federal poverty level (FPL), and who are not eligible for Medicaid. Average monthly enrollment in the CHIP program declined from 2003 to 2006. However, these declines in caseload prompted lawmakers to reverse course on a 2003 state law requiring enrollees to prove their verified eligibility every six months, pass an assets test, and enter a 90-day waiting period before enrollment took effect. When the 80th Legislature extended CHIP eligibility to one full year without reapplication, it created separate periods of continuous eligibility for children's Medicaid (6 months) and CHIP (12 months). After lawmakers expanded the program in 2007, the state expected roughly 500,000 enrollees in 2009. New policies combined with an economic downturn caused enrollment to increase significantly. As of October 2012, there were 581,420 enrollees.

The 2010 federal health care law extended the CHIP program through 2019 with the eligibility levels that states had on the date of the law's enactment. With this extension, the law eliminated all asset and resource tests and kept a provision to disregard 5% of the family income.

While the CHIP program is to all intents and purposes an expansion of the Medicaid program, there are two main policy differences between the two. Unlike Medicaid, CHIP is not an entitlement, and federal funds that are available to states through a matching arrangement are capped. Importantly, since CHIP is not an entitlement, states have greater flexibility to design a benefits package and require recipients to share in the cost of care.

The Facts

- CHIP serves children under age 18 who are ineligible for Medicaid, but whose families make less than 200% FPL, with a 72% match from the federal government through 2015. From 2016 to 2019 the match rate for CHIP is 95%.

- For the 2012-13 biennium, CHIP funding totaled $2.0 billion in All Funds. State general revenue funds account for $597.1 million of the CHIP budget.

- The CHIP caseload peaked in August 2012, with 583,151 children enrolled. Average monthly enrollment is expected to continue at similar levels through the 2012-13 biennium.

- Although CHIP is not an entitlement program and spending is theoretically capped, it has required supplemental appropriations to prevent budget shortfalls, and budgets have steadily grown since its inception.

Recommendations

- Require all insurance plans contracting with the state for CHIP coverage to offer some coverage on the private market, making a private insurance product available for purchase to all CHIP applicants determined ineligible or disenrolled.

- Should the efforts to repeal the newly enacted health care law prove successful, reinstate the reforms passed in 2003 and reversed in 2007, including mandating a 90-day waiting period for benefits, requiring an assets test, and removing the 12-month period of continuous eligibility.

- CHIP benefits should be no more generous than state employee benefits. Additional benefits, such as dental and vision services, should come at the family's option with separate cost-sharing.

Resources

Texas Medicaid and CHIP in Perspective, Health and Human Services Commission (Jan. 2011).

CHIP Enrollment by Income Group, Texas Health and Human Services Commission (Apr. 2010).

Fiscal Size-Up: 2012-2013 Biennium, Legislative Budget Board (Jan. 2012).

Health Insurance Regulations

The Issue

In recent years, lawmakers have enacted legislation requiring health insurance plans to cover a variety of conditions and forcing insurers to guarantee access for beneficiaries to an array of health care providers.

The majority of health insurance mandates fall into three categories: those that force health plans to cover specific services or benefits, those that require access to specific health care providers, and those that mandate guaranteed coverage to particular individuals. As of February 2012, Texas has 62 mandated benefits that run the gamut of coverage options.

Good intentions lie behind legislation that requires specific forms of health care services, not the least of which include guaranteeing reimbursement for providers, insuring coverage for individuals with chronic or unique conditions or diseases, and extending health benefits to more individuals. However, these mandates ultimately harm consumers by making health insurance more expensive and requiring individuals to buy health benefits they would arguably forego if they had the option.

Legislation that defines the parameters of health insurance policies inflates the cost of health plans by requiring policies to cover an array of services, which many consumers never use. A prime example is the Texas law requiring all insurance policies to cover in-vitro fertilization (IVF), a service that costs on average $8,158 plus an additional $4,000 in medication costs. It is estimated that insurance coverage of IVF treatments can increase health insurance costs by as much as $2 per member per month. This may seem like a trivial amount at first blush, but the cumulative effect of 62 mandates can significantly add to the cost of insurance.

Additionally, these predefined policies limit the opportunity for insurers to develop new and innovative products tailored to the individual and designed as valuable investments. Instead, these mandates force consumers to buy all-inclusive health plans with few alternatives to these more expensive, heavily mandated plans.

The incurred cost of insuring everyone, regardless of health status, eliminates the risk-based aspect of health insurance and, again, forces healthy consumers to compensate for the expense of less healthy individuals. Regardless, these onerous mandates have been imposed on the small group health insurance market. As a result, small employers are struggling to provide affordable health insurance for their employees, and many are forced to drop coverage altogether.

Although all of Texas' 62 mandates were passed with the intent of making health care accessible to more people, by significantly contributing to the rising cost of health insurance, they have actually added to the growing uninsured population across the state.

The Patient Protection and Affordable Care Act (PPACA) will require all health insurance plans to provide minimum essential health benefits as defined

by the law. These requirements are generous and can be expanded in the future by the Secretary of Health and Human Services. If implemented, the state should roll back any mandate that goes beyond federal minimums.

Texas Mandated Insurance Coverage Benefits	
Acquired Brain Injury	Home Health Care
Alcoholism	Immunizations-Children
Alzheimer's	In-Vitro Fertilization
Autism Spectrum Disorder	Mammogram
Bariatric Surgery & Tests for Early Detection of Heart Disease	Mastectomy Stay
Basic Health Care Services	Maternity Stay
Bone Mass Measurement	Mental Health Parity
Breast Reconstruction	Mental Illness Crisis Stabilization & Residential Treatment for Children & Adolescents
Cardiovascular Disease-Screening	Newborn Hearing Screening
Cervical Cancer or HPV Screening	Off-Label Drug Use
Chemical Dependency Benefits	Osteoporosis Detection & Prevention
Colorectal Cancer Screening	PKU/Formula
Contraceptives	Point of Service Coverage
Dental Anesthesia	Prescription Drugs-Formulary
Diabetes	Prostate Cancer Screening
Diabetic Supplies	Prosthetic & Orthotic Devices
Emergency Care Services	Reconstructive Surgery-Children w/Craniofacial Abnormalities
Hearing Aid	TMJ Disorders
Hearing Screening-Children	Well Child Care
HIV, AIDS, or HIV-Related Illness	
HPV Testing	

Texas Mandated Providers	
Acupuncturists	Occupational Therapists
Chemical Dependency Treatment Facility	Optometrists/Ophthalmologists
Chiropractors	Physical Therapists
Dentists	Physician Assistants
Dieticians	Podiatrists
First Nurse Assistant	Professional Counselors
Government Hospital	Psychologists
Marriage Therapists	Public or Other Facilities
Mental Health/Psychiatric Day Treatment	Speech/Hearing Therapists
Nurse Practitioners	

continued

Health Insurance Regulations (cont.)

Texas Mandated Covered Persons	
Adopted Children	Domestic Partners
Children of Spouse	Extension of Benefits- Totally Disabled Persons
Children Up To Age 25	Extension of Benefits- Upon Acceptance of Premium
Children w/Developmental Delays	Extension of Benefits- Upon Termination by Insurer
Children w/Medical Support Order	Grandchildren
Continuation Dependents	Handicapped Dependents
Continuation Employees	Mental Illness/Nervous Disorders w/Demonstrable Organic Disease
Continuation for 6-9 Month Period	Mental Illness-Serious Mental Illness
Continuation Upon Death of Spouse	Newborn Children
Continuation Upon Divorce	
Conversion to Non-Group	
Dependent Students	

The Facts

- Texas' insurance plans are subject to 62 mandates, ranking the state as one of the country's 10 most heavily regulated.
- The combined effect of mandates drives up the cost of a basic health plan with each mandate adding from just under 1% to as much as 10%.
- One out of four uninsured individuals does not have health insurance because of the inflated prices resulting from government programs and mandates.

Recommendations

- Eliminate all insurance mandates not required by federal law.
- Allow Texans to purchase health insurance policies offered by providers regulated by other states.

Resources

Health Maintenance Organization Texas Mandated Benefits/Offers/Coverages Including Changes Made by the 82nd Legislature by Texas Department of Insurance.

Health Insurance Mandates in the States 2010 by Victoria Craig Bunce and JP Wieske, Council for Affordable Health Insurance (2010).

Mandating Expensive Health Insurance in Texas by Kalese Hammonds, Texas Public Policy Foundation (Mar. 2008).

State Laws Related to the Coverage of Infertility Treatment by the National Conference of State Legislatures (Mar. 2010).

Consumer-driven Health Care

The Issue

Consumer-driven health care has become an often-heard term with the creation and widespread adoption of personal health accounts. These include Health Reimbursement Arrangements (HRAs), Health Savings Accounts (HSAs), and any other product or program that decreases the influence of third-party payers on cost and utilization.

As the popularity of consumer-driven health care has grown, however, so have issues that affect the ability of individuals to make value decisions about their health care. Issues like price transparency and an emphasis on measuring quality have emerged as central issues in the health care debate, driven largely by the growth of these new methods of paying for health care services.

Health Savings Accounts
FSAs and HRAs preceded HSAs, which were created by Congress in 2003 and first became available on the market in 2004. Since then, HSA use has grown rapidly as these instruments offer greater patient control and even more flexible features than similar accounts.

The term HSA refers to a savings account that is combined with a high deductible health plan (HDHP) and is used to pay for health care with pre-tax dollars. An HDHP requires participants to meet their deductibles by paying medical bills out-of-pocket (presumably with funds in the HSA), rather than with co-payments and co-insurance. Premiums are often lower than under traditional health insurance plans that feature high premiums and low, or no, deductibles or cost-sharing. Funds remaining at year-end are rolled over to the next year, continuing to build.

In September 2004, there were 438,000 people enrolled in an HSA-qualified HDHP; in January 2012 there were more than 13.5 million. The overall growth in HSAs increased 18% last year, after seeing growth every year as high as 40%. Total HSA deposits exceeded $10 billion in 2010. Recent studies show that about 40% of those purchasing an HSA-qualified HDHP in the individual market were previously uninsured, perhaps attracted by the low price and tax benefits.

HSAs are frequently criticized as being only for the healthy and wealthy, but experience disputes this. Indeed, individuals with chronic conditions can benefit from the flexibility that an HSA provides, not to mention a fixed out-of-pocket expenditure and a family deductible, rather than the per-person deductible often found in other traditional health insurance plans. In addition, the opportunity to save for health care with pre-tax dollars is at least as appealing as the premium savings that an individual (or an employer) realizes from purchasing a high deductible plan.

Critics claim that individuals with HSAs will forego needed care in order to save money. Studies have indeed shown this occurs only in minor circumstances. Reason suggests that personal responsibility for health care makes screenings and treatment regimens look better than the cost of neglected medical com-

continued

plaints. Overall, HSAs provide individuals with greater control over both health care decisions and the way in which health care services are paid.

Health Reimbursement Arrangement

Another consumer-driven alternative to traditional health insurance is the Health Reimbursement Arrangement (HRA) as a means for small organizations to offer health care coverage to their employees. HRAs allow employers to reimburse employees for qualified medical expenses using pre-taxed dollars. Employers also have the option of allowing unused funds to accrue from year to year as an incentive to encourage employees to be price conscious when choosing medical providers and other medical services. A unique feature of HRAs is that the Internal Revenue Code permits funds from an HRA to be used to reimburse employees for health insurance premiums.

These arrangements make health insurance more affordable for employees by lowering the cost of premiums through the use of pre-tax dollars and allowing employees to purchase cheaper, individual policies whose prices have not been inflated by many of the costly regulations imposed on small group health plans, such as the guaranteed issue mandate. These arrangements give employees the option of buying individual policies or using the funds in the HRA to pay for approved medical expenses.

Agency clarification of the Texas Insurance Code qualifies reimbursements for premium payments as de facto small group policies subject to all of the rules and regulations created by the Health Insurance Portability and Accountability Act (HIPAA). By classifying these reimbursements as small group insurance policies, the Texas Insurance Code forces coworkers to share in the cost of insuring fellow employees enrolled in the same plan by enforcing costly mandates such as guaranteed issue to individual plans purchased with funds from an HRA. Additionally, this interpretation strips employers of one of their most economical options for providing health care coverage. It could force many small employers to drop health coverage all together.

Medicare Part D

Medicare Part D was created using a number of market-based cost containing mechanisms that do not exist in other entitlement programs. Because of this Part D has been more successful at cost containment than other programs. The average Part D premium in 2012 is projected to be $30.00, a modest decrease from the 2011 average of $30.76. In a time when the goal is cost containment, Part D has achieved cost reduction.

The two policies in Part D that achieve this are premium support and the "donut hole." These two policies keep clients invested in the cost of their policy as well as their actual care, which in this case is prescription drugs. These have resulted in the cost of the program to be 30% below original estimated costs through 2011, and projected to be 40% below original estimated costs in the first 10 years. The savings have not been confined to Part D. Part D has also had the effect of reducing the retail prices for prescription drugs by 19%. For clients with limited previous drug coverage, enrolling in Part D was associated with a reduc-

tion of $1,200 a year in non-drug medical spending according to the *Journal of the American Medical Association*.

One should note that under ObamaCare the "donut hole" is eliminated. This is likely to adversely affect the future cost reduction in Part D. Part D is only one part of an entitlement program that has significant unfunded liabilities. However, the impact of consumer driven health care in Medicare Part D offers a window into the effects it could have on the greater health care marketplace.

The Facts

- In September 2004, 438,000 people had an HSA-qualified HDHP; in January 2012, more than 13.5 million. In 2010, combined account balances in HSAs topped $10 billion.
- In 2011, 844,832 Texans were enrolled in an HSA/HDHP, the second highest number in the nation.

Recommendations

- Offer state employees an option to enroll in an HSA/HDHP.
- Clarify existing state law to make sure the purchase of individual health insurance, through an HSA, is not subject to small group requirements.

Resources

Reducing the Cost of Health Care: A Case Study on Health Savings Accounts by Spencer Harris, Texas Public Policy Foundation (Dec. 2010).

Consumer-Driven Price Transparency: Making Health Care Prices Transparent Through the Free Market by Mary Katherine Stout, Texas Public Policy Foundation (June 2006).

Individual or Group Coverage: Regulating Health Reimbursement Arrangements in Texas by Kalese Hammonds and Mary Katherine Stout, Texas Public Policy Foundation (Feb. 2008). http://www.texaspolicy.com/pdf/2008-02-PP06-HRA-kh-mks.pdf

HSAs for State Employees by Mary Katherine Stout, Texas Public Policy Foundation (Aug./Sept. 2006).

Health Savings Accounts: Affordable, Portable, and Accessible Health Insurance by Mary Katherine Stout, Texas Public Policy Foundation (Mar. 2005).

Healthy Competition: What's Holding Back Health Care and How to Free It by Michael Cannon and Michael Tanner, CATO Institute (2007).

Health Savings Accounts: Answering the Critics, Parts I-III by John Goodman and Devon Herrick, NCPA, Brief Analysis Nos. 544, 545, and 546 (Mar. 2006).

"George W. Bush, Health Reformer: Flat Medicare Drug Premiums Show That Choice and Competition Work" by Avik Roy, *Forbes* (5 Aug. 2011). America's Health Insurance Plans, PowerPoint Presentation.

Scope of Practice

The Issue

Texas has 226 regions designated as Medically Underserved Areas (MUAs). In fact, only 23 of Texas' 254 counties have fully adequate levels of medical providers. Nearly 90% of rural Texas counties fit wholly or partially into this category. Twenty-five counties have no physician at all, and nearly 20% of Texans, or 3.2 million people, lack adequate access to a primary care provider.

Broader use of advanced practice nurses (APRNs), particularly nurse practitioners, could improve this situation by increasing access to trained health care providers. However, Texas operates one of the country's most highly regulated environments for APRNs, greatly restricting the ability of these highly qualified medical professionals to operate effectively and provide lower cost health care services to Texas consumers.

APRNs are trained and educated to provide the majority of basic needs within their given field of practice. For instance, a nurse practitioner is capable of administering a physical exam, treating a basic wound or infection, or managing a treatment regimen for a chronic disease such as diabetes. Unlike physicians, APRNs are not allowed to practice outside of their education and training. For instance, if a pediatrician diagnosed a young child with strep throat and the mother asked the physician to examine her as well, the pediatrician would be able to. However, if the same scenario was encountered by a pediatric nurse practitioner, they would have to get an appropriately licensed nurse practitioner or a physician to examine the adult mother.

Texas law requires that a nurse practitioner be supervised by a licensed physician in order to practice in a separate facility. Oversight requirements mandate that a physician works on site with the nurse practitioner 10% of the time, and site-based regulations require the supervising physician to work no more than 75 miles from the facility where the nurse practitioner works. The physician does not deliver care nor does he supervise the nurse practitioner delivering care; rather, the physician reviews a minimum number of charts. The law further restricts the number of available nurse practitioners by allowing physicians to supervise a maximum of four.

Thirty-three states allow APRNs to diagnose and prescribe, and 11 of those do not require collaboration with a physician. No increased threat to patient safety has been reported in any of the 33 states with only minimal to moderate restrictions. Access to affordable and convenient care has improved as the number of retail clinics has expanded in states where regulations are more favorable.

Nationwide, a shortage of 44,000 to 46,000 primary care physicians is anticipated by 2025, due in large part to the declining number of medical school students selecting primary care specialties. Given Texas' rapid population growth, and the aging of the Baby Boom generation, physicians will be unable to keep pace with demand for their services. Fewer than 13,000 board certified family practice physicians, internists, and pediatricians now practice in the state.

The lack of primary care will hit hardest in rural areas that are financially unable to attract enough physicians. Giving APRNs the ability to practice to the extent of their education and training will improve patient access to prompt treatment as well as efficient and effective patient-centered care, without affecting quality of care. The Board of Nursing has well-defined regulations that prevent nurses from stepping outside of their individual levels of education and training. Studies have shown that the quality of service consumers get does not decline when receiving care from a non-physician clinician. Other research findings support that appropriately trained APRNs can provide as high a quality of care as doctors for the services they provide.

The Facts

- Only 23 of Texas' 254 counties have adequate levels of health care professionals. Nearly 90% of rural Texas counties are partially or completely designated as medically underserved. Twenty-five Texas counties have no physician at all, and nearly 20% of Texans, or 3.2 million people, do not have adequate access to a primary care provider.
- The number of retail clinics is expanding in the 33 states where regulations are more favorable to the development of retail health clinics.
- Research findings support that appropriately trained nurses can provide as high a quality of care as doctors for the services they provide. APRNs also provide care to Medicaid clients at an 8% discount from the physician's rates.
- Giving APRNs the ability to practice to the extent of their education and training will improve patient access to prompt treatment as well as efficient and effective patient-centered care, without affecting quality.

Recommendations

- Repeal onerous regulations surrounding APRN scope of practice such as site-based requirements and oversight requirements.
- Permit nurse practitioners to practice to the extent of their education and training as defined by the Board of Nursing. Allow prescriptive authority to be determined by the Board of Nursing.

Resources

The Future of Nursing: Leading Change, Advancing Health by Institute of Medicine (Oct. 2010).

The Pearson Report by The American Journal for Nurse Practitioners (Feb. 2009).

Texas Needs a New Approach to APRN Prescriptive Authority by Texas Nurse Practitioners (Apr. 2012).

State Employee Health Benefits

The Issue

The Employees Retirement System of Texas (ERS) oversees state employees' retirement and insurance benefits. ERS provides health care benefits through their Group Benefit Program (GBP). Despite reforms to employee health benefits enacted in 2003, the cost of employee health benefits remains the full obligation of the state. Currently, Texas covers the entire cost of an employee's health benefits, as well as 50% of premiums for dependents.

During the 82nd legislative session (2011), ERS was facing a shortfall of $400-$600 million in its health insurance program. This prompted the ERS, along with the state and the employees, to enact cost-saving measures. These include a higher coinsurance, co-payments, and deductibles. The plan also incorporated higher payments for smokers specifically. The GBP also incorporated program changes designed to save money such as the Dependent Eligibility Audit, contracts with regional medical providers for medical home initiatives, utilization management, and lower provider contract rates.

These changes, among others, allowed ERS to cover the shortfall they faced in 2011. Individual state employees have realized an increase in their exposure to risk through higher co-insurance and co-payments. Additionally, this increase in exposure has come without a corresponding increase in real benefits. However, there is still a need for further improvements. ERS expects that contributions to the GBP will have to increase by 7% to 8% each year to maintain the current program. The state's budget is increasingly constrained by Medicaid growth along with other needs, and it is unlikely that the state will be able to maintain 7% to 8% annual growth.

In 2009, Texas was one of only 14 states to fully fund employee health benefits. It is reasonable to ask state employees to contribute to the cost of their health care as costs increase at 7% to 8% annually. ERS has made improvements in cost containment in the GBP over the last few years, and it is in better condition than many other state employee health benefit funds across the nation. The GBP could be further strengthened through new choices for state employees.

The Facts

- In FY 2011, ERS provided insurance benefits to more than a half million state employees, retirees, and dependents.
- Texas pays the full cost of the premium for state employees and half the cost of the premium for an employee's dependents—a total appropriation of about $2.4 billion for the 2010-11 biennium.
- Texas state employees also have the option of participating in the TexFlex program—a Flexible Spending Account to which they make pre-tax savings deposits for out-of-pocket health and child care expenditures.
- In Plan Year 2004, the premium for employee-only benefits was $300 per month, for Plan Year 2007, the monthly cost for the employee-only benefit increased 20% to $360 per month, and remained the same for Plan Year

2008. The state's present contribution is estimated at $2.7 billion for group insurance premiums—an increase of $236.5 million in General Revenue Funds compared to the 2010-11 biennium.

- ERS commissioned a Milliman study on the offering of an HSA to state employees. The state has long passed the recommended start date of September 1, 2009. Had the state begun offering the HSA as an option we would now be realizing the impact of the slower growth in costs that HSAs are proven to afford. Their growth rate is roughly half the rate of traditional insurance.
- ERS has seen a unique problem in noncompliance with prescription medication among the clients of ERS. For instance, only 52% of clients with diabetes are compliant in taking their prescribed medications. This can cost the program the plan an additional $3,700 each year. An HSA would be well positioned to address this issue as clients have greater exposure to first dollar coverage such as prescription medications.
- Many states make large contributions—almost $1,400 annually in Indiana's case—to individual employee HSAs.

Recommendations

- Readjust cost sharing for state employees, requiring them to pay a portion of the monthly premium.
- Offer state employees the option of a high deductible health plan and health savings account to control costs.
- Fully fund the employees who choose the high deductible health plan and health savings account leaving the difference between the amount per beneficiary on traditional health insurance and the HSA as the required employee contribution. This will incentivize enrollment in the HSA option.
- Allow employees choice of a high deductible health plan with the minimum high deductible allowed under law or a plan with even higher deductible.

Resources

Facts About Health Savings Accounts by Mary Katherine Stout, Texas Public Policy Foundation (May 2007).

Reducing the Cost of Health Care: A Case Study on Health Savings Accounts by Spencer Harris, Texas Public Policy Foundation (Dec. 2010).

State Employee Benefits by National Council for State Legislatures (Jan. 2012).

Health Savings Accounts: Answering the Critics, Parts I-III by John Goodman and Devon Herrick, National Center for Policy Analysis, Brief Analysis Nos 544, 545, 546 (Mar. 2006).

Legislative Budget Board "Fiscal Size-Up" 2012-13 Biennium by Legislative Budget Board.

Texas Employees Retirement System 2011 Comprehensive Annual Financial Report by Legislative Budget Board.

Environment

Regulatory Impact Analysis

The Issue

The basic purpose of regulation in our state and federal constitutional scheme is to implement the laws enacted by popularly elected representatives—no more and no less. The Legislature creates and delegates to agencies the authority to promulgate and enforce regulations. Regulations carry the force of law. These are very broad powers which can—but should not—authorize regulation not clearly authorized by specific law. For example, the Texas Commission on Environmental Quality (TCEQ's) general powers provide authority "necessary and convenient" to carry out the agency's statutory mission to protect health, safety, and the environment.

If limited government is the guiding principle, state regulation must come under specific and limited—in contrast to general—authority. Regulation issued solely by the general powers of an agency should be the exception and only exercised under heightened justification. Statutes articulating clear policy objectives and preferred regulatory mechanisms limit regulatory scope and can facilitate measurable results. Although agencies often prefer more general statutes granting broad discretionary authority, clear statutory language stipulating regulatory goal and mechanism reduces regulatory "creep," i.e., regulations exceeding authorizing statutes.

The number, scope, and cost of environmental regulations have dramatically increased in the last 20 years. TCEQ now implements and enforces roughly 6,000 rules, the majority of which are dictated by federal law. Although multiple benefits to health, safety, and the environment may flow from these rules, there is no accessible mechanism for tracking their cost and effectiveness.

The federal government has long required cost-benefit analysis of proposed rules. Texas has no similar requirement. The Texas Administrative Procedures Act, governing all state rulemaking, requires an assessment of fiscal implications of new regulations on state and local government but not of impacts on the private sector. The General Govt. Code "Regulatory Analysis of Major Environmental Rules" (Sec. 2001.0225) does require this analysis of cost to the private sector for a limited number of "major" rules. However, a "major" environmental rule includes only rules: 1) exceeding an express requirement of federal or state law, 2) adopted solely under the agency's general powers, or 3) exceeding a requirement of a delegation agreement. The formal Regulatory Impact Analysis (RIA) required in these provisions apparently has only been included in one rulemaking over the 14 years since enactment. The current statutory definition of "major rule" has been effectively interpreted to exclude all rules promulgated.

Court decisions seem to validate this interpretation of current law. In *Brazoria County v. Texas Com'n on Environmental Quality* (App. 3 Dist. 2004)128 S.W.3d728, the court held that TCEQ's rules implementing requirements for vehicle inspection and lawn maintenance did not trigger the statutory requirement for a Regulatory Analysis for a Major Environmental Rule, since the TCEQ developed the regulation to meet, not exceed, the National Ambient Air Quality Standard for ozone.

Texas environmental agencies generally avoid most of the excesses and inefficiencies typical of the federal agencies. State and local governments are connected to the regulated entities and the communities in which regulated business operates. TCEQ has wisely striven to resist unwarranted, counter-productive, unlawful

dictates of federal agencies. Yet Texas, whose population is larger than many countries and whose economy is larger than most countries, has a regulatory purview that is, indeed, vast. However well-honed now, efforts to streamline regulatory design and to measure effectiveness should remain a constant focus of Texas state agencies.

Proposed rules with extremely high cost and minimal or immeasurable environmental effect should be sent back to the drawing board. Alternative definition of standards, requirements, and methods of compliance can yield greater environmental outcomes at lower cost. With over 80 steps in TCEQ's internal rulemaking process, this cost-effectiveness analysis of a select few "major" rules need not add time or expense to the agency's work.

The Facts

- Texas does not currently require state agencies to perform a cost-benefit analysis for new regulations in most circumstances. A current requirement that RIA be done for "major" new environmental rules has been invoked only once in 14 years.
- The Texas Administrative Procedures Act requires an estimate of the fiscal implications of new rules for state and local government but not for costs for private business and Texas residents.
- In the 82nd Legislature, Rep. Ken Legler introduced HB 125, which would have implemented RIA requirements for new TCEQ regulations. HB 125 passed the House, but did not make it to the Senate floor in time for passage.

Recommendations

- Before imposing new regulations, Texas agencies should be required to do a three-step regulatory impact analysis that: 1) identifies the problem the rule is intended to address, 2) estimates the rule's environmental effectiveness, and 3) estimates the financial cost directly on regulated entities and indirectly on Texas citizens.
- In conducting this analysis, actual monitored data (credible, representative measures of actual air quality) should trump modeled data (computer simulations of projected air quality).
- Performance measures for regulatory agencies should include measured outcomes (i.e., measurable improvement in air quality, water quality) and not merely outputs (i.e., number of permits, enforcement actions).

Resources

"Taming the Fourth Branch of Government" *The Daily Caller* by Kathleen Hartnett White (Sept. 2011).

Time for Regulatory Transparency by Kathleen Hartnett White, Texas Public Policy Foundation (May 2009).

Basic Good Governance: Regulatory Transparency by Kathleen Hartnett White, Texas Public Policy Foundation (Apr. 2009).

EPA's Impact on Texas

The Issue

Over the last few years, the Environmental Protection Agency (EPA) has embarked on what *The Wall Street Journal* calls "a regulatory spree unprecedented in human history." EPA rules scheduled to become effective in the next three years could cumulatively cost more than $1 trillion and destroy hundreds of thousands of jobs. And while these rules pose a danger to the national economy, they would have a disproportionately severe impact on Texas given its high concentration of energy-intensive businesses and the new oil and gas boom currently underway in many parts of the state.

Proposed regulations such as the Cross-State Air Pollution Rule, the Mercury Rule, greenhouse gas limits for power plants, and denial of the Texas flex permitting program, add up to a potentially devastating effect on Texas. Adopted or proposed regulations have already delayed development of so much new electric capacity that Texas' electric reliability is questionable under peak demand. EPA's new mandates are unachievable or impracticable for businesses dependent on abundant and affordable coal, natural gas and petroleum.

Perhaps most damaging in the near term was the EPA's Cross-State Air Pollution Rule (CSAPR). EPA included Texas in this regulation at the last hour, concluding that Texas emissions affected one air quality monitor in Illinois. That monitor, however, is in attainment of the relevant federal standard and is projected to maintain the standard under existing regulation. Texas attains the federal standard for the emission in question. In August 2012, this rule was invalidated by the federal courts.

The impact of CSAPR on Texas' economy and electrical reliability would have been severe. The Electric Reliability Council of Texas concluded that "had the EPA rules been in effect [during the summer of 2011] Texans would have experienced rolling outages and the risk of massive load curtailment." In response to the rule, Luminant, the largest generator in Texas, announced it would idle 1,200 MW of generating capacity, closing three Texas lignite coal mines and laying-off 500 employees. A new version of this rule by EPA is expected to be forthcoming.

The EPA's new fine particulate matter ozone standards are also a concern. Texas has successfully reduced ozone in major urban areas but EPA continually strengthens the standard on the basis of increasingly questionable science. EPA has begun implementation of a standard of 75 ppb, but EPA is required by law to review and possibly change that standard in 2013. After huge reduction of ozone precursor emissions from stationary sources to meet the 85 ppb standard, the majority of the remaining pollutants in Texas are from mobile sources, over which states have no regulatory authority.

The Administration's rejection of the Keystone XL Pipeline jeopardizes burgeoning oil and gas production. This pipeline would relieve the current bottlenecks in North Dakota and from terminals at Cushing, Oklahoma, bringing oil to Texas refineries that have already invested billions to reconfigure their facilities to process Canadian oil transported by the planned Keystone pipeline.

Since 2009, EPA interference with Texas' state environmental programs has also increased. In July 2010, EPA rejected Texas' Flexible Permitting Program, an innovative regulatory program that has achieved major gains in air quality faster and at less cost than traditional permitting programs. The majority of large power plants and industrial sources in Texas have operated under Flex Permits. In August 2012, the Fifth Circuit Court of Appeals invalidated EPA's disapproval and remanded the case to EPA for further action.

In 2010, EPA took the exceptional step of imposing a Federal Implementation Plan (FIP) on Texas to force regulation of greenhouse gas emissions. Under the Clean Air Act, states develop State Implementation Plans (SIPs) to implement federal air quality standards. EPA must approve the SIPs on pain of sanctions to the states. In late December 2009, EPA issued an automatically effective FIP on Texas, because the state considered EPA's greenhouse gas regulations unlawful. Promulgated as an "Interim Final Rule," without notice and comment as required by the CAA, this automatic FIP is the first in EPA history.

The Facts

- In modeling impacts of CSAPR, EPA assumed the state's 10,000 MW of installed wind capacity would translate to 10,000 MW of actual electric generation. By contrast, ERCOT derates wind to 8.7% of capacity, because Texas wind is weak during summer's peak demand.
- In 2009 and 2010, the Houston region attained the federal standard of 85 ppb, though the intense summer heat in 2011 pushed the city slightly back over the attainment level. The Dallas-Fort Worth area reduced ozone levels from 96 ppb in 2006 to 86 ppb in 2009, a remarkable improvement.

Recommendation

- Texas must continue to exercise its state authority—as recognized in the CAA—and challenge EPA actions when they exceed federal laws' authority and impede effective and efficient state action.

Resources

EPA's Approaching Regulatory Avalanche by Kathleen White, Texas Public Policy Foundation (Feb. 2012).

Texas vs. Environmental Protection Agency by Josiah Neeley, Texas Public Policy Foundation (Apr. 2012).

EPA Process vs. Texas Results by Kathleen White, Texas Public Policy Foundation (Sept. 2010).

"Impacts of the Cross-State Air Pollution Rule on the ERCOT System" by Electric Reliability Council of Texas (Sept. 2011).

Climate Science

The Issue

Climate change, often referred to as global warming, has been used as a justification for a wide array of interventions in the economy, ranging from carbon caps to taxpayer funding for alternative energy.

To accept the case for drastic government action to avert climate change, one must simultaneously believe that climate change 1) is occurring, 2) is primarily the result of human activity, 3) will have serious net negative impacts, 4) can be prevented by governmental policies, and 5) these policies can be implemented at a reasonable cost. While there may be some sound science behind some of these claims, others are a matter of speculation, or rely on economic and political assumptions divorced from the province of climate science.

In the summer of 2009, the U.S. House of Representatives narrowly passed the 1,500 page Waxman-Markey (W/M) cap-and-trade bill. With 1,000 new rules implemented by 21 federal agencies and new spending of $825 billion, the W/M legislation would force reduction of fossil fuel use to a level not seen since the late 19th century. Growing awareness of the staggering cost, job loss, government growth, and ineffectiveness stalled action on the bill in the U.S. Senate.

International support for emissions controls is also waning. In late 2009, thousands of emails among key climate scientists involved in the Intergovernmental Panel on Climate Change were disclosed and revealed document manipulation and destruction of key data, active subversion of the peer review process to silence dissenting views, and alleged violations of Freedom of Information laws. Popularly labeled as the Climate Gate scandals, the leaked emails along with other admissions of errors raised questions about the integrity of scientific findings supporting climate change.

The failure of the 2009 U.N. Climate Change Conference in Copenhagen to reach agreement on new binding reduction plans, due primarily to opposition from developing countries, is widely seen as a turning point on the issue of global warming. Canada recently announced that it was withdrawing from the Kyoto Protocols. And states such as Florida and Arizona have repealed state climate law or withdrawn from regional emissions reduction agreements.

Despite this, EPA has begun the initial phases of regulation of greenhouse gas (GHG) emissions under the Clean Air Act. In December 2009, EPA issued an "Endangerment Finding" regarding greenhouse gases, which found that current and projected levels of GHGs threaten the health and human welfare of current and future generations. EPA has now promulgated at least six other GHG regulations including a CO_2 limit for power plants that precludes new coal-fired plants. Texas' Attorney General challenged the scientific sufficiency of the Endangerment Finding, as well as the other proposed GHG regulations. (The case is still pending and will likely end up before the U.S. Supreme Court.) Meanwhile, EPA is now requiring GHG limits that will increase the cost of obtaining permits for most industries, endanger federal approval of projects like the Keystone XL pipeline, and foreclose the building of any new coal-fired plants.

The experience of the European Union Emissions Trading Scheme, a European equivalent to W/M, has also cast doubt on the effectiveness of cap-and-trade as a solution. Launched in 2005, the scheme has cost $287 billion as of 2011, according to UBS Investment Research, and has had "almost zero impact" on overall emissions in the EU.

Governments across the world have begun official reviews of the Climate Gate scandals, as well as of IPCC's conclusions more generally. To date, the U.S. government has not done so. Federal courts, however, may compel a formal reassessment. At least 16 states have joined Texas in contesting EPA's Endangerment Finding, which relies largely on IPCC science.

The Facts

- CO_2 is not a pollutant but is necessary for human life. Photosynthesis by plants would be impossible without CO_2. Over the last 150 years, the amount of CO_2 in the atmosphere has roughly doubled, to 390 parts per million.
- Average global temperatures have risen about 0.8 degree Celsius over the same period, less than the 1 degree Celsius that standard models would predict.
- Models predicting more warming are based on claimed "positive feedbacks" from water vapor and clouds, which the IPCC itself admits are uncertain.
- For the U.S. to achieve an 85% reduction in GHG emissions—the global reduction promoted by the IPCC to avert dangerous interference with the climate—emissions would have to be reduced to a level not seen since the 19th century.
- EPA's proposed restrictions on GHGs are expected to increase the cost of a vehicle $3,100 by 2025, and, if successful, would prevent only 0.01 degree Celsius of the expected warming.

Recommendations

- Urge federal policymakers to establish an independent, rigorous review of IPCC science.
- Suspend state programs that require or incentivize GHG reduction and avoid state and federal mandates to reduce CO_2.

Resources

Global Warming: What Should Texas Do? by Ian Murray, Texas Public Policy Foundation (Apr. 2007).

Coalition for Responsible Regulation, et al, v. Environmental Protection Agency, No. 09-1322, D.C. Cir. Filed Feb. 16, 2010 (state litigation over Endangerment Finding).

Cool It: The Skeptical Environmentalist's Guide to Global Warming by Bjorn Lomborg, Knopf (2007).

Global Warming: How to Approach the Science by Richard S. Lindzen (22 Feb. 2012).

Cut Environmental Bureaucracy

The Issue

The Texas Commission on Environmental Quality (TCEQ) is the largest state environmental regulatory agency in the country and the second largest environmental agency in the world, after the federal Environmental Protection Agency (EPA). The size of TCEQ is, in part, a reflection of the geographical size of the state, large population, growing economy, and the state's strong energy and manufacturing sector.

The size and cost of the agency, however, is also a direct consequence of the state's choice to implement federal programs delegated by EPA to the TCEQ. At least 80% of TCEQ's programs and actions are dictated by EPA and paid for by multiple fees imposed on private business and local governments. For the last 20 years, Texas governors and the Legislature strongly supported delegation of EPA programs to the state.

The Facts

- Over 84%, or $583.5 million, of TCEQ's budget came from imposed fees (considered General Revenue dedicated funds), and 11.4%, or $78.6 million, came from federal funding.
- Appropriated General Revenue funds amount to $11.8 million, or only 1.7% of the agency's total funding of $692 million.
- The Texas Department of Agriculture and the Texas Parks and Wildlife Commission spend millions of taxpayer dollars on marketing and promotion.
- The Texas Emission Reduction Program (TERP) today serves as a subsidy rather than a way to improve air quality.

Recommendations

- **Eliminate the following programs:**
  - ***The Texas Emission Reduction Program (TERP)*** is supported by general revenue dedicated funds derived from a surcharge on all title fees. The original purpose of TERP was to help the state attain the federal ozone standard without having to impose draconian controls such as "no-drive days" and limiting hours of operation for road building. TERP no longer serves this purpose and federal approval of this program is unclear.
  - ***The Pollution Prevention Advisory Council,*** which advises TCEQ on pollution prevention and recycling programs.
  - ***The Take Care of Texas Program,*** which aims at convincing the public to reduce their environmental impact.
  - ***The Texas Clean School Bus Program,*** which provides grants to school districts and charter schools to cover installation costs for retrofitting school buses.

- ***The Recycling Market Development Implementation Program,*** which coordinates TCEQ recycling efforts with other state agencies and programs.
- ***Seed Quality, Seed Certification, Feral Hog Abatement, and Agricultural Commodity programs*** at the Texas Department of Agriculture.
- ***Promotion and Outreach programs*** at the Texas Parks and Wildlife Department; reduce funding for TPWD's Wildlife Conservation and Technical Guidance programs.
- ***Energy Resource Development and Alternative Energy Promotion programs*** at the Texas Railroad Commission.

- **Eliminate Fee-Driven Dedicated Funding at TCEQ.** Since TCEQ funding consists largely of fee-driven dedicated funds, its impact on the General Revenue budget deficit is minimal. Dedicated funds, however, can be an inefficient means of funding agency programs that may needlessly burden the local governments and the private sector. Through direct appropriation of general revenues—even if in an amount commensurate with existing fees—the Legislature would be forced to more directly scrutinize the activities funded by the fees and the burden imposed on the private sector and local governments to pay the fees.

- **Return Certain TCEQ Programs to EPA Administration.** In addition, the majority of TCEQ funds are spent administering EPA mandated programs at the state level. The current EPA's unprecedented regulatory initiatives have made it increasingly difficult for the state to administer EPA programs in a manner consistent with state interests. Texas' recent experience with TCEQ's refusal to implement EPA's greenhouse gas regulations (which resulted in an EPA takeover of the state's permitting program) raises doubts about whether these programs can continue to be effectively administered by the state government. Certain federal programs, such as Title V operating permits, are particularly appropriate to return to EPA.

Resources

Fiscal Size-up: 2012-13 Biennium, Legislative Budget Board (Jan. 2012).

EPA's Approaching Regulatory Avalanche by Kathleen Harnett White, Texas Public Policy Foundation (Feb. 2012).

Electricity

Electric Competition & Resource Adequacy

The Issue

Investment in new electrical generation has slowed as price signals, i.e., low prices, have caused companies to shy away from Texas. Critics blame the lack of new generation on the market. However, the market is not the problem.

Today's low prices 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 by supporting wind power. However, consumers still pay for the electricity generated by wind, meager compared to the demand for power, through higher taxes.

Another external source leading to reduced investment has been various forms of price regulation. Despite the obvious benefits of the Texas market, some still feel that the ability for prices to shift will hurt consumers. 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 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 ending our "energy only," free-market approach to generating electricity won't help. In fact, it will make electricity more expensive for consumers. The solution to Texas' energy issues is not to regulate the market more, but to regulate it less.

There are real challenges facing Texas' competitive electricity market. First, the market has become more efficient, especially after the move to nodal, so profits are harder to come by. Second, we have greater government intervention in the market, largely in the form of wind energy (which has increased significantly since deregulation began), wholesale price caps, and interventions in the real-time/non-spin markets. All three have pushed prices and profits artificially low and created significant regulatory risk.

This means that capital for new generation is harder to find in Texas and what can be found is more expensive. In large part this is because capital is fleeing Texas to other states where governments provide compensation via fiat, rate of return regulation, capacity payments, etc. By moving capital to other states, not only can the generators avoid regulatory uncertainty here, but they can avoid market risk as well.

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. 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.
- Do not adopt Sunset Commission proposals to increase PUC fines and give the PUC emergency cease and desist authority.
- Define more clearly the concept of market power and market power abuse.
- Eliminate the Renewable Portfolio Standard 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, Texas Public Policy Foundation (May 2011).

Competition in the Texas Electricity Market by Bill Peacock, Texas Public Policy Foundation (Mar. 2011).

Texas' Renewable Energy Experiment by Bill Peacock, Texas Public Policy Foundation (Dec. 2010).

Renewable Energy & Energy Mandates

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 (RPS) 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. Despite this increase, Texas met the RPS target for installed wind capacity in 2010, a full 15 years ahead of schedule.

In addition to Texas' RPS, generous federal subsidies, combined with 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.

Looking at installed capacity of Texas' wind generation overstates the available energy Texas can receive from wind power. There is a critical distinction between a power source's installed capacity, i.e., the amount of electricity that could be generated by a plant operating at full power 24/7, and its actual net generation, i.e., its capacity factor. 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). Periods of high wind can also be problematic, if they do not occur during periods of peak demand for electricity.

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 only around 8.6% of installed capacity.

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 construction of the Competitive Renewable Energy Zone (CREZ) transmission lines. To date, the CREZ lines are Texas' largest subsidy for renewable energy—though integration costs may soon surpass them. The cost to build the CREZ lines will be directly added to the bill of every electric consumer in ERCOT. While this same process is true of all transmission built in Texas, it is

proper to characterize these costs as subsidies for renewable energy—particularly wind—because these lines are being built to where there is little generation other than wind. And that is likely to remain the case. Initial implementation of CREZ transmission has caused intense opposition from thousands of landowners. Transmission service providers anticipate thousands of eminent domain proceedings. The hundreds of miles of transmission through the CREZ lines can also mean line loss of roughly 10%.

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

- 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 cost of wind Renewable Energy Credits—perhaps $41 million per year—is passed on to consumers through the price of electricity.
- CREZ transmission lines—being built to transmit electricity from wind farms in West Texas—will add as much as $1.3 billion annually to electricity bills once the lines have been completed.
- The back-up generation and grid-related costs of wind energy could increase ERCOT's system production costs by $1.82 billion per year.

Recommendations

- Eliminate the Renewable Portfolio Standard.
- 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

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).

Energy Efficiency

The Issue

The Texas Legislature has mandated the state's current energy efficiency program that calls for "each electric utility [to] provide … incentives sufficient for retail electric providers and competitive energy service providers to acquire additional cost-effective energy efficiency for residential and commercial customers equivalent to at least … 20% of the electric utility's annual growth in demand of residential and commercial customers by December 31, 2009."

Energy efficiency has greatly benefitted society and has been a key part of America's and Texas' economic growth. Energy intensity, the amount of energy it takes to produce a unit of output (i.e., a unit of GDP), has been decreasing steadily. Since at least the Industrial Revolution, the world has been increasingly energy efficient. Yet, at the same time, the world has used more energy.

Ultimately, energy efficiency makes energy less expensive so we can use more energy. The public benefit of energy efficiency is that we are able to use more energy that produces more economic growth that makes society wealthier and healthier.

However, government-mandated energy efficiency programs today are designed to decrease energy use. They generally do this by increasing the cost of energy, which results in a decrease in energy use, and subsequently in economic growth.

Texas is almost alone among the states in using a Program Administrator Cost Test (PACT) to evaluate its efficiency programs. The PACT ignores the expenses consumers incur in achieving the reduced energy consumption, understating the total costs of the programs and thus overstating the cost savings, i.e., efficiency, of the programs. For instance, the purchase of a refrigerator with an actual cost of $450 might save future power costs of $400, with the utility giving the consumer $75 to make the purchase. The consumer happily pays the remaining $375 to save $400 on their power costs. The utility reports that its $75 investment has passed a PACT test by saving $400 of power. Society, however, has spent $450 in order to buy only $400 of power savings.

The claim that Texans benefit from a state-mandated "increase in energy efficiency services … and a decrease in overall energy consumption" demonstrates a fundamental economic misunderstanding. An uncompensated decrease in a person's consumption of any economic good is a cost, not a benefit. The fact that the person has chosen not to purchase the "energy efficiency services" and chosen instead to consume electricity is an indication that a program to mandate this change makes them worse off, not better.

Because of the nature of the energy efficiency program, increased gains in efficiency come at progressively higher costs. In other words, each unit of decreased electrical use comes at a higher monetary cost. The PUC's own rules state, "An energy efficiency program is deemed to be cost-effective if the cost of the program to the utility is less than or equal to the benefits of the program." Yet,

as noted above, the agency cannot accurately determine at this point whether or not the programs under this rule are actually cost effective. As the goals are increased, it will be increasingly difficult for utilities to implement programs that are not burdensome and inconsistent with the statute. This is particularly true when it comes to the reduced load served by the utilities as the result of the increased goals. While the utilities are mostly compensated for the expenses of these programs, they are necessarily reducing their overall demand, and thus their revenues. As regulated entities, they have no other means for increasing demand and the associated revenues except through the PUC.

The Facts

- Between 2002 and 2011, the total cost of the energy efficiency program has been $591 million, and the cost increases as the program expands.
- The state's energy efficiency program cannot be justified through the cost-benefit method currently employed by the PUC, since the method does not accurately measure the full costs of the program.
- Increases in the goals of energy efficiency programs make them less efficient.

Recommendations

- Eliminate the state energy efficiency program.
- If the state's energy efficiency program remains in existence, change the way the state evaluates it to encompass all the costs (including those to the program, consumers, and the Texas economy) involved with energy efficiency.
- Any future increases to the program's goals should be closely examined to ensure that they will reduce the cost of energy use.

Resources

Energy Efficiency: Is Texas Getting Its Money's Worth? by Robert J. Michaels, Ph.D. and Bill Peacock, Texas Public Policy Foundation (July 2010).

Making Electricity More Expensive: Texas' Energy Efficiency and Renewable Energy Programs by Bill Peacock, Texas Public Policy Foundation (Aug. 2010).

A Tale of Two Markets: Telecommunications and Electricity, A Sunset Report on the Texas Public Utility Commission by Bill Peacock, Texas Public Policy Foundation (May 2010).

Comments to the Public Utility Commission of Texas Regarding Rulemaking Proceeding to Amend Energy Efficiency Rules by Bill Peacock, Texas Public Policy Foundation (Mar. 2010).

PUC Sunset Review

The Issue

Texas has the most competitive electricity market in the world. Its telecommunications market is equally successful. Both have brought tremendous economic benefit to the state through billions of dollars of investment, lower prices, increased efficiencies, and by making Texas the best state in the country for living and doing business.

It has been almost 15 years since Texas began the process of restructuring its regulatory system of these markets. The direction was laid out in the Texas Utilities Code:

> "The legislature finds that … electric services and their prices should be determined by customer choices and the normal forces of competition." *Public Utility Regulatory Act (PURA), Chap. 39*

> "[T]he policy of this state … [is] best achieved by … fostering free market competition in the telecommunications industry." *PURA, Chap. 51*

Texas policymakers made the decision to let these markets work and not manipulate prices or access policies—unlike policymakers in other states where the move to electricity competition almost universally failed. Bucking the national trend, they did not "design" a market in any meaningful sense; instead they set general rules for market participants and allowed them to compete as they wished within those rules.

While the details of the transitions to competition for these two markets differ, the timeline and the results are remarkably similar. Both took a little over a decade to reach today's level of competition and have resulted in exceptional increases in consumer choice and similar decreases in consumer prices.

These similar results are viewed quite differently by some, as seen in the *Sunset Advisory Commission's 2010 Staff Report on the Public Utility Commission of Texas.* Yet there are no functional, economic, or political reasons to treat these markets differently. In fact, recent concerns about resource adequacy make it even more important to do so.

Unfortunately, Texas hasn't stuck to the original plan to allow market participants to compete. Since the market was originally designed, there has been a steady regulatory creep that has harmed competition and reduced investment in the industry, particularly investment in new generation.

The regulatory creep includes price caps and floors in the wholesale market, merger and approval authority by the PUC, disgorgement authority at the PUC, increased use of the non-spin market, and others. When combined with the significantly greater level of wind subsidies in Texas and increased federal environmental regulation, these have created a high level of regulatory uncertainty that has brought about a higher cost of capital and caused some investors to take capital to other states in search of better returns.

Two recommendations contained in the *2010 Sunset Advisory Commission's PUC Report* would exacerbate the problem of resource capacity. They are:

> Sunset Recommendation 1.2: Increase PUC's administrative penalty authority to $100,000 per violation per day for violations of ERCOT's reliability protocols or PUC's wholesale reliability rules.
>
> Sunset Recommendation 1.3: Authorize PUC to issue emergency cease-and-desist orders.

The report's recommendations are flawed for two primary reasons. First, nowhere does the report identify any violations or problems to justify the recommendations. Second, the recommendations will actually harm competition in the market and further exacerbate the current challenges Texas faces when it comes to resource adequacy. Instead, Texas should continue down the tremendously successful path toward deregulation for both of these markets.

The Facts

- Texas has the most competitive electricity market in the world. Its telecommunications market is equally successful.
- Neither of these markets have shown signs of anticompetitive behavior.
- In 2010, the Sunset Advisory Commission recommended that the PUC have the ability to increase fines and have emergency cease-and-desist authority—even though no examples of violations were cited to justify the recommendations
- This increased enforcement authority, combined with last session's grant of disgorgement authority, could be used as a bludgeon to force businesses to stop activity that is legal but not favored by regulators.
- These recommendations are an example of the regulatory creep that has occurred in Texas since the onset of competition that has harmed competition and led to concerns about resource adequacy.

Recommendation

- The Texas Sunset Commission should not re-adopt its 2010 recommendations to increase PUC fines or give the Commission emergency cease-and-desist authority.

Resources

A Tale of Two Markets: Telecommunications and Electricity, A Sunset Report on the Texas Public Utility Commission by Bill Peacock, Texas Public Policy Foundation (May 2010).

Competition in the Texas Electricity Market: A Texas Success Story by Bill Peacock, Texas Public Policy Foundation (Mar. 2011).

Solutions in Search of a Problem by Bill Peacock, Texas Public Policy Foundation (Mar. 2011).

Disgorgement

The Issue

Last session, 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, should a company somehow attract the PUC's ire, 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 also may contribute to the flight of capital from Texas which is limiting new investment in generation in Texas.

Texas' continuing economic success depends on deregulation of the energy markets; disgorgement threatens the success of those markets, 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 anti-competitive 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

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

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

10th Amendment

Agenda for State Action

The Issue

Our Constitution has withstood the test of time. But the Framer's original design, in which States would protect and nurture the American tradition of self-governance, and federal power would be used only for limited ends, has been undermined. Waves of assault on the constitutional constraints meant to limit federal power, combined with the steady expansion of the federal bureaucracy, have led to a progressive consolidation of power at the federal level.

For more than 100 years, the federal government has been expanding its power and reach. The steady concentration of power in Washington has been accompanied by a steady intrusion into areas of state authority that the Framers assumed the federal government would never be involved in. In the Framers' conception of democracy, state-based self-government and individual liberty went hand in hand. It was for this reason that they insisted on a federal government of strictly limited powers. They enshrined this ideal in the Tenth Amendment of the Constitution: "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people."

A return to the limited system of government envisioned by the Founders will not be easy. The vital solution lies in self-governance itself, what John Locke might have called a "government properly so-called." We the People have a responsibility to engage and understand the issues that affect the fate of our democracy. By elevating our understanding of the need to preserve the authority of the States, and ultimately the sovereignty of the people—the most contentious and important agreement reached at the Constitutional Convention in Philadelphia more than two centuries ago—we can continue to forge a more perfect Union.

The Facts

- The Patient Protection and Affordable Care Act of 2010 ("ObamaCare") is a dramatic expansion of the federal government's reach into our daily lives, on an unprecedented scale. ObamaCare contains an individual mandate to maintain health insurance, a clear constitutional overreach. In addition, ObamaCare requires that States dramatically expand their Medicaid programs, and establish new health insurance exchanges to be regulated as utilities for the socialization of health care costs.
- The Environmental Protection Agency and Department of Interior are using regulatory power to invalidate highly successful state programs that are entirely within the law; to accomplish climate-change policies that have been rejected by Congress; to create stifling regulatory uncertainty in those sectors of industry that compete with the goals of radical environmentalists; and to punish States that pursue a free-market, limited-government regulatory model.

Recommendations

- Interstate compacts are an effective way to regulate areas of mutual concern among two or more States. In areas of overlapping state and federal jurisdiction, or where state legislation is preempted by an enumerated federal power, the Constitution requires congressional consent (Art. I, Sec. 10). The Supreme Court has held that such congressional consent trumps prior federal law and may even subordinate federal agencies to agencies created by the interstate compact. Interstate compacts have enormous unexplored potential as a way of shielding areas of traditional state authority from the concentration of power in Washington. Texas should enact an interstate compact allowing citizens greater choice in purchasing health insurance across state lines, and should consider other areas where an interstate compact might be an effective solution.
- Texas should examine the benefits of using constitutional amendments aimed at controlling runaway federal spending. Constitutional amendments can be proposed in one of two ways. First, Congress itself can propose the amendment. Second, Article V of the Constitution provides that on the call of two-thirds of the states, Congress must convene a convention for the purpose of proposing amendments. Any amendments proposed by this convention must then be ratified by three-fourths of the states.
- States have been fighting back against the federal government by suing in federal court. More than half the states have sued the federal government to escape the impositions of ObamaCare. Texas has filed at least a dozen challenges to various federal environmental rules and actions. Texas should continue to seek relief where appropriate through the federal courts, and the legislature should adopt laws requiring our attorney general to file suit in defense of specific rights.

Resources

Reclaiming the Constitution: Towards an Agenda for State Action by Ted Cruz and Mario Loyola, Texas Public Policy Foundation (Nov. 2010).

Shield of Federalism: Interstate Compacts in Our Constitution by Ted Cruz and Mario Loyola, Texas Public Policy Foundation (Dec. 2010).

A Constitutional Solution to Runaway Federal Spending: The Need for a Balanced Budget and Spending Limits Amendment by Mario Loyola, Texas Public Policy Foundation (May 2011).

Conditional Federal Grants

The Issue

Unlike states, which have the general authority to legislate, Congress is limited to those specific powers granted by the Constitution. When it comes to spending, however, the Spending Clause of Article I, Section 8 of the United States Constitution provides that Congress may provide for the "general Welfare of the United States," which has long been held to allow Congress to give grants of federal dollars to states for purposes it could not accomplish directly through legislation.

More controversial, however, are conditional federal grants, where a grant of federal funds to a state is made dependent on the state behaving in a certain manner. In *South Dakota v. Dole*, for example, the Supreme Court upheld a federal law that threatened states with the loss of 5% of federal highways funds if they did not raise their drinking age to 21. The Court noted that the penalties attaching to such conditional federal programs could not be so onerous as to pass "the point at which pressure turns into compulsion." The concern about federal coercion expressed is not unique to *Dole*. More than 75 years ago, in *United States v. Butler,* the Supreme Court noted that through the device of conditional federal grants, "constitutional guarantees, so carefully safeguarded against direct assault, are open to destruction by the indirect, but no less effective, process of requiring a surrender, which, though, in form voluntary, in fact lacks none of the elements of compulsion."

Dole insists that state prerogative must be preserved, both in theory and in fact, but would have us believe that freedom of choice is preserved in the state's ability to refuse the funding and its conditions. But any amount of money taxed away from the states and returned to them only on condition of compliance with federal preferences weakens the state's ability to choose. The only question is whether it weakens that freedom of choice a little or a lot—a question not of kind but of degree.

Conditional federal grants also break down the accountability that is necessary to our democratic system. For democracy to function properly, legislators must be responsive to local preferences and the federal government must be accountable for its own policies. Conditional grants may seem helpful, but in fact, they subvert state government powers, defeat legislators' ability to represent those who elected them, and blur accountability.

Such grants pose a severe threat to state sovereignty and must be resisted. This will require states to work together to overcome the temptation that federal funds pose for budget constrained state governments. To paraphrase Benjamin Franklin, states must hang together in resisting conditional federal grants if they are not to be hung out to dry separately or face subservience to the federal government.

In ruling that the federal government cannot condition large existing federal funding streams on the States' acceptance of new programs, the Supreme Court's decision in the ObamaCare case (*NFIB v. Sebelius*) offers hope that the Court will be more protective of the autonomy and flexibility of the States.

The Facts

- Federal funds represent nearly a third (31.5%) of the funds for Texas budget in the 2012-13 biennium.
- Accepting federal funding for Medicaid will require Texas to increase its own general revenue funding for Medicaid by approximately $10.5 billion during the upcoming biennium.
- Texas has already rejected several conditional federal grants, including education funding under the Race to the Top program, and unemployment insurance funding under the 2009 federal stimulus package, because of the conditions attached to the grants.

Recommendations

- During the next session, the Texas legislature should pass a resolution declaring its opposition to federal grant programs.
- Texas should also enact reciprocal legislation requiring rejection of federal funds in certain circumstances.
- As a result of the Supreme Court's decision on Medicaid expenses in the ObamaCare case, Texas has gained a potentially significant degree of flexibility with respect to programs where the federal government tied compliance to existing funding streams. Those cross-conditions are now potentially unenforceable after the Supreme Court's ObamaCare decision.

Resources

NFIB v. Sebelius U.S. (2012).

South Dakota v. Dole, 483 U.S. 203 (1987).

United States v. Butler, 297 U.S. 1 (1936).

Trojan Horse: Federal Manipulation of State Governments and the Supreme Court's Emerging Doctrine of Federalism by Mario Loyola, 16 Tex. Rev. of L. and Pol 113 (Fall 2011).

Reclaiming the Constitution: Towards an Agenda for State Action by Ted Cruz and Mario Loyola, Texas Public Policy Foundation (Nov. 2010).

K-12 Education

Home-rule School Districts

The Issue

Home-rule school districts, or home-rule charters, were authorized in Texas in 1995 as a part of the state's first initiative to allow charter schools. They were envisioned as a way to empower parents, citizens, and local administrators to govern schools in a manner that best suits the needs of students in their district. This governance path would be voted into place by the local electorate, and would in theory be exempt from many fiscal, academic, and governance regulations that pertain to traditional ISDs. However, none have been created since they were authorized in 1995 due to the following two factors:

1) There are too many roadblocks in the existing law. School boards, rather than parents, control the charter process; voter turnout and petition requirements are too high.

2) The law imposes many of the same mandates on home-ruled school districts that traditionally-run school districts face. Texas could make a number of changes to the home-rule code to make the home-rule school district a much more inviting alternative to traditional ISD.

While not a "fix-all" for the number of problems in Texas public education (not the least of which is the state's school finance system, which could be on the eve of drastic change as five finance lawsuits work their way through the Texas courts), more districts choosing this path would lead to a drastic expansion of local, district level control in education, rather than keeping all our schools under the top-heavy, state-driven bureaucracy they operate under now.

Encouraging independent school districts to move toward a more flexible, locally responsible, fiscally manageable system of governance will in turn increase general efficiency in the state's education system. Competition would become more prevalent, and so potentially could innovation. Home-rule school districts, with fewer restrictive state mandates, could use their budgets to explore learning technologies and structure learning environments in their schools to fit the specific needs of their local student population.

However, to make this possible, we must change the existing home-rule school district laws so that it is not only more possible to enact a home-rule school district, but also so that there is enough differentiation between traditional ISDs and home-rule school districts to encourage participation in the program.

The Facts

- The current process for creating a home-rule charter requires that voters work through their local school board, rather than allowing them to petition to get a home-rule charter placed directly onto the election ballot.
- To pass a home-rule charter, 25% of the district's electorate must participate in the election. This is an extremely high turnout for any type of local election.

- Home-rule school districts have the same rules regarding the hiring and termination of instructors that traditional ISDs operate under.
- Home-rule school districts are subject to the state's 22:1 K-4 class size.
- Home-rule school districts have identical attendance and seat-time requirements to traditional ISDs.
- Home-rule school districts must offer bilingual education to English language learners, rather than being able to offer alternatives such as sheltered English immersion. This rule is also identical to that which governs traditional ISDs.

Recommendations

- Remove the 25% voter turnout requirement in local elections.
- Empower parents to drive the charter process by enabling them to create and have their charter petition placed directly on a local election ballot without working through their local school board.
- Remove seat-time requirements to encourage online and blended learning models in home-rule school districts.
- Remove the 22:1 class-size cap for home-rule school districts.
- Do not require home-rule school districts to use bilingual education as their default provision for English language learners. Rather, allow them to choose a program that best suits the needs of their student body, such as sheltered English immersion.

Resource

Improving Efficiency And Local Control in Texas Education: Home-Rule Districts and Campus Charters by James Golsan, Texas Public Policy Foundation (July 2012).

Campus Charters: A Parent-Trigger for Texas

The Issue

The Texas Education Code allows for the creation of campus charter schools or charter programs if a majority of both parents and teachers at a campus petition a school board. These are different than the local charter schools that districts can create on their own, with the process driven from the bottom up. Most commonly, this procedure is referred to as a "parent-trigger." Such laws are gaining popularity in a number of other states, such as California and, most recently, Louisiana, and are designed to empower parents to make significant education reforms at the campus level.

The creation of these campus charters or campus program charters are governed by Sec. 12.052, Education Code:

a) In accordance with this subchapter, the board of trustees of a school district or the governing body of a home-rule school district may grant a charter to parents and teachers for a campus or a program on a campus if the board is presented with a petition signed by:

   1) the parents of a majority of the students at that school campus; and

   2) a majority of the classroom teachers at that school campus.

b) For purposes of Subsection (a)(1), the signature of only one parent of a student is required.

c) The board of trustees may not arbitrarily deny a charter under this section.

Campus charters can be run semi-independently from its parent ISD, as well as from the state education system. This provision is the closest thing Texas has to a parent-trigger.

However, much like with Texas' home-rule district law, this attempt to foster innovation has not been taken advantage of by parents because of various barriers that stand in their way. The main barrier is that parents cannot petition for a charter on their own—the petition must also be supported by a majority of teachers on the campus. While it is important for parents and teachers to work together, it is the parents who should be able to direct the education of their children.

The Facts

- For a campus charter to become operative in Texas, the votes of 50% of the parents of students at the school, as well as 50% of the teachers, are necessary.
- Campus charters can be run semi-independently from its parent ISD, as well as from the state education system.
- Unlike open-enrollment charters, there is no cap as to the number of such charters that could exist in Texas.

Recommendations

- Change Sec. 12.052, Education Code to require a board of trustees of a school district or the governing body of a home-rule school district to grant a campus charter or a program on a campus charter to the parents of a majority of students on the campus.
- Make the requirement that 50% of the teachers at a school approve the campus charter optional, rather than mandatory.

Resource

Improving Efficiency and Local Control in Texas Education: Home-Rule Districts and Campus Charters by James Golsan and Bill Peacock, Texas Public Policy Foundation (July 2012).

The Cost of Texas Education

The Issue

Over the last 10 years, state and federal education funding has increased from $14.6 billion annually to $24.8 billion. Total spending (federal, state, and local funds) on K-12 education increased from $27.687 billion in 2001 to $46.081 billion in 2011.

State and Federal Biennial Education Funding (in billions)					
2002-03	2004-05	2006-07	2008-09	2010-11	2012-13
$29.166	$30.043	$33.596	$50.257	$50.119	$49.639

Advocates for ever-increasing educational funding claim that the Texas Legislature reduced "public education funding by approximately $5.4 billion" during the last legislative session. However, the truth is that the Legislature reduced overall funding for school funding by less than $500 million. State funding actually increased by $2.5 billion to help make up for the loss of federal stimulus funds.

Over the course of the last decade, spending on Texas education increased at a substantially faster rate than the school population has grown during that same time period.

So what does the cost of Texas education look like? For the 2012-13 biennium, the Legislative Budget Board states that the Texas Education Agency (TEA) was appropriated just over $47 billion in all funds. The cost breakout is as follows:

- **Foundation School Program Operations:** $34 billion. Operating costs are typically defined as monies that for the most part flow directly to the classroom.
- **Foundation School Program Facilities:** $1.36 billion. These funds go to the physical upkeep of Texas schools.
- **State Education Programs:** $542 million. These are primarily education support programs designed to augment classroom education.
- **Federal Education Programs:** $7 billion.
- **Federal Child Nutrition Program:** $3.4 billion.
- **Instructional Materials:** $608 million. These funds are spent primarily on textbooks.
- **Agency Administration and Educator Certification:** $279.1 million. These costs cover TEA's central office, as well as their educator certification and a portion of their professional development costs.

Currently, there are five school finance lawsuits moving through the Texas courts that could result in substantial reform in the way Texas funds its public schools. While they are couched in the terms of "efficiency," "equity," and "quality," they all have one primary goal: more taxpayer money spent on Texas public schools. What

has been absent from the debate thus far, however, is whether reforms other than simply spending more money and redistributing it within the system might improve Texas schools.

The Texas Constitution requires that the Texas Legislature "establish and make suitable provision for the support and maintenance of an efficient system of public free schools." Though the Texas Supreme Court has noted that efficient "conveys the meaning of effective or productive of results and connotes the use of resources so as to produce results with little waste," it has functionally interpreted the term in context of school finance to mean "[c]hildren who live in poor districts and children who live in rich districts must be afforded a substantially equal opportunity to have access to educational funds."

What should be the focus, however, is whether taxpayers, parents, and children can receive the benefits of a high quality education system at equal or less cost than the current system. This is the true meaning of efficiency, and requires Texans to examine whether the state is getting the most out of every dollar it spends on public education. Does the state really need bureaucracy layers like Regional Education Service Centers? Does it need to have one non-teaching employee for every teacher it puts in the classroom? Do local educators really need to be under the thumb of policymakers and bureaucrats in Austin and Washington, D.C.?

Sustainable school finance reform for Texas will require willingness to rethink entirely how we operate our public schools. As the latest crop of school finance lawsuits move through the courts, fiscal efficiency—i.e., increasing the quality of education without increasing its costs—must be the ultimate goal for the state's lawmakers. This should mean high accountability for the dollars Texas spends on public education and increased competition within the system, to ensure that as much of our tax expenditure as possible is following students directly to the classroom.

The Facts

- Texas is constitutionally obligated to provide an efficient public education system.
- According to the Texas Education Agency and the Bureau of Labor Statistics' data, enrollment growth in Texas plus general inflation increases grew by 49% between the 1999-2000 school year and the 2009-10 school year.
- Comparatively, actual total education expenditures increased by 76% over the period, about 1.5 times faster.
- During that same time period, Texas' per student spending, when all education expenditures are taken into account, rose from $8,003 per student to $11,642.
- The Texas Office of the Comptroller estimates that Texas spent over $11,000 per student during the 2010-11 school year.
- Despite the increases in education spending, Texas' SAT, ACT, and NAEP performance has remained stagnant over the course of the last decade.

continued

The Cost of Texas Education (cont.)

- At present, Texas has very few policies that encourage competition and efficiency in its public schools.

Recommendations

- Texas should reduce the money it spends on administration, overhead, and non-instructional functions.
- Increase competition in the Texas education system through education scholarships, tax credits, and expanded charter law so that our public schools are incentivized to run more efficiently.
- Have state funding follow the students, thereby empowering students to hold districts and schools accountable for performance.
- Reduce or remove any regulations at the state and local level that increase the cost of education, hinder innovation, and do not lead to higher student achievement, such as: state minimum salary schedule; locally-adopted salary schedules; paying teachers more for an advanced degree; multi-year contracts; teacher tenure; class size mandates; and teacher certification restrictions.
- Increase access to distance learning by reducing restrictions on online learning in Texas.
- Explore means to save costs on Texas education facilities. This could mean anything from creating more flexibility in seat-time requirements to increased use of learning technologies in the state's public schools.
- Redesign the state's school finance formula so that Texas delivers on its constitutional obligation to provide an efficient system of public education.
- Remove unnecessary levels of state and regional bureaucracy, such as Regional Education Service Centers.

Resources

Examining Decades of Growth in K-12 Education by Brooke Dollens Terry, Texas Public Policy Foundation (June 2010).

The Texas F.A.S.T. Report by the Texas Office of the Comptroller.

Finding Real Efficiencies in Texas Public Schools by James Golsan, Texas Public Policy Foundation (Jan. 2012).

School Finance: Increasing Efficiency Through Personnel Management by James Golsan, Texas Public Policy Foundation (Apr. 2012).

Regional Education Service Centers: A Question of Necessity by James Golsan, Texas Public Policy Foundation (Apr. 2012).

Teacher Quality & Compensation

The Issue

Research clearly shows that the quality of a student's teacher is the most important school-related factor in raising student achievement. In fact, a Tennessee study found that students with strong teachers for three consecutive years achieve 50% more than students with weak teachers. The study also found that students with strong teachers erase the achievement gap associated with race, ethnicity, and income within three to five years.

How precisely to measure teacher effectiveness is subject to some debate, as a number of factors can influence the learning quality in a classroom on a day-to-day basis. Regardless of how, ultimately a teacher's effectiveness is best determined at the local level. An administrator at his or her given school knows the staff, and the conditions the staff works in better than anyone. The state, however, does have the power to create an environment that empowers administrators to maximally encourage and reward effective teaching.

The Facts

- Becoming a teacher in Texas requires a lengthy certification process that makes it difficult for otherwise qualified individuals to enter the teaching profession.
- Texas maintains a state minimum salary schedule that encourages school districts to give annual raises to all instructors in the district based on longevity within the profession.
- As of 2010, approximately 27% of Texas teachers have a master's degree and receive an extra $1,423 per year equaling more than $124.5 million spent on a method of compensation that has no correlation with higher student achievement.
- Educators in Texas are generally granted "term contracts" that serve a function similar to that which teacher tenure provides in other states.
- It is extremely difficult to dismiss ineffective teachers in Texas, as a lengthy notification and appeals process is afforded for the dismissal of any contract employee.

Recommendations

- Texas should lower barriers to entry into the teaching profession. Ideally, this would include allowing individuals with strong credentials in a pertinent subject area to get in front of a classroom in a few weeks instead of having to go through a year-long certification process.
- Eliminate Texas' minimum salary schedule and local salary schedules based on longevity to allow school officials more freedom at the local level to target resources at local needs.

continued

Teacher Quality & Compensation (cont.)

- Discourage school districts from paying teachers more for possession of a master's degree.
- Remove state mandates and term contracts that make it difficult for school administrators to remove ineffective teachers from the classroom.

Resources

Teacher Effectiveness in Texas by James Golsan, Texas Public Policy Foundation (June 2012).

Short Changing our Kids: How Poor Teacher Quality and Failed Government Policy Harm Students by Brooke Dollens Terry, Texas Public Policy Foundation (Oct. 2009).

Applying Free Market Principles and Common Sense to Teacher Compensation by Brooke Dollens Terry, Texas Public Policy Foundation (Oct. 2008).

School Choice

The Issue

School choice is expanding nationwide. Numerous charter, voucher, and virtual education programs have become operational over the last decade. Unfortunately, Texas is lagging behind in this important area of education reform. As states such as Ohio, Indiana, and Wisconsin all either expanded or enacted new school choice legislation in 2011, the 82nd Legislature made no significant legislative moves to expand school choice in Texas. In 2013, Texas lawmakers will have an opportunity to drastically improve freedom of education for Texas students.

If school choice is to flourish in Texas, the state must first remove policies that hinder growth in its existing choice programs. Texas currently sits comfortably in the middle of its second decade of operating open enrollment charter schools within its public education system. Though the number of operating charters in the state has grown since 1995, Texas still has a hard cap of 215 open enrollment charter schools, a limitation that prevents a large number of Texas students from having access to alternative education. The Texas Charter School Association estimated that in 2011, there were more than 120,000 students on wait lists for charter schools in Texas.

Charter schools are not the only vehicle for school choice in the public education system, but they are one of the few models that Texas actually has in place. Shifting portions of school funding from district control to parental control is another means of implementing choice. Broadly referred to as "vouchers," these measures can include giving parents direct control over how state funds are spent on their students, including using the funds to send their child to a private school of their choosing, or to shift their child from one school district to another. Despite the documented academic and civic successes of San Antonio's Edgewood ISD voucher program, which ran from 1998 to 2008, there are currently no voucher laws on the books in Texas.

A second, similar option in this arena is education tax credits. There are typically two types of education tax credits: personal-use tax credits, which reimburse parents for educational expenses spent on their children; and donation tax credits, which give a tax credit to individuals or corporations who donate to an education scholarship fund. Education tax credits and tax deductions have several advantages. Tax credits save the state and taxpayers money, have a broad base of support that appears to be growing, and are less vulnerable to attacks in court as they have never been declared unconstitutional at a state or federal level despite several court challenges.

There is no reason for Texas not to be a leader among the other states in this area. In 2013, lawmakers must examine carefully the benefits of expanding school choice, both for the benefit of students and parents, who want more options, and for the state, which must find ways to make public education more fiscally efficient. More school choice is an option that fits from both perspectives.

continued

School Choice (cont.)

The Facts

- The number of students on wait lists for Texas charter schools has expanded substantially over the last few years, from 45,000 in 2009 to 56,000 in 2010, up to 120,000 in 2011.
- Texas has a hard cap of 215 on its open enrollment charter schools, which serves as a direct limitation for expanding school choice in Texas.
- Many states have made substantial expansions and improvements to their choice programs over the last few years. Texas remains reluctant to enact school choice policies of its own.
- Presently, Texas has no active voucher program or education tax credit program in place.
- Improving school choice options in Texas will not only serve to satisfy the demands of a number of Texas parents, but could result in an improvement in fiscal efficiency in the Texas public education system.

Recommendations

- Remove the hard cap of 215 open enrollment charter schools in Texas. This will allow the state to more easily address the large number of students on wait lists for charter schools in the state.
- Enact policies that allow for voucher and education scholarship programs to operate in Texas. Such policies would create more freedom for Texas students, and could save the state a substantial amount of education funding.
- Allow more aggressive options, i.e., allowing partial enrollment in Texas public schools, which would create tremendous flexibility for parents seeking the maximum amount of choice in regards to their child's education, allowing them to participate in a potential mix of traditional public, online, and even home-school based learning resources.
- Create an environment that allows Texas public schools to operate with minimal top down interference from the state.

Resources

School Choice in Texas: Where We Are, Where We Should Be by James Golsan, Texas Public Policy Foundation (Oct. 2011).

Helping Parents Pay for Education: Examining Education Tax Credits and Deductions by Brooke Dollens Terry, Texas Public Policy Foundation (Apr. 2010).

Charter Schools 101 by Brooke Dollens Terry, Texas Public Policy Foundation (Mar. 2010).

Virtual Education

The Issue

Virtual and blended virtual learning are education's newest frontier. They are mediums that encompass a broad variety of education tools, from distance education for high school students to putting iPads in second grade classrooms. At the K-12 level, the potential of virtual education is enormous. Through the use of technology, students in rural districts would have access to the same educational resources as students in more populated areas. Familiarization with technology could prepare students for the workforce more quickly. Further, states facing budget difficulties now have a resource that allows them to educate their students with greater efficiency.

While Texas is attempting to grow digital learning gradually through the Texas Virtual School Network (TxVSN), the state's general policies in this area remain too restrictive. If virtual education and blended learning are to flourish in Texas, the state must remove policies that add needless red tape and expense to virtual learning and technological expansion in Texas classrooms.

There are many benefits to digital and blended learning, perhaps the foremost of which is greater access to quality instruction. Virtual education provides more opportunities for students to learn from a quality teacher. While there is no guarantee that every purveyor of online education will be top quality, at the very least, virtual education gives students an alternative to the teachers present in their own school, should they be faced with an educator who is less than ideally qualified.

Course availability is another obvious and central benefit of expanding virtual education. Often, smaller or poorer school districts are unable to offer the same variety of courses that their larger, better funded counter parts can. For instance, many students use the TxVSN's online course catalog to augment the education available at their school; according to the TxVSN, the bulk of its public school students attend on a part-time basis, generally taking one to two courses a term on top of their traditional course work.

Additionally, Texas has a substantial dropout problem that virtual learning could help address; between the 2008-09 and 2009-10 school years, Texas saw around 75,000 students drop out of its public schools. While there is no "silver bullet" to fix this or any other problem in education, virtual education gives students who have dropped out a chance to begin recovering their middle and high school credits, particularly if the student that dropped out is facing the prospect of getting their course credits around a work schedule. Online learning provides an option beyond attending traditional brick-and-mortar schools for degree completion.

It can also not be understated that virtual and blended learning could be a significant cost saver to the state, particularly over a longer period of time. Full-time digital students can potentially be educated at $1,500-$3,000 less than traditional, brick-and-mortar students, and it is highly conceivable that the use of more technology in blended learning classrooms could make schools much more efficient.

continued

Virtual Education (cont.)

The Facts

- The inception of the TxVSN has demonstrated the popularity of online learning in Texas; since it went operational in 2009, enrollment has expanded from just over 250 to comfortably over 8,000 students.
- Texas still trails behind true leaders in this arena, like Florida, which as of 2007, had 130,000 students enrolled in their virtual school program.
- Texas is facing a budget problem in public education. Online students can be funded for up to $3,000 dollars less than brick-and-mortar students.
- Approval for a student to take courses in the TxVSN requires multiple approvals from both their own district and the provider district.
- There are very few full-time students in the TxVSN, and those that are must have been in Texas public schools the year previous.
- Virtual education in Texas is funded through an allotment in the budget, rather than being a part of the mainstream funding formula.

Recommendations

- Change the funding structure in Texas virtual education so that monies flow directly through the finance formula, rather than from a set aside allotment. This would allow students to pursue virtual education in Texas more freely.
- Remove cumbersome restrictions on school districts' budgets that tell them how to spend their money, breaking down barriers to expansion of blended learning and technology in the classroom.
- Encourage the use of blended learning as a teaching tool in Texas classrooms.
- Allow public school districts to run their own virtual education shops, rather than running through the red tape of the virtual school network process.
- Allow greater freedom for private providers of virtual education than is currently available in the state's virtual learning law.
- Allow more flexibility for private and home-schooled students to take place in publicly provided virtual education in Texas.

Resources

Virtual Education and the Future of Texas Education by James Golsan, Texas Public Policy Foundation (Mar. 2012).

Virtual Schools: The Future is Now by James Golsan, Texas Public Policy Foundation (Mar. 2011).

Virtual Learning Across the Nation by James Golsan, Texas Public Policy Foundation (Aug. 2011).

Higher Education

Higher Education Quality

The Issue

While most of us expect college students to graduate in four years, the average time-to-graduation at Texas universities is 5.3 years. One prominent cause of this disappointing statistic is that current higher education funding formulas overwhelmingly encourage universities to enroll students, but not to graduate them. Nor do they encourage universities to graduate students with an externally verifiable level of competence.

Recent national data suggest that 1) college students lack the appropriate level of basic knowledge in American history, government, and economics; and 2) as a result, they score poorly on tests measuring critical thinking and complex reasoning.

The Legislature took an important step toward remedying this with the passage of HB 9 in 2011. On this important foundation the Legislature should consider building further. Rather than continue to appropriate the bulk of funding on the basis of the number of students enrolled, it should further adjust the formula so that graduation—i.e., the successful completion of the university's central mission—is taken more into account. Students who fail to graduate leave school often burdened with student-loan debt, the repayment of which is made all the more difficult by their lack of a degree.

Another area in which universities need to improve quality is in the study of civics. In 2007, the Intercollegiate Studies Institute (ISI), a non-profit educational organization, issued a study that found Texas undergraduates fail at civics. Nationwide, 50 universities were surveyed, three of them in Texas—Baylor University, West Texas A&M, and the University of Texas at Austin. Nearly 1,000 Texas freshmen and senior students were given a 60-question test on American history and institutions.

Texas students performed worse than their peers nationwide. More troubling still, the survey found that only 2.9% of students' civic knowledge is learned in the college classroom. Texas' comparative deficiency in knowledge of civics is likely explained by another of the study's findings: undergraduates at these three Texas universities were below the national average in the number of history, government, and economics courses taken during college.

These disheartening statistics lend credence to the fear that Texas higher education is far from exempt from the alarming results of a 2011 study of collegiate learning. *Academically Adrift*, published by the University of Chicago Press, employed the Collegiate Learning Assessment (CLA) to measure what our undergraduates are learning in college. Of the students across the country whom it surveyed, 45% showed "small or empirically non-existent" gains in critical thinking capacities after two full years in college. After four years in college, more than one in three (36%) still scored at this low level.

Given the role that history, government, and economics play in developing critical thinking—and the fact that Texas students suffer a comparative disadvantage nationally in the number of such courses taken—we in Texas should be concerned that our students, too, have been cast "adrift." None of this denies that Texas boasts some of the most prestigious universities in the world. Nevertheless, the areas described above need improvement.

The Facts

- The six-year graduation rate at Texas universities is only 58.4%.
- By 2020, 60% of jobs will require a career certificate or college degree.
- Texas students gain only 2.9% of their civic knowledge during their college careers.
- Undergraduates at Texas universities are below the national average in the number of history, government, and economics courses taken during college.

Recommendations

- Institute reforms that tie university funding to student success results such as the number of degrees issued, learning outcomes (as measured by the Collegiate Learning Assessment) and employment outcomes five years after graduation.
- Simultaneous with the above, encourage university regents to institute measurements of learning outcomes at the freshman and senior years, using the CLA.
- Encourage university regents and other administrators to institute reforms that place more focus on teaching students basic American history, government, economics, and Western Civilization, whether through a standardized test or more course options/requirements.
- Building on the foundation laid last year by HB 736 (Sec. 9), improve information systems by giving students input on: student academic performance, graduation rates, post-graduate earnings, percentage of classes taught by part-time faculty, and evidence of post-graduate earnings (from sites like PayScale.com, etc.). Make this information available on a statewide site with a common format, with the site to be administered by the Texas Higher Education Coordinating Board.

Resources

Higher Education: Facts at a Glance by Thomas K. Lindsay, Texas Public Policy Foundation (Jan. 2012).

Academically Adrift by R. Arum and J. Roksa (Chicago: University of Chicago Press, 2011).

Texas Higher Education Coordinating Board Data.

Texas Undergraduates Fail at Civics: ISI's American Civic Literacy Survey Results by Gary Scott, Texas Public Policy Foundation (Mar. 2007).

Complete College America "Time is the Enemy" (Sept. 2011).

Higher Education Affordability

The Issue

In Texas, and nationwide, college tuition and student-loan debt are escalating at unsustainable rates. Between 2003 and 2009, the cost of attending Texas public universities rose 72% in constant dollars. Yet median family income in the state declined 1.5% from 1999-2009. To pay for tuition, students and their parents have taken on historic levels of debt. At one trillion dollars, total student-loan debt is now greater than credit-card debt. Moreover, as reported by the Institute for Research on Higher Education, Texas "students and their families, already burdened by tuition hikes, have been forced to assume more responsibility for funding financial aid, too, through set-asides from tuition increases." The surge in tuition is pricing our top public universities out of the reach of middle-class families. Lower-income students have access to scholarships, grants, and other need-based aid. Higher-income parents can afford tuition for their students. But families in between are being increasingly squeezed.

Two factors play a large role in the explosion of college tuition. According to research conducted by the Center for College Affordability and Productivity, "at research universities in the U.S. between 1988 and 2004, it is estimated that teaching loads fell 42%. Even in private liberal arts colleges that pride themselves on their attention to instruction, those loads fell 32%." Falling teaching loads are the natural response to the incentives currently operating in higher education. Faculty promotion and prestige are based in large part on publications, which enhance a school's national reputation. Faculty publications play a role in a college's ranking in *U.S. News Best Colleges*, the holy grail of academic status. In contrast, excellent teachers are known by a comparative few. Aside from perhaps a once-in-a-career teaching award, they are less likely to be rewarded than are their more-research-oriented peers. Small wonder that, under the current system, both faculty and administrators see lower teaching loads as a verification of excellence.

Along with decreased teaching productivity, increased administrative staffing raises the price of college. As documented in Benjamin Ginsberg's *The Fall of the Faculty,* "forty years ago, the efforts of 446,830 professors were supported by 268,952 administrators and staff. Since then, the number of full-time professors increased slightly more than 50%, while the number of administrators and administrative staffers increased 85% and 240%, respectively." Adjusting for inflation, from 1947 to 1995, "overall university spending increased 148%. Administrative spending, though, increased by a whopping 235%. Instructional spending, by contrast, increased only 128%, 20 points less than the overall rate of spending increase." Senior administrators have done particularly well under the new regime. From 1998 to 2003, deans and vice presidents saw their salaries increase as much as 50%, and "by 2007, the median salary paid to a president of a doctoral degree-granting institution was $325,000."

The Facts

- THECB reports that from 2003-09, statewide average academic charges for a student taking 15 semester credit hours at a public university increased 72%.

- According to a recent Pew Research Center study, 57% of potential students say that the higher education system fails to provide good value for the cost, and 75% say college is unaffordable.
- "Forty years ago," reports Benjamin Ginsberg, "U.S. colleges employed more faculty than administrators. But today, teachers make up less than half of college employees."
- According to the *Higher Education Employment Report*, "colleges and universities continued to focus more on hiring administrators and executives over faculty in Q1 2012, although the rate of change has slowed."

Recommendations

- Require all public institutions to increase aggregate credit hours taught by tenured and tenure-track faculty by 10%.
- Reduce the administrative staff budget for all colleges and universities by 10%.
- Expand the online-degree rider, added to HB 1 in 2011. The rider requires colleges and universities to submit cost studies of the four most popular degree plans that can be offered online. These studies should be expanded to include all STEM courses not covered by the first study, plus all lecture courses in all fields.
- Require all public institutions of higher education to submit to THECB feasibility studies for crafting $10,000 degrees in their four most popular degree plans as well as for all degrees they offer in STEM subjects.
- Place a two-year moratorium on all new building projects, to take advantage of the increasing popularity of online courses.
- Require all non-Tier I public institutions to submit to THECB feasibility studies for changing the academic calendar to three semesters a year. A three-semester calendar will allow for a more efficient use of university resources. Employing campus facilities year-round will reduce the relative per-student cost.

Resources

Higher Education Facts at a Glance by Thomas K. Lindsay, Texas Public Policy Foundation (Jan. 2012).

Hard Choices Ahead: Performance and Policy in Texas Higher Education by J. Finney, L. Perna, and P. Callan, Institute for Research on Higher Education (Apr. 2012).

The Fall of the Faculty: The Rise of the All-Administrative University and Why it Matters by Benjamin Ginsberg, Oxford University Press (2011).

25 Ways to Reduce the Cost of College by R. Vedder, et al., Center for College Affordability and Productivity (Sept. 2010).

Tuition Deregulation Overview Texas Higher Education Coordinating Board (Apr. 2010).

Texas Model

The Sunset Process

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 streamline 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 a 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.

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 new provision will help reduce the special interest policy initiatives and allow the Commission to concentrate on reducing the size, scope, reach, and cost of government.
- Focus the SAC 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.

- Require all policy related 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. These committees will be responsible to work with the SAC staff to reduce the cost of government for those agencies that are less than 1% of the biennium budget.

Resources

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

Economic Freedom, Texas-style

The Issue

At the Texas Public Policy Foundation, we have been doing a lot of research recently on what we call "Economic Development: Texas-style." What we mean by this is that rather than rely on government payouts to businesses, government spending, or government programs to keep the economy growing, Texas tends to rely on economic freedom.

Economic freedom doesn't get much press these days, and it gets even less attention from our courts and legislatures. This shouldn't be the case, though, because economic freedom is the most fundamental of all of our freedoms. What good is freedom of speech, assembly, or petition if our property, money, and ability to work are taken away from us?

The results of Texas' focus on economic freedom speak for themselves. Texas has created more jobs in the last 10 years than all of the other states combined. The five largest cities in Texas rank in the top seven nationally—out of 66—when it comes to job growth.

One way is in lower government spending. Texas government spends much less as a percentage of the private economy than the U.S. or our largest competitor, California. The reason for this is that when the spending burden has begun to grow—usually during a recession, Texas policymakers have stepped up to the plate and brought it under control.

Next, it follows that if a state keeps its spending low, its taxes will be low as well. Indeed, that is the case here in Texas; low taxes are the second way in which Texas fosters economic growth through economic freedom. Texans ranks 43rd in state tax collections at $1,646 per capita. One reason for this is that we don't have a state income tax.

Finally, Texas promotes economic freedom through a focus on protecting private property rights. There are two parts to this: stopping the government from taking our property through eminent domain, and stopping the government from limiting our ability to use our property through land-use restrictions and economic regulation. In both, we do better than most.

To sum it all up, Texas is the national leader in economic freedom because we spend less, tax less, and regulate less.

But we need to remain vigilant. Texas' spending burden has begun to increase again, and we are facing what looks to be a $4 billion plus budget deficit in 2013 and $10 billion plus shortfall in 2014-15. Calls for new revenue are coursing through the political debate. Plus, Texas still allows cities too much leeway when it comes to imposing regulations on property owners.

The Facts

- Texas has created more jobs in the last 10 years than all of the other states combined.

- The five largest cities in Texas rank in the top seven nationally—out of 66—when it comes to job growth.
- Supply-side economist Dr. Art Laffer ranks Texas as having the third best state economic performance—and first among the most populous 44 states—in the last 10 years.
- Challenges to keeping our economic lead lie ahead: we are facing what looks to be a $4 billion plus budget deficit in 2013 and $10 billion plus shortfall in 2014-15.

Recommendations

- Texas does not need any new revenue in its effort to balance the budget in 2014-15. Texas shouldn't raise taxes to keep up with increased government spending; instead, the growth in government must be reduced to keep spending within available revenue.
- Get government spending on education, medical care, and welfare under control by increasing consumer choice, promoting economic growth in order to reduce the need for much of this spending, and letting the competition work in all of these systems to increase efficiencies and reduce costs.
- Reduce the overregulation, unnecessary programs, and subsidies to businesses and consumers that cost Texans billions of dollars each year while reducing economic growth.
- Implement Tax and Expenditure Limitations so that state and local spending from all sources increase only by the sum of population growth plus inflation or the growth in gross state product or personal income, whichever is less.
- Amend the Texas Real Private Property Rights Preservation Act to cover regulatory takings of property by cities.

Resources

Texas' 2012-13 Budget: The Good, the Bad, and the Ugly by The Honorable Talmadge Heflin and James Quintero, Texas Public Policy Foundation (Mar. 2012).

The Texas Model: Texas v. U.S. Unemployment Rate Update by James Quintero, Texas Public Policy Foundation (Feb. 2012).

Economic Freedom, Texas Style by Bill Peacock, Texas Public Policy Foundation (Dec. 2010).

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).

Economic Development: Texas Style by Bill Peacock, Texas Public Policy Foundation (Mar. 2010).

Jobs and the Texas Model

The Issue

Texas has long led the nation in job creation and economic growth. In 2011, the Texas economy created more than 200,000 net new jobs, making it the first large state to see its labor market returned to pre-recession employment levels. Over the last 10 years, the level of job growth has been even more impressive: Texas created more than 1 million jobs during this period, more than all other states combined; while California, New York, Florida, and Illinois lost 930,000 jobs combined.

In terms of economic growth, Texas' economy grew at a quicker pace than did the rest of the nation. In 2011, Texas' real gross domestic product grew by 2.4% whereas the nation's GDP grew by just 1.6%. This year, Texas' economy is again expected to grow slightly faster than the nation as a whole.

So the question is: How has Texas been able to achieve so much while many other states are still struggling?

Simple. It's kept taxes low, kept regulations to a minimum, passed a series of reforms to create a sound civil justice system, and has generally kept reliance on the federal government at a lower level than other states. This has become known as the Texas Model.

Some examples of the Texas Model in action over the years include:

- **Balancing the Budget with Available Revenue.** In the last legislative session, state lawmakers closed a $15 billion budget shortfall without raising taxes, opting instead to cut spending to match available revenue. Total state spending declined for the first time in more than 50 years, shrinking the cost of government and keeping more money flowing through the private sector.
- **Maintaining Texas' Right-to-Work Status.** Texas has long been a right-to-work state; it allows residents to work regardless of whether they choose to join a union. This also provides employers with greater flexibility in meeting their workforce and business needs, and allows them to control their cost of doing business.
- **Deregulation.** In the decade since Texas deregulated its electricity market, companies have invested $41 billion in new generation and transmission capacity. This has allowed Texas' electricity supply to keep pace with our state's rapid growth, and for retail electricity rates to be lower today than they were in the final days of Texas' utility monopolies.
- **Sensible Land Use Policies.** Texas' relatively open land-use policies have allowed housing to remain well balanced between supply and demand, largely protecting our state from the booms and busts that have so dramatically affected the east and west coasts.
- **Lawsuit Reform.** The Lone Star State has been a leader in lawsuit reform since the mid-1990s. Through a series of legislative proposals and constitutional amendments—including non-economic damage caps in medical

malpractice lawsuits and last year's "loser pays" legislation—Texas has acted decisively to reduce the number of frivolous lawsuits filed in the state.

By cultivating an environment of low taxes and limited government, past Texas legislatures have helped transform the state into America's economic engine. And by continuing to pursue these free market, limited government policies, the next legislature can help to make sure that it stays that way.

The Facts

- Texas' state and local tax burden ranked 45th nationally in fiscal 2009, according to the Tax Foundation. This compared favorably to other large states like New York (2nd), California (6th), Illinois (13th), and Florida (31st).
- In 2011, Texas' economy added more than 200,000 jobs returning the state's labor market to pre-recession levels.
- Texas' unemployment rate is a full percentage point lower than the national average. Moreover, the state's unemployment has been at or below the national average for over five years.
- Texas' real gross domestic product grew by 2.4% in 2011, while the nation's GDP grew by just 1.6%.

Recommendations

- Texas should not deviate from the Texas Model: low spending and taxes, a predictable, low level of regulation with strong property rights protection, a sound civil justice system, and minimal dependence on/interference from the federal government.
- Balance the state's 2014-15 budget with available revenue, without raising taxes and fees or creating new revenue streams, while safeguarding the Economic Stabilization Fund.

Resources

Why the Texas Economy is Booming by Talmadge Heflin, Texas Public Policy Foundation (Mar. 2012).

The Texas Model: Texas v. U.S. Unemployment Rate Update by James Quintero, Texas Public Policy Foundation (Feb. 2012).

The Texas Model by Bill Peacock, Texas Public Policy Foundation (Jan. 2012).

Texas' Economic Leadership Due to Our Leadership in Limited Government Policies by Bill Peacock, Texas Public Policy Foundation (June 2011).

Consumers

Local Right of Way Fees

The Issue

For years, Texas municipalities have imposed franchise fees upon telecom and utilities providers to provide revenue that supports general city expenditures. These fees are much higher than needed to support the use of the city rights of way by these companies. Ostensibly charged as a form of "rent" for use of public right of way to benefit taxpayers of a city, these fees are simply a tax charged to those citizens in their role as consumers.

In 2011, the cost of the right of way (ROW) fees to consumers and businesses in the 10 largest Texas cities was more than $530 million. Since 2008, the cost to consumers has totaled more than $2 billion. Rather than serving as benefit to taxpayers, these excessive fees represent a major cost to consumers, as well as a bar to new competitive entrants into these markets.

The problem is not in the charging of fees for use of public land; however, the revenue generated far exceeds what is necessary to maintain the ROWs. Instead, the money becomes a general use fund for the cities, at the consumers' ultimate expense, and acts as a tax on those who pay for the services that use ROWs.

Despite municipality claims to the contrary, "rent" is an inaccurate way to describe the function of franchise fees. Governments are not private landlords whose obligation is to extract the maximum rent from users; they are defenders of the public interest.

The public ROW is not created like private development, which comes about through personal investment and a good deal of risk. The ROW is usually created through the police power of the government, solely for the benefit of the community. It is harmful for a municipality to maximize franchise fees at the expense of its own citizens, making them pay more to use their own property, disrupting the efficiency of the ROW, and obstructing the entry of new consumer technologies.

Today's excessive franchise fees stymie competition and strain consumer budgets. Charging a fee to cover the cost of providing ROW access is appropriate; charging Texas consumers over $2 billion since 2008 to essentially use their own property is not.

The Facts

- Since 2008, Texas municipalities have charged $2 billion dollars in franchise fees to companies for right of way access, a burden ultimately borne by consumers.
- The fees raised far exceed the cost for ROW maintenance.
- The revenue obtained by these fees often goes to entirely unrelated projects.

- GDP grew by just 1.6%.

Recommendation

- ROW fees should be significantly reduced, limited to recouping the marginal cost of using the ROW.

Resources

The Municipal Right-of-Way Fee: A Heavy Burden on Texas Consumers by Bill Peacock and John Di Pietro, Texas Public Policy Foundation (July 2012).

Local Franchise Fees Generate Hundreds of Millions for Cities, by Bill Peacock & Jordan Brownwood, Texas Public Policy Foundation (Jan. 2011).

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 the most recent legislation—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 will allow 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.

However, there is 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).

Texans pay higher rates on the purchase of most telecommunications services (except satellite) than they do on fireworks and hard liquor. In fact, only cigarettes are taxed at a higher rate.

The Facts

- Landline telephone customers paid an average of $11.12 per month, or 22.30% of an average monthly telephone bill.
- Wireless telephone customers pay an average effective tax rate of 19.25%.
- Cable video customers paid an average of $5.90 per subscriber per month, or 14.33% of an average monthly bill of $41.17.
- Consumers who subscribe to cable television and wireline and wireless voice services pay an annual tax bill of $318.
- 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.
- The dual system in Texas of deregulated urban markets and regulated rural markets could create a "digital divide" between urban and rural customers.

Recommendations

- Eliminate the "tax on a tax" aspect of the state and local sales taxes. **Taxpayer Savings: $90 million per year.**

- Municipal Franchise Fees. Restructure these fees to reflect the marginal costs of providing services through the right-of-way. **Taxpayer Savings: More than $250 million per year.**
- Private Network Service. Eliminate mandated provision of Private Network Service, which is subsidized through the USF. **Taxpayer Savings: $2 million per year.**
- Universal Service. Do not expand Universal Service Fund subsidies or fees to new services or technologies, e.g., broadband, VoIP. Examine ways to further reduce the Universal Service Fund.

Resources

Telecommunications Taxes in Texas by Bill Peacock and Chris Robertson, Texas Public Policy Foundation (Apr. 2009).

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, Ph.D., Texas Public Policy Foundation (Apr. 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 (Apr. 2009).

Testimony Regarding the NFL Network Dispute by Bill Peacock, Texas Public Policy Foundation (Dec. 2007).

Texas Telecom Deregulation by Bill Peacock, Texas Public Policy Foundation (Apr. 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).

Homeowners' Insurance

The Issue

Reform of the Texas homeowners' insurance market in 2003 called for a file-and-use regulatory system. However, last biennium 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."

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.

Another 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 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.

Resources

Consumers, Competition, and Homeowners' Insurance by Bill Peacock, Texas Public Policy Foundation (May 2010).

More Intervention in the Insurance Marketplace: SB 871 by Bill Peacock, Texas Public Policy Foundation (Mar. 2011).

Freedom of Contract Creates Regulatory Certainty and Lower Insurance Rates by Ryan Brannan, Texas Public Policy Foundation (Mar. 2011).

Homeowners' Insurance: The Problem with Prior Approval by Bill Peacock, Texas Public Policy Foundation (May 2009).

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 62% in 2011.

Yet the 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 2012 hurricane season, TWIA had somewhere between $250 and $275 million in the Catastrophe Reserve Trust Fund to pay claims. Average claims along the coast could range from $4.4 billion in Galveston and $3.7 billion in Corpus Christi to $606 million in Brownsville.

The Facts

- TWIA's market share grew from 17.9% in 2001 to 62% in 2011.
- Here is the exposure for TWIA in three areas of the coast:
  - Galveston: $37.9 billion
  - Corpus Christi: $15.3 billion
  - Brownsville: $4.9 billion
- In the case of a strike by a Class 4 hurricane, here is the average projected loss in each area:
  - Galveston: $4.4 billion
  - Corpus Christi: $3.7 billion
  - Brownsville: $606 million
- At the start of the 2012 hurricane season, TWIA had somewhere between $250 and $275 million in the Catastrophe Reserve Trust Fund to pay claims.
- The number of TWIA policyholders increased from 68,756 in 2001 to 257,818 at the end of June 30, 2012.

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

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).

"Can't Compete," Letter to the Editor by Drew Thornley, Texas Public Policy Foundation, Corpus Christi Caller-Times (Apr. 2008).

Q&A on Homeowners' Insurance Regulation in Texas by Drew Thornley and Bill Peacock, Texas Public Policy Foundation (Feb. 2008).

Missing the Big Picture in Homeowners' Insurance Debate by Drew Thornley, Texas Public Policy Foundation (Mar. 2008).

Homeowners' and Windstorm Insurance in Texas, PowerPoint presentation by Bill Peacock, Texas Public Policy Foundation (Oct. 2007).

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, no fewer than 18 bills targeted the practice, including ones 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, only two of the 18 bills passed, and they were the least restrictive and harmful to the market (one requiring a posting of rates in storefronts, and one requiring fee payment and registration by lenders with the Consumer Finance Commissioner). However, 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.

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

Consumer Benefits of Access to Short-Term Credit by Ryan Brannan, Texas Public Policy Foundation (Mar. 2011).

Evaluating Consumer Access to Short-Term Lending by Ryan Brannan, Texas Public Policy Foundation (Apr. 2011).

Center for Economic Freedom: Review of the 82nd Session of the Texas Legislature by Bill Peacock and Ryan Brannan, Texas Public Policy Foundation (June 2011).

Property Rights

The "Buy-back" Provision

The Issue

While steps have been made to restore property rights that have been eroded through years of court rulings up through the *Kelo* decision, there are still problems that need to be addressed. The 82nd Texas Legislature's SB 18 was the latest attempt by the Texas Legislature to protect private property rights.

Most of the provisions of SB 18 were well-founded and will move eminent domain law in the right direction. However, SB 18's "buy-back" provision—while well intentioned—did nothing to advance the cause of property rights in Texas.

One of the problems in eminent domain law has been that once a property has been condemned, it can be used for just about any purpose—the condemnor is not required to use it for the purpose it was taken. This would seem to be contrary to the U.S. and Texas constitution's requirement that property be taken only for a public use. The buy-back provision in SB 18 was supposed to fix this, but instead it will be completely ineffective.

Under SB 18, a condemnor is required to meet two of seven criteria within ten years of the taking that are supposed to demonstrate that the entity has made "actual progress … toward the public use" for which the property was taken. However, the seven criteria that a condemnor must meet to keep the land are so easily achieved that any government entity will be able to keep all the land it takes without ever using one parcel for the use specified in the condemnation proceedings.

For instance, if a city simply acquires two tracts of land then applies for state or federal funds to develop the tracts for the purported public use, the city will have met the criteria. It makes no difference whether or not the city ever gets the funds or the permit. Or another government entity could just meet one criteria such as applying for a federal permit then avoid the second criteria altogether by adopting a resolution stating that it "will not complete more than one action … within 10 years of acquisition of the property."

The Facts

- Though the Texas Constitution allows property to be taken only for a public use, Texas law allows the government to take property and use it for any purpose.
- The San Antonio Water System acquired approximately 2,500 acres under the threat of eminent domain for the "Applewhite Reservoir." The reservoir was never built, and much of that land today is being used for a Toyota truck manufacturing plant and a land heritage preserve.
- SB 18 from the 82nd Texas Legislature was supposed to solve this problem, but instead its "buy-back" provision is completely ineffective.

Recommendation

- Grant property owners the right to repurchase their property if the initial use of the property taken from them is not the public use for which the property was acquired.

Resources

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

What's Next for Senate Bill 18? by Bill Peacock, Texas Public Policy Foundation (Apr. 2011).

Senate Bill 18: The "Buy-back" Provision by Ryan Brannan and Bill Peacock, Texas Public Policy Foundation (Feb. 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 two 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 of 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.

- 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.

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

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 Greg Abbott.

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).

Public Use vs. Public Purpose

The Issue

According to the United States and Texas constitutions, eminent domain can only be used for a public use. Specifically, Article 1, Sec. 17 of the Texas Constitution says, "No person's property shall be taken, damaged, or destroyed for or applied to public use…"

However, in most cases, Texas statutes refer to "public purpose" or simply "purpose" when authorizing the use of eminent domain. For instance, here is the statute granting eminent domain authority to the University of Texas System:

> Sec. 65.33. EMINENT DOMAIN. (a) The board has the power of eminent domain to acquire for the use of the university system any land that may be necessary and proper for carrying out its ***purposes*** in the manner prescribed by Chapter 21, Property Code.

Then in subsection (c), the Legislature declares the purposes of the University of Texas System to be for the use of the state:

> (c) The taking of the property is declared to be for the use of the state.

In other words, the Legislature declares that whatever purpose the University of Texas System may have for a piece of property it takes from an owner becomes a public use simply through the exercise of eminent domain. The courts need not worry about the facts.

Texas courts also have fallen into using purpose when referring to property takings. Here is language from one Texas Supreme Court opinion:

> In any event, a mere declaration by the Legislature cannot change a private ***use*** or private ***purpose*** into a public ***use*** or public ***purpose***.

The good news here is that the Supreme Court's decision stands opposed to the Legislature's declaration about the University of Texas System's exercise of eminent domain. The bad news, though, is that the Court also confuses use and purpose.

Until 2011, all grants of eminent domain authority revolved around purpose rather than use. The 82nd Texas Legislature recognized the problem with this language and began to address it in SB 18 by changing the language in the authorizing statutes for cities, counties, and school districts from public purpose to public use.

Some have questioned the need to make such changes. However, clarity in law is crucial, as can be seen in cases like *Kelo* where the U.S. Supreme Court said that "public purpose" can include such things as economic development and increased tax revenue. Because the Texas Legislature and Texas courts have closely followed the national trend of blurring the distinction between public use and public purpose, it is important to restore clarity in Texas law by restoring constitutional language in Texas statute.

The next step is to finish the process by making the purpose to use change in all places in statute where eminent domain is authorized for use. This includes authorizations for entities such as universities, state agencies, municipal utility districts, hospital districts, common carriers, etc. With these changes made, it will be clear that all subdivisions of the state and all private entities are granted the power of eminent domain to take property only for a public use.

The Facts

- Both the United States and Texas constitutions authorize the use of eminent domain only for a "public use."
- Most grants of eminent domain authority by the Texas Legislature, however, allow takings for "public purposes."
- Last session, the Texas Legislature began to reverse this in SB 18 by authorizing the use of eminent domain for cities, counties, and school districts only for a public use.

Recommendation

- Change all references to in statute to "public purposes," "public purpose," or simply "purpose" when authorizing the use of eminent domain to "public uses" or "public use."

Resources

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

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

Eminent Domain: Balancing the Scales of Justice by Ryan Brannan and Bill Peacock, Texas Public Policy Foundation (May 2010).

Property Rights and the 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.

Most 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. The Court's majority opinion cited legal precedent dating back to William Blackstone. Thus it is possible for the public to acquire an easement over time as a beach gradually shifts and the public uses it without interference

from property owners. But the law is clear that a beach cannot become public overnight.

Finally, despite not being a property rights case, *Barbara Robinson v. Crown Cork and Seal* deserves special mention, since it showcases a turning away from prior eras of judicial deference to the legislature. In this case, the Supreme Court invalidated a law that protected companies from asbestos claims they inherited from companies they took over, saying that unless the law made "a convincing public-welfare showing," such a law would not stand.

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

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

Amicus Brief in Beach Access Case by Vikrant P. Reddy (June 2011).

Senate Bill 18: Presumption by Ryan Brannan and Bill Peacock (Feb. 2011).

Water

Water Supply

The Issue

Providing an adequate supply of water is an increasingly urgent challenge for Texas. The 2012 State Water Plan (SWP) issued by the Texas Water Development Board estimates that our state needs an additional 8.3 million acre-feet of water in 2060 to meet the demands of a population projected to increase from 25.4 million in 2010 to 46.3 million.

Sixteen years have passed since enactment of SB 1 in 1997. This landmark water legislation has led to nationally-acclaimed regional and state water supply plans. However, regulatory and financial constraints stymie timely implementation of projects to increase water supply.

As required by SB 1, Texas has completed detailed water plans measuring available water supply, future demand and identifying strategies to increase supply. The 16 Regional Water Planning Groups have developed comprehensive plans, which the Texas Water Development Board (TWDB) compiled into the official State Water Plan. TWDB issued its first SWP in 2002, with revised versions published in 2007 and 2012. In addition, Regional Water Plans identify hundreds of strategies to augment available supply by 9 million acre-feet of water by 2060.

According to an assessment in the 2012 State Water Plan, only 28% of the nearly 500 planned projects had reported some form of progress, and only 13% were fully operational. The prolonged delay in completing significant water supply projects increases, year by year, the challenge of meeting demands even in the near term. By law, Texas plans for enough water to meet demands during a drought of record and that model may need revising. The drought of record refers to hydrologic conditions averaged over the decade of the 1950s. Yet, in 2009 and again in 2011, most of Texas experienced a drought unprecedented in its intensity with hydrological conditions worse than the historical drought of record.

Although the Regional Water Planning Group members, water purveyors, and local governments have worked effectively, project implementation has been delayed, in large measure, by state regulatory issues and funding. Indeed, following passage of SB 1 in 1997 the Legislature has, perhaps inadvertently, passed legislation which complicates—rather than facilitates—new water supply projects. SB 2 in 2001 and HB 1763 in 2005 enlarged the authority of Groundwater Conservation Districts to limit private development of groundwater. In 2007, SB 3 established a multi-layered process leading to the Texas Commission of Environmental Quality adoption of Environmental Flow Standards. Water supply projects based on development of groundwater and new surface water right permits are delayed by these new groundwater and environmental flow statutes.

Other regulatory issues complicate completion of water supply projects. The "junior rights" provisions required for inter-basin water transfers remain an impasse for projects. Unresolved issues about water right amendments and indirect reuse of water delay many projects.

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. Except in a few areas, water marketing in Texas is far more limited than anticipated.

The Facts

- The 2012 State Water Plan estimates Texas will need an additional 8.3 million acre-feet of water a year in 2060 to meet demand under drought conditions.
- Implementation of the water supply strategies in the 16 Regional Water Plans has an estimated capital cost of $53 billion.
- Voluntary redistribution of existing water supply through water marketing is constrained by state and local district regulations.
- Water conservation strategies could generate nearly 2.2 million acre-feet of additional supply per year by 2060, according to the State Water Plan.
- Surface water strategies in the State Water Plan are estimated to produce about 3 million acre-feet of additional supply per year by 2060.
- Finally, the State Water Plan recommends construction of 26 new reservoirs, which would add 1.5 million acre-feet of new supply annually.

Recommendations

- Remove legal barriers to private investment in water supply projects.
- Amend Texas law to simplify TCEQ approval of water right amendments.
- Simplify requirements for bed and banks authorization for indirect reuse of water.
- Eliminate the "junior rights" restrictions on inter-basin water transfers.
- Amend SB 3 to clarify that the policy objectives for Environmental Flow Standards are critical flows during a drought of record.
- Clarify 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

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

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

Science Advisory Committee Report on Water for Environmental Flows, prepared for Study Commission on Water for Environmental Flows (Oct. 26, 2004).

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

Groundwater Rights

The Issue

Groundwater has long provided a major portion of the Texas water supply. Scientific assessment of the undeveloped groundwater indicates groundwater resources can help meet growing demand for water in Texas.

Texas has two distinct legal systems governing water: groundwater and surface water. Surface water in Texas is owned by the state, which grants water rights to use specific volumes of water for beneficial uses. A surface water right in Texas is a "usufructory" right, or a right to use. In contrast, under Texas common law and statute, landowners hold a vested private property right in the groundwater beneath their land. The landowner's property right in groundwater is often confused with the rule of capture. The right of capture is corollary to the landowner's ownership right. The rule of capture does not define the groundwater rights but explains the means by which a landowner may exercise the property right in groundwater.

For more than a century, Texas courts have recognized a landowner's vested property right in the groundwater below his/her land. Texas courts first articulated a landowner's vested property right in groundwater in the 1904 Supreme Court case, *Houston and Texas Central Railway v. East*:

> An owner of soil may divert percolating water … It is the same as land, and cannot be distinguished in law from land. So the owner of land is the absolute owner of the soil and of percolating water which is a part of, and not different from the soil.

This principle has recently been reaffirmed by both the Texas legislature and courts. During the 82nd Legislative Session, Texas passed SB 332, which clearly stated that "a landowner owns the groundwater below the surface of the landowner's land as real property." Chapter 36 of the Texas Water Code likewise affirms the landowner's property right: "The ownership and rights of the owners of the land and their lessees and assigns in groundwater are hereby recognized …" (TWC 36.002). A landowner's ownership of groundwater in place was also clearly upheld by the Texas Supreme Court in *Edwards Aquifer Authority v. McDaniels*. The Court held that the rule of capture is not inconsistent with ownership of groundwater in place, noting that "the landowner is regarded as having absolute title in severalty to the oil and gas in place below his land. The only qualification is that it must be considered in connection with the law of capture and is subject to police regulation … [This rule] correctly states the common law regarding the ownership of groundwater in place." Texas law could not be more clear than groundwater is a protected property right under the Texas constitution.

Like fee title ownership of land, "absolute" ownership of groundwater is subject to reasonable regulation. As early as 1904, the East Court acknowledged that the landowner's rights could be limited by "positive authorized legislation." The 1917 Conservation Amendment (Article XVI) of the Texas Constitution created the state authority to regulate natural resources, including groundwater. In 1949, legislation provided authority for local Groundwater Conservation Districts

(GCDs). In 1995, the powers of GCDs were expanded to include pumping limits on wells and tract size, and in 2001, SB 2 enlarged GCD this authority including preservation of historic uses and creation of Groundwater Management Areas (GMAs) based on regionally shared aquifers. In 2005, passage of HB 1763 dramatically enlarged the scope of groundwater regulation, requiring Regional Groundwater Management Districts to articulate "desired future conditions" and to permit groundwater withdrawals on the basis of "managed available groundwater" (MAGs) calculated by the TWDB. As of 2012, there are 99 local GCDs, which are recognized in law as the state's "preferred method of groundwater regulation." (TWC 36:0015)

While recognizing groundwater rights is an important step, Texas must go further to allow the private development of new groundwater supplies. The full implications of SB 332 and the *McDaniel's* decision for Texas groundwater law are not yet clear. Although the Court said this private property right was (in principle) compatible with GCD permitting authority, the Court also said there is a point at which regulation could become an unconstitutional taking of private property for which compensation to the landowner would be required. The Court also distinguished between the more restrictive authority of the Edwards Aquifer Authority and Chapter 36 of the Texas Water Code, which governs other parts of the state.

The Facts

- By 2060, water demand in Texas is projected to increase by 22%, while available water supply is expected to decrease by 10%.
- 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 99 local groundwater districts covering all or part of 174 counties.

Recommendations

- Remove legal impediments to the private development of new groundwater supplies and to proper functioning water markets in Texas.
- Review to what extent existing regulations in local Groundwater Conservation Districts and the desired future conditions proposed by the Regional Groundwater Management Areas may conflict with new SB 332's and McDaniel's clear affirmation of the landowner's real private property right to groundwater in place.

Resources

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

Edwards Aquifer Authority v. McDaniel, 55 Tex. Sup. J. 343 (2012).

Houston and Texas Centennial Railway Co. v. East, 98 Tex. 146, 81 S.W. 279 (1904).

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

Criminal Justice

Overcriminalization

The Issue

Criminal law is not just for criminals anymore—at least not criminals as traditionally defined. Texas lawmakers have created more than 1,700 criminal offenses, including 11 felonies relating to harvesting and handling oysters. Moreover, the 1,700 figure does not include criminal offenses that have been created through agency rulemaking pursuant to catch-all statutory provisions that make any violation of any agency rule a crime, as well as the more than 4,000 federal criminal offenses and myriad local criminal ordinances.

Additionally, in many spheres of economic activity, voluntary transactions have been "criminalized," i.e., made illegal under either civil or criminal law. Many antitrust laws, for example, provide for either civil or criminal penalties for transactions to which both buyer and seller have voluntarily consented. Criminalization of activities of this sort should be eliminated.

Texans once lived under a criminal code that resembled the Ten Commandments. Today, nearly 10,000 federal, state, and local offenses confound more often than command, diluting the traditional focus of criminal law.

The traditional criminal acts found in the Penal Code—from murder to many types of theft—account for less than 300 offenses. This leaves over 1,400 byzantine offenses scattered outside of the Penal Code. Many of these are "regulatory offenses"—those relating to ordinary, non-fraudulent business activities in fields such as agriculture, health care, natural resources, and insurance.

Significant differences between criminal and civil law make criminal law an overly blunt instrument for regulating non-fraudulent business activities. Whereas administrative rulemaking and civil proceedings may utilize a cost-benefit analysis to evaluate the conduct at issue, no such balancing occurs in criminal proceedings, which is appropriate provided criminal law adheres to its traditional focus on conduct for which there is clearly no justification. Also, criminal law, because it is enforced entirely by state prosecution, tends to minimize the role of the victim. Indeed, the prototypical "regulatory" offense, such as not filing the correct paperwork with a state agency, does not include anyone actually being harmed as an element of the offense. Finally, civil law and criminal law have traditionally been distinguished by the requirement that a criminal must have a guilty state of mind, expressed in the Latin term *mens rea*. Nevertheless, an increasing number of regulatory offenses dispense with the *mens rea* requirement, or require merely criminal negligence rather than intentional, knowing, or reckless conduct.

The Facts

Examples of excessive Texas criminal laws include:

- Under the Agriculture Code, Chapters 76.201(e) and 76.202(b), it is a Class A misdemeanor (punishable by up to a year in jail) to use, handle, store, or dispose of a pesticide in a manner that injures vegetation, crops, wildlife, or pollinating insects.

- Chapter 26.3574(s)(16) of the Water Code makes it a second degree felony (punishable by up to 20 years in prison) not to "remit any fees collected by any person required to hold a permit under this section."
- Occupations Code Section 165.151 makes it a Class A misdemeanor (punishable by up to one year in jail) to violate a rule of a professional licensing board covered under this chapter.

Recommendations

- Refrain from creating new criminal offenses, especially those regulating non-fraudulent business activities.
- Avoid licensing new occupations and revise laws to eliminate criminal penalties associated with many occupations.
- Don't criminalize voluntary economic transactions using either civil or criminal law.
- Enact the Rule of Lenity, a rule of statutory interpretation instructing a court to resolve ambiguities concerning whether the business-related conduct at issue is criminally prohibited against the state.
- Narrow the scope of catch-all statutes allowing agencies to create rules that carry criminal penalties. Offenses should be limited to statutory violations, and non-compliance with rules should be enforced by civil penalties and the revocation of permits and licenses.
- Eliminate the possibility of jail time for a first-time conviction of a regulatory misdemeanor, unless the person does not comply with the fine or probation conditions.
- Require that each bill creating an offense so specify in the caption and improve fiscal notes so that they state the full cost of the bill, including prosecutorial and judicial expenditures and the appointment of counsel for indigent defendants.
- Ensure that an appropriate culpable mental state is included for all non-traffic offenses and that it applies to each element of the offense.
- Repeal excessive and unnecessary offenses and narrow the scope of overly broad offenses. Eliminate criminal offenses based on voluntary economic transactions involving legal products and services. (Fraudulent transactions, meaning those that involve coercion, would not be included in this category.)
- Amend the Code of Criminal Procedure to allow for citation without arrest for additional misdemeanors and prohibit arrest for regulatory Class C misdemeanors, unless the defendant does not respond to a court summons.

continued

Overcriminalization (cont.)

Resources

12 Steps for Overcoming Overcriminalization by Marc A. Levin and Vikrant P. Reddy, Texas Public Policy Foundation (May 2012).

"Criminal Law v. Free Enterprise: What's the Verdict?" audio of panel featuring Texas Rep. Bill Callegari, Cato Institute Criminal Justice Director Tim Lynch, and Texas District and County Attorneys Association Legislative Director Shannon Edmonds at the 10th Annual Policy Orientation for the Texas Legislature (Jan. 2012).

Amicus Brief in Shelton v. Sec'y, Dep't of Corrs., No. 11-13515-GG (11th Cir. 2011) by Vikrant P. Reddy, Texas Public Policy Foundation (Nov. 2011).

Analyze Before You Criminalize: A Checklist for Legislators by Marc A. Levin, Texas Public Policy Foundation (Apr. 2011).

Time to Rethink What's a Crime by Marc A. Levin, Texas Public Policy Foundation (Feb. 2010).

Empowering & Restoring Crime Victims

The Issue

When a property or violent crime occurs, the primary party that has been aggrieved is the individual victim, not the government. This simple and long-acknowledged truth is at the heart of the restorative justice movement. In ancient times as well as in colonial America, victims often brought their own prosecutions.

Leviticus 6:2-5 teaches that stolen property should be returned to the owner, plus one-fifth of the value. This is based on the concept that recompense should go to the individual victim, not the government. The same concept is found in the sacred texts of nearly every major religion and widely implemented through the practice of sentencing circles in Aboriginal and American Indian cultures, where the victim, offender, and community come together to discuss the offense and agree on the steps that the offender will take to make the victim and community whole.

Informal restorative practices are not likely to displace the modern criminal justice system, due largely to factors such as population growth, urbanization, and the transient nature of many modern communities. Still, a growing body of evidence indicates the benefit—to victims, taxpayers, and offenders—of integrating practices designed to empower and restore victims into today's criminal justice processes.

In 1989, Texas adopted a constitutional amendment—now in Article I, Section 30—establishing various rights of crime victims, including the right to be reasonably protected from the accused throughout the trial process, the right to notification of court proceedings, the right to be present at all public proceedings, the right to confer with a prosecutor's representative, and the right to restitution.

Current state law allows a victim to submit a written impact statement for consideration prior to sentencing but after conviction of the defendant. The victim may also submit an oral statement after the sentence is handed down.

The Texas Department of Criminal Justice Victim Services Division offers a telephone line through which victims can obtain assistance, including automated updates about an offender's status.

Texas courts have always had the power to order restitution to victims, which then becomes a term of probation or follows the offender to prison. In 2005, HB 1751 became law, requiring trial courts that decline to order restitution to provide a written explanation.

The Crime Victims' Compensation Fund, created in 1979, is overseen by the Attorney General. It offers victims reimbursement of up to $50,000 in medical and other costs resulting from violent crime in cases where victims are unable

continued

to fully collect restitution directly from the offender. The Fund receives monies from court fees and restitution paid by offenders, along with a share of the proceeds from a privately operated secure and monitored pay telephone system for prison inmates legislatively authorized in 2007.

Texas does not have a statewide pretrial victim-offender mediation program, although 11 Texas juvenile probation departments, as well as a few alternative dispute resolution centers, offer criminal mediation in addition to their civil mediation programs. These 17 dispute resolution centers, located around the state, are funded primarily through civil court fees. Many are willing to begin handling criminal mediations or greatly increase their caseload at no additional cost or a nominal cost if prosecutors would refer cases to the centers.

Victims must elect mediation over the traditional court system, and offender participation is also voluntary, since the offender must take responsibility for his conduct and waive his right to trial and appeal. Mediation offers victims an expedited means of obtaining justice in contrast with often protracted pretrial proceedings, jury selection, and appeals.

Through mediation, a written agreement is reached that typically requires restitution, community service, and counseling. The agreement is then ratified by the prosecutor or judge. Failure to comply subjects the offender to traditional prosecution and, if necessary, incarceration. There are more than 1,300 mediation programs today, including more than 300 in North America, mostly focused on first-time property offenders. Because mediation enables offenders to avoid a conviction on their record, they are often more successful in finding or retaining jobs that enable them to pay restitution.

The Facts

- More than 87,000 victims are registered with the state's notification system, informing them of the progress of the case and the offender's status.

- In 2008, Texas probationers who owed victim restitution paid an average of $109, totaling $46.8 million. Probationers also performed 9.7 million community service hours, worth $63.3 million based on an hourly rate of $6.55 per hour. In 2008, Texas prison inmates paid a mere $501,000 in total victim restitution, fines, fees, and court costs, an average of only $3.21 per inmate. Parolees did better, paying $1.2 million solely in victim restitution.

- A national study found that 95% of cases resolved through victim-offender mediation result in a written agreement, 90% of which are completed within one year, far exceeding the average restitution collection rate of 20% to 30%.

- One study found that 79% of victims who participated in mediation were satisfied, compared with 57% in the traditional court system. Also, the 1,298 juveniles who participated in mediation were 32% less likely to re-offend.

Recommendations

- **Enable Victims to Choose Pretrial Victim-Offender Mediation.** Victims of property crimes should be empowered to select mediation with a binding restitution contract enforced by the state as an alternative to traditional prosecution and sentencing. Such legislation was unanimously adopted by each Texas legislative chamber, but time ran out before a conference committee agreed on a final version, and therefore, it has yet to be ultimately enacted.
- **Give Victims a Seat at the Table in Plea Bargaining.** Texas should follow Arizona in two reforms: 1) giving victims the right to participate in any plea negotiations with the accused, and 2) requiring that the victim's position on the plea deal be considered by the prosecutor and presented to the judge prior to approval of the plea.
- **Incentivize Restitution Collection and Strengthen Probation.** The state should evaluate probation departments partly based on their success in collecting restitution and incorporate the collection rate as an element in creating a performance-based probation funding formula. More effective probation supervision and treatment programs not only save taxpayer funds by reducing the unnecessary use of prison capacity, but also help victims since probationers pay exponentially more restitution than prisoners and prevent future victims by reducing re-offending.
- **Expand Victims' Access to Offenders' Funds.** When a victim converts an unpaid restitution order into a civil judgment, lower exemption thresholds should apply than the standard $60,000/$30,000 married/individual property exemptions.
- **Give Rights to Property Crime Victims.** The state statute on victims' rights defines "victim" as a person injured by a violent crime. Thus, despite a constitutional victims' rights provision that is not limited to violent crime victims, the silence of Texas statutes means that property crime victims have no legal rights concerning involvement in the criminal justice process. Filed in the 82nd session, HB 1715, would have conferred certain rights on victims of felony property crimes, including the right, upon request, to be informed of relevant proceedings, attend those proceedings, and express a preference to the prosecutor on the type of punishment.

Resources

Restorative Justice in Texas: Past, Present & Future by Marc Levin, Texas Public Policy Foundation (Sept. 2005).

Victim-Offender Mediation and Plea Bargaining Reform in Texas by Marc Levin, Texas Public Policy Foundation (Apr. 2006).

Testimony on HB 2139 by Marc Levin, Texas Public Policy Foundation (May 26, 2009).

Treating Texas Crime Victims as Consumers of Justice by Marc Levin (Mar. 2010).

Parole & Reentry

The Issue

In 2011, 70,916 inmates were released from Texas prisons and state jails, along with nearly all of the approximately 1 million individuals annually received into county jails. A little over 30% of released state prison and jail inmates are re-incarcerated within three years, either for a new offense or for violating the rules of their parole supervision.

Some 34,000 of those released from state prisons and jails were placed on parole supervision. Another 30,558 were released without supervision. Another 5,739 were placed on probation for the remainder of their sentence, nearly all of whom were inmates incarcerated in the state's Substance Abuse Felony Punishment Facilities (SAFPFs). The bulk of the prison population is governed by Discretionary Mandatory Supervision (DMS). Constitutionally, their release is within the sole discretion of the Board of Pardons and Paroles (BPP).

All but 158 of the 22,705 inmates released from state jails in 2011 were freed without supervision because before 2011, state jail inmates served a flat sentence of up to two years. In the 82nd session, however, the law was changed to award diligent participation credits to state jail offenders who make progress in educational, vocational, and treatment programs that can result in up to a 20% reduction in time served behind bars.

The remaining releases without supervision in 2011, totaling nearly 8,011, involved those who served their entire sentence for a third degree or higher felony, either because they were statutorily ineligible for early release due to the seriousness of their crime or because they were denied parole by the BPP.

The Board uses several factors in making its decisions, including a risk assessment process developed with the assistance of the National Institute on Corrections that scores inmates based on their individual risk factors, such as offense history and severity. Each of the more than 2,000 felonies in Texas law is classified by the BPP as low, medium, high, or extremely high severity. Institutional parole officers interview each candidate for parole and DMS and write a report, which becomes part of the file reviewed by the BPP. The public, including district attorneys and victims who are automatically notified, may submit written comments to the board. Family, friends, ministers, and others who know the candidate often submit comments as well.

As of August 2011, some 107,194 Texans were under parole supervision. The number of parolees convicted of a new crime declined 31% from 2007 to 2010, despite an increase in the total number of parolees. Parole revocations, whether for a new conviction, law violation, and rules violations, fell 32% from 2007 to 2010.

This success may be due to the recent strengthening of parole supervision and treatment. For example, prior to 2007, drug tests were sent to a laboratory, creating a delay of a few weeks. Now, results are instant, and most parolees with drug problems admit to it before being tested. Violators who do not pose a public safety risk are immediately referred to outpatient treatment.

Also, parolees who repeatedly violate the rules or commit a misdemeanor are often sent to an Intermediate Sanctions Facility (ISF) for approximately 75 days, in lieu of being revoked to prison. Some parolees at ISFs receive drug treatment along with follow-up counseling upon release. Literacy, Graduate Equivalency Degrees, and workforce preparation programming are available at some facilities. In fiscal year 2010, TDCJ placed 9,373 offenders in ISFs.

Upon reentering society, ex-inmates face challenges such as obtaining employment and housing and establishing positive associations. In 2009, the Legislature enacted a measure developed by the Foundation that allows many qualified ex-offenders to obtain provisional licenses to enter most licensed occupations. Evidence shows employed ex-offenders are less likely to offend and those in higher-paying jobs, which are more likely to be licensed, re-offend at the lowest rate.

The Facts

- In 2010, parole cost $3.74 per day per offender, compared to $50.79 a day per prison inmate.
- The most dangerous Texas sex offenders are ineligible for parole. The most seriously violent inmates serve 85% of their sentences and those incarcerated for indecency with a child serve 91.7%. Yet more than two-thirds of offenders enter state lockups for a nonviolent offense.

Recommendations

- Continue to strengthen parole supervision and treatment programs that reduce recidivism and revocations.
- Create a supervised reentry program for inmates now discharged after serving the entire sentence in prison.
- Require nonviolent parolees revoked for technical violations, not new crimes, to be sent to an ISF rather than prison, provided they have not been to an ISF within the last two years.
- Provide relief to employers from negligent-hiring lawsuits on the basis that the employee is an ex-offender.

Resources

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

"Texas Parole Reforms Lowered Crime, Cost" by Marc Levin, *Dallas Morning News* (Jan. 2010).

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

Adult Probation

The Issue

Nearly 450,000 Texans are on probation, including 170,000 felony probationers. Revoked probationers account for 37% of prison intakes and 41% of state jail intakes. The 23,881 probationers revoked in 2011 are projected to serve an average of 2.5 years at a cost of $50.79 a day, resulting in an annual cost of $442 million.

Since 2005, $55 million in state probation funding has been incentive-oriented. Departments are eligible for the incentive funding if they adopt graduated sanctions and pledge to reduce their technical revocations. Graduated sanctions involve utilizing graduated 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. Technical violations involve conduct that contravenes the terms of probation such as missing appointments but does not constitute a new crime.

Most of the state's 121 probation departments have participated in the incentive funding plan, and these departments have reduced their technical revocations by 16% while non-participating departments increased technical revocations by 8%. Had all departments increased their revocations by 8%, another 2,640 probationers would have been revoked to prison at a cost of $119 million. Departments receiving the funding used most of it to reduce caseloads from 150 to about 110 probationers per supervising officer. Overall, the Texas felony probation revocation rate has fallen from 16.4% in 2005 to 14.7% in 2010.

The Facts

- To help avoid spending $2 billion on building and operating new prisons, the 80th Legislature strengthened probation, including adding 1,400 beds at probation and parole intermediate sanctions facilities (ISFs). These facilities are typically located in major urban areas, such as the one across from Minute Maid Park in Houston, and have average stays of 60 days and primarily house probationers and parolees who would otherwise be revoked for technical violations or misdemeanors.
- Probation costs $2.92 per day, about 53% of which is paid for by offenders in probation fees. Prison costs $50.79 per day, all of which is paid for by taxpayers.

Recommendations

- **Require probation with mandatory treatment for first-time, low-level drug possession offenders with no prior violent, sex, property, or drug delivery crimes.** Senate Bill 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, which

they would have to pay for. 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 of both. 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 his/her conditions of probation, he/she could be revoked to prison for up to 10 years. The LBB estimated that SB 1909 would have saved taxpayers $500 million over five years, not including potentially even more in avoided prison construction costs.

- **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. Accordingly, the current statute that mandates funding based on the number of probationers should be revised to instruct the TDCJ Community Justice Assistance Division to develop a new formula that includes the following factors: 1) the number of felony probation referrals; 2) an incentive for early termination of compliant probationers who have fulfilled all of their obligations and do not pose a risk to public safety, 3) adjusted funding based on risk level of the caseload, and 4) 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.** Evidence has established that drug courts, mental health courts, DWI courts, and other problem-solving courts can reduce recidivism and lower costs to taxpayers by diverting appropriate offenders from incarceration while still holding them accountable. State funding and oversight for these courts should be consolidated into one agency, 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 in problem-solving courts that could be better used to divert offenders who might otherwise be incarcerated.

Resources

Breaking Addiction Without Breaking the Bank by Marc Levin, Texas Public Policy Foundation (Apr. 2011).

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

Corrections Budget & Prison Operations

The Issue

Texas has the fourth highest incarceration rate in the nation and the most prisoners of any state. Today, Texas has approximately 154,000 prison inmates, about half of whom are non-violent offenders. Texas' non-violent prison population is larger than the total prison population of the United Kingdom. However, since 2005 when the state began strengthening probation and other alternatives to incarceration, the state's incarceration rate has fallen 9%. During this same period, Texas' crime rate has dropped 12.8%, reaching its lowest level since 1973.

Two key budgetary strategies adopted in 2005 and 2007 enabled Texas to avoid building more than 17,000 new prison beds, which the Legislative Budget Board (LBB) had projected would be needed by 2012. Most importantly, the state's crime rate has fallen over this time.

The first strategy involved appropriating $55 million in 2005 for probation departments that agreed to target 10% fewer prison revocations and to implement graduated sanctions—issuing swift, sure, and commensurate sanctions (e.g. increased reporting, extended term, electronic monitoring, weekend in jail, etc.) for rules violations such as missing meetings rather than letting them pile up and then revoking that probationer to prison. Most of the funding went toward reducing caseloads from approximately 125 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 reduced revocations, allowing the state to avoid at least $226 million in incarceration costs.

The second strategy was the appropriation of $241 million for a package of prison alternatives enacted in 2007. This included more intermediate sanctions and substance abuse treatment beds, drug courts, and substance abuse and mental illness treatment slots. Some of the money was used to clear out the waiting lists of 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). All told, the 2008-09 budget added 4,000 new probation and parole treatment beds, 500 in-prison treatment beds, 1,200 halfway house beds, 1,500 mental health pre-trial diversion beds, and 3,000 outpatient drug treatment slots.

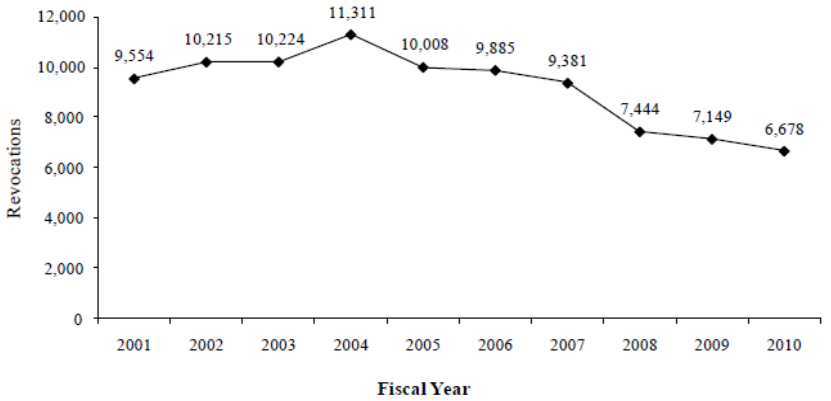
Given that nearly all offenses in Texas can result in either probation or prison, sentencing trends may reflect the confidence that judges, juries, and prosecutors have in the effectiveness of probation. Although the LBB has traditionally assumed an annual 6% increase in the number of offenders sentenced to prison due to population growth and other factors, sentences to prison actually declined 6% in 2009 while more nonviolent offenders went on probation.

In addition to the impact of sentencing decisions, probation and parole revocations together account for approximately half of the annual prison intakes, and

both have declined over the last several years as supervision has been strengthened. From 2005 to 2010, Texas' probation revocation rate fell from 16.4% to 14.7%.

Similarly, during the last several years, parole offices have improved supervision by expanding the use of graduated sanctions, implementing instant drug testing, and restoring the parole chaplaincy program. Thus, despite there being more parolees, the number of new crimes committed by parolees declined 8.5% from 2007 to 2010, contributing to a sharp reduction in parole revocations.

Texas Parole Revocations to Prison Fall By Nearly Half from 2004 to 2010



Sources: Legislative Budget Board; Texas Department of Criminal Justice, *Statistical Report*.

Capitalizing on Texas' recent success, the Legislature in 2011 followed the recommendation of both the Texas Public Policy Foundation and Governor Rick Perry in ordering the closure of the Sugar Land Central Unit, the first such prison closure in Texas history, which is 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.

The Facts

- Prisons cost Texas taxpayers $50.79 per inmate per day, amounting to $18,538 per year, which is below the national average.
- Each new state prison bed costs more than $60,000 to build.
- Probation costs $2.92 per day, of which the offenders pay $1.62 of that in fees, resulting in a taxpayer cost of $1.30 per day.
- TDCJ's budget increased from $793 million in 1990 to more than $3 billion in 2012.

continued

Recommendations

- **Reinstitute mandatory supervision for most third degree drug possession offenders.** This would save $26 million by automatically discharging third degree felony drug possession offenders on to parole supervision after completing half of their sentence with good behavior. Third degree drug possession involves between one and four grams of most controlled substances. Inmates serving time for drug dealing as well as those with prior violent, sexual, or felony property offenses would be ineligible. This policy change would give the Board of Pardons and Paroles more time to carefully scrutinize those parole candidates who have committed crimes against person and property while recognizing that the use of prison for long-term incapacitation should be prioritized for those who have harmed others.

- **Implement Senate Bill 1055, which was unanimously enacted in 2011 to incentivize lower costs and less recidivism.** This measure authorizes counties to voluntarily enter into an agreement with the state to reduce prison commitments of low-level offenders whereby the community receives a share of the state's savings on lower prison costs, partly based on the county's performance in reducing probationers' recidivism rate and increasing the share of probationers who are current on their victim restitution. A provision is needed in the next budget authorizing TDCJ to implement SB 1055 by reallocating to participating counties some of the savings from prison closures achieved through the implementation of the local commitment reduction plans described in the legislation. In 2010—the first fiscal year of Texas' Juvenile Commitment Reduction Program—juvenile commitments to state lockups fell 36%, saving taxpayers at least $114 million, while juvenile crime continued to decline. 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.

- **Cap maximum time nonviolent revoked probationers can serve for technical violations.** Although technical revocations have declined, there were still 12,094 technical revocations in fiscal year 2011. Such revocations account for more than half a billion dollars in annual prison costs. 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 18 months with eligibility for parole occurring no earlier than 6 months.

- **Incorporate virtual education into prison education.** The Windham School District, which serves Texas prisons, should implement blended learning approaches incorporating the state's existing virtual school network with appropriate firewalls. Evidence indicates this could better address the challenge of inmates who are at very different baseline levels and learn at very different paces than relying on traditional classroom instruction alone.

Resources

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

The Role of Parole in Texas by Marc Levin & Vikrant Reddy (Apr. 2011).

Incentivizing Lower Crime, Lower Costs to Taxpayers, and Increased Victim Restitution by Marc Levin (Apr. 2011).

Juvenile Justice

The Issue

On December 1, 2011, Texas juvenile justice was reshaped by the merger of two state agencies formerly responsible for different silos of the juvenile justice system. This merger was brought about not only for administrative cost savings, but also to further embed evidence-based and results-driven practices throughout Texas.

The juvenile justice system is necessary to protect public safety—much like the criminal justice system. However, unlike the criminal justice system, the juvenile justice system often works as a substitute for familial discipline and parentally directed behavior control. Therefore, whenever possible, the juvenile justice system should increase parental involvement in the process in order to restore the natural order of discipline in a juvenile delinquent's life. The most efficient way of doing so is to place as many juveniles as safely possible within county-level or community-based facilities, where families are physically closer, and a juvenile's community—schools, churches, and non-profit organizations—plays a more significant role in his or her rehabilitation.

This approach is consistent with the evidence that local and community-based programming has been proven to provide more effective results for juveniles and the public safety at a lower cost than traditional state lockups.

The newly formed Texas Juvenile Justice Department is uniquely positioned to implement such reforms for two reasons. First, the Legislature used the enabling legislation to expressly direct the new department to prioritize community-based alternatives for juvenile placements. Second, while the previous system was divided between two agencies, with segregated funding streams for county juvenile probation and state-level secure incarceration, it is now headed by one agency, which will permit far more efficient transfers of resources and youths from the state level to the county level.

The other effect of the merger is to increase oversight, which has already permitted areas of inefficiencies to be identified. There are a few areas in which the juvenile justice system is overspending without any resulting benefit to the public safety, and reducing these inefficiencies will lessen the burden on taxpayers and allocate resources more efficiently.

In the next legislative session, policymakers should focus on further oversight of the merged juvenile justice agencies and ensure that all possible cost savings are implemented while streamlining the bureaucracy, all while increasing the effectiveness of the justice system to continually maximize public safety and successful offender outcomes.

The Facts

- The population of youth incarcerated at the state level continues to shrink, from more than 5,000 youth in 2006 to just one-third of that today. While some improvements in conditions and programs at these lockups have been made, costs still exceed $300 per day, per juvenile, and exiting youths' re-

incarceration rate is still approximately 35%—a dramatic difference from the more efficient and effective community-based programs.

- Senate Bill 653, from the 82nd Texas Legislature, merged two state agencies into one. However, additional steps are needed to fully implement the cost savings and administrative reductions possible through this merger.
- Recent research and oversight of the juvenile justice system have revealed inefficiencies, including an inefficient and ineffective parole system and an overreliance on pretrial detention of nonviolent youths in some counties.

Recommendations

- Mentally ill juvenile delinquents are a key population to focus on given their unique treatment needs, as well as the potential for inefficient system handling of their mental illness. By providing more avenues for diversion from the juvenile justice system, coupled with strong, outcome-oriented performance measures and assessments to better match youths and programs, Texas can ensure adequate mental health treatment while protecting public safety and preventing unnecessary expenditures at the state level.
- The budget for juvenile parole in Texas has stayed constant even while the population of juveniles on parole has dropped by half. This suggests there are significant inefficiencies in the system, compounded by the poor indicators of program effectiveness and outcomes. A more effective parole system, coupled with very short reductions in lengths of stay, could produce significant cost savings and decreased rates of re-offending in Texas.
- Pre-trial secure detention is expensive and often unnecessary in Texas. Harris and Dallas County have achieved success with innovative methods of pretrial supervision in lieu of detention for appropriate juveniles, resulting in lower rates of re-offending and fewer juveniles missing court dates, all while crime decreased by larger margins than the rest of Texas. Utilizing such alternatives in other counties could result in more effective juvenile case management, safer communities, and streamlined detention budgets.

Resources

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 (Feb. 2012).

Out for Life: Pathways to More Effective Reentry for Texas Juvenile Offenders by Jeanette Moll, Texas Public Policy Foundation (Jan. 2012).

Testimony on Interim Charge 1, House Corrections Committee by Jeanette Moll, Texas Public Policy Foundation (Mar. 6, 2012).

Ten Truths about Juvenile Justice Reform by Jeanette Moll, Texas Public Policy Foundation (Dec. 2011).

School Discipline & Delinquency Prevention

The Issue

Public schools across Texas are designed to educate our youth and provide them with the building blocks for higher education or future employment. To effectively impart this education, schools must be safe places for students of all ages, which requires effective school discipline.

Unfortunately, school discipline has recently become far too reliant on justice system interventions. Students' minor misbehavior, previously handled with traditional disciplinary methods by teachers collaborating with parents, is now often handled in the justice system through formal court proceedings. This shift came as a result of the adoption of zero-tolerance policies, as well as the ease of offloading responsibility onto the justice system.

Exchanging school discipline for justice system intervention comes at a high cost. To the youths and families involved, the cost includes precious education hours missed while sitting in court or in an out-of-school disciplinary program, not to mention the time lost at work and costs to the parents when forced to accompany their children to court. These costs can be unnecessary in the absence of conduct that creates a substantial danger, in contrast to the minor misbehavior often underlying disciplinary action, such as spraying perfume or shouting in class.

This exchange also comes at great cost to Texas taxpayers and citizens. Simple, effective, and low-cost in-school disciplinary measures have been forgone for more expensive justice system interventions—such as the frequent use of Class C misdemeanor tickets and referrals to Juvenile Justice Alternative Education Programs (JJAEPs). These expend valuable court resources, overfill dockets of municipal court judges, squander precious district funds, and overburden taxpayers. Texas courts are clogged with hundreds of thousands of school discipline cases, limiting access for citizens and cases in true need of justice handed down from the bench.

Fortunately, there is an exit strategy from this overreliance. Implementation of a tiered school discipline program can provide effective intervention in a misbehaving student's life, while ensuring appropriate justice system referrals are still available for serious problems on school campuses.

Such a policy would operate in this way: prior to referring a student to the justice system, school administrators would simply be required to use traditional disciplinary methods first. After exhausting the first "tiers" of a disciplinary system, if the misbehavior has not been corrected, then more serious justice system interventions are available. Further, serious incidents of criminal behavior, such as bringing a weapon to school, would be eligible for immediate referral to the justice system, ensuring that schools remain a safe, effective, educational environment for all students while preventing overreliance on the justice system.

In addition to implementing a reasonable tiered discipline policy, policymakers can look to streamlining disciplinary standards codified in the Education Code and reducing the categories of mandatory suspensions and expulsions, permitting teachers and school districts more latitude to properly discipline their students.

The Facts

- Citable offenses are too broad. Disrupting class is a citable offense in the Education Code, which includes ordinary misbehavior such as "emitting noise of an intensity that prevents or hinders classroom instruction," and requires a student to appear in court with a fine of up to $500.
- Disciplinary Alternative Education Programs (DAEPs) are ineffective but have expanded over the last decade. From 1999-2009, the number of youth assigned increased 24%, to 92,719 students, including 13,382 first through sixth graders. The dropout rate for students assigned to a DAEP is 225% higher than the dropout rate for Texas schools as a whole (and 80% of Texas adult inmates are dropouts).
- In the 2009-10 school year, there were 284,028 students suspended out-of-school 575,306 times. Notably, 95% of these suspensions were discretionary. These suspensions translate to multiple days spent without parental supervision or education.

Recommendations

- Require districts to implement a tiered discipline system that first uses traditional disciplinary methods prior to justice system involvement except for serious offenses.
- Permit school police officers and other law enforcement personnel to issue civil citations to juveniles rather than arresting them for minor misdemeanors. Civil citation programs often include community service.
- Narrow the focus of citable offenses in the Education Code to behavior that poses a danger to others and reduce arbitrariness in enforcement.
- Incorporate school disciplinary outcomes into the state school accountability system.
- Narrow categories of conduct mandating expulsions and suspensions to limit such responses to blameless behavior, such as validly prescribed but unregistered prescription drugs or asthma inhalers.

Resources

Expelling Zero Tolerance, Reforming Texas School Discipline for Good by Jeanette Moll, Texas Public Policy Foundation (Aug. 2012).

Testimony before the House Public Education Committee Regarding Juvenile Justice Reforms by Jeanette Moll, Texas Public Policy Foundation (Apr. 2012).

Schooling a New Class of Criminals: Better Disciplinary Alternatives for Texas Students by Marc Levin, Texas Public Policy Foundation (Mar. 2006).

Civil Justice

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).

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 his or her 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.

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.

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 Apr. 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 session 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 pre-trial 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 pre-trial 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 pre-trial 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

U.S. Tort Costs: 2004 Update by Tillinghast-Towers Perrin (2005).

"Is Multi-district Litigation a Just and Efficient Consolidation Technique?" by Danielle Oakley, 6 *NVLJ* 494 (2005).

"Unsettling Efficiency: When Non-Class Aggregation of Mass Torts Creates Second-Class Settlements" by L. Elizabeth Chamblee, 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.

continued

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 "mark up" 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 session 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.

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.

Mills v. Fletcher, 229 S.W. 3d 765. (Tex. App. 2007).

Black's Law Dictionary, p. 782 (8th ed. 2004).

Black v. American Bankers Ins. Co., 478 S.W. 2d 434 (Tex. 1972).

2009 Legislative Session Summary, Texas Civil Justice League, 2009 Session.

Experts

The Honorable Chuck DeVore, *VP of Communications; Senior Fellow for Fiscal Policy*

AREAS OF EXPERTISE: Tax and Fiscal Policy, Elections, Foreign Affairs, Military Affairs, Energy and Environmental Policy
cdevore@texaspolicy.com (512) 472-2700

James Golsan, *Education Policy Analyst*

AREAS OF EXPERTISE: K-12 Education Growth, Increasing Public School Efficiency, Education Choice
jgolsan@texaspolicy.com (512) 472-2700

The Honorable Talmadge Heflin, *Director, Center for Fiscal Policy*

AREAS OF EXPERTISE: State Budget and Taxation, Economic Stabilization Fund, Local Government Spending, Pension Reform, Federal Funds
theflin@texaspolicy.com (512) 472-2700

Marc Levin, *Director, Center for Effective Justice*

AREAS OF EXPERTISE: Adult Corrections, Juvenile Justice, Overcriminalization, Victim Empowerment & Restitution, Law Enforcement, School Discipline
mlevin@texaspolicy.com (512) 472-2700

Thomas Lindsay, Ph.D., *Director, Center for Higher Education*

AREAS OF EXPERTISE: Higher Education, Culture Wars (Political correctness, cultural decline, etc.), America's Founding Principles, Online Learning
tlindsay@texaspolicy.com (512) 472-2700

Mario Loyola, *Director, Center for 10th Amendment Studies*

AREAS OF EXPERTISE: Tenth Amendment, Constitutional Law, Environment, Energy
mloyola@texaspolicy.com (512) 472-2700

Jeanette Moll, *Juvenile Justice Policy Analyst*

AREAS OF EXPERTISE: Juvenile Justice Reform, Victims' Rights, Overcriminalization, Constitutional Limitations on Corrections
jmoll@texaspolicy.com (512) 472-2700

Josiah Neeley, *Energy & Environment Policy Analyst*

AREAS OF EXPERTISE: Constitutional Law, Environment, Energy
jneeley@texaspolicy.com (512) 472-2700

Bill Peacock, *VP of Research; Director, Center for Economic Freedom*

AREAS OF EXPERTISE: Electricity Markets & Renewable Energy, Insurance, Technology and Telecommunications, Tort Reform, Property Rights, Economic Development, Consumer Issues
bpeacock@texaspolicy.com (512) 472-2700

James Quintero, *Senior Fiscal Policy Analyst*

AREAS OF EXPERTISE: Tax Reform, State Budget and Taxation, Tax and Expenditure Limit, Employment Trends, Financial Transparency
jquintero@texaspolicy.com (512) 472-2700

The Honorable Kathleen Hartnett White, *Distinguished Senior Fellow-in-Residence; Director, Armstrong Center for Energy & the Environment*

AREAS OF EXPERTISE: EPA Regulation, Energy and Environmental Policy, Endangered Species Act, Water Rights, Free Market Environmental Policies
khwhite@texaspolicy.com (512) 472-2700

The Honorable Arlene Wohlgemuth, *Executive Director; Director, Center for Health Care Policy*

AREAS OF EXPERTISE: Health Care
arlene@texaspolicy.com (512) 472-2700

900 Congress Ave., Ste. 400, Austin, Texas 78701 | 512.472.2700 phone 512.472.2728 fax
www.TexasPolicy.com