

VERITAS

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Welcome to Veritas!

While the cold of winter is finally upon us, the heat of public policy debates rages on. In this *Veritas* you will find a sampling of the issues that will be debated and discussed in Austin and around the state in 2004, as we prepare both for a special session this Spring on school finance, and for the 79th Legislature in 2005.

For many, state policy questions do not have the appeal of federal issues. However, it is policy at the state and local level that most directly affects the lives of people. Whether it is the roads we drive, the schools our children attend, or the phone calls we make, state policy has a deep, personal impact on the lives of everyone, every day.

This, of course, is why the Texas Public Policy Foundation is so important. In order for the right decisions to be made, policymakers need the best, most up-to-date information and research. Day in and out, the Foundation studies the most pressing issues to provide policymakers, opinion leaders and the public with the ammunition it takes to battle for a better Texas.

Our values are your values: free markets, private property rights, individual liberty and responsibility. These are the cornerstones upon which we build our research, and the boundaries that mark our actions.

I hope you enjoy this edition of *Veritas*!

For Texas,

A handwritten signature in blue ink, appearing to read 'Brooke Leslie Rollins', written in a cursive style.

Brooke Leslie Rollins, President

Medicaid Issues and Challenges

By Beau Egert

Medicaid continues to drive state budgets across the country. As state revenues have declined, Medicaid costs per enrollee have almost doubled in the last five years.¹ Largely as a result, the National Governors Association reported in November 2002 that “nearly every state is in a fiscal crisis.”² Nationally, Medicaid and other health care services comprise 30% of state budgets, and these costs increased by 13% in 2002, which was the largest increase in a decade.³ “Growth in Medicaid continues to put a severe strain on state budgets,” and 28 states anticipate shortfalls in Medicaid spending for the current fiscal year.⁴

Texas is no exception to these trends. Without reform, Medicaid threatens to consume an ever increasing share of the state budget, potentially jeopardizing every other budgetary item. Some predict that left unreformed, Medicaid will bankrupt every state in as little as 20 years.⁵ The right policy response to Medicaid demands first a proper understanding of the problem. How did Texas’ Medicaid program get to where it is today? What is driving these costs and where should the state begin in addressing them? An attempt to answer these questions is the purpose of this paper.

Rising Costs

Medicaid began in the 1960s as a part of President Johnson’s continuing “War on Poverty.” It was intended as a social safety net to provide health insurance for the poor, disabled and elderly. Not long after its inception, Medicaid expenditures quickly outgrew Congressional expectations, and its history is largely that of failed government

attempts to rein in spiraling costs.

In Texas, Medicaid spending grew rapidly in the 1980s and early 1990s due to increased caseloads and costs, but by the mid-1990s, more modest single digit growth replaced double digit figures. This decline “briefly suspended [Medicaid’s] image as the top state budget growth driver.”⁶ It is important to note that although Medicaid spending slowed dramatically from 1996 to 2000 (26%) compared to 1991-1996 (118%),⁷ it still substantially outpaced nominal budgetary growth. Since 2000, Texas has experienced a steady upward trend in enrollment and the return to annual double digit growth rates.⁸ The primary drivers of this growth mirror the national trends of increased enrollment due to the economic downturn, rising prescription drug and hospital costs, and increased costs of both acute and long-term care for the elderly and disabled populations.⁹ The elderly and disabled populations in particular accounted for almost 60 percent, or \$50 billion, of the national growth in Medicaid spending from 2000-2002.¹⁰

The Texas Health and Human Services Commission along with other health policy experts expect this growth in Medicaid expenditures to continue for several reasons:

- Increased enrollment, primarily non-disabled adults and children,
- Increased utilization and cost of prescription drugs,
- Increased provider payments,
- Medical inflation; and,
- Increased long-term care expenditures.¹¹

High Overall Costs

While these factors account for Medicaid’s spending growth, they do not necessarily explain

why Medicaid is so expensive overall. A number of issues contribute to making Medicaid such an expensive program. First, Medicaid simply covers a medically needier population, many of whom would be unable to attain health insurance on the private market. This population includes the elderly and disabled, but also Medicaid's general adult population who has a poorer health status compared to low-income adults with private insurance.¹² In addition, unlike employer-based health insurance, where coverage begins upon hiring, Medicaid coverage is often triggered by a specific health need. Secondly, Medicaid's eligibility requirements create perverse incentives for beneficiaries. Since eligibility is based on having low-income and few assets, Medicaid penalizes those who succeed and encourages the spending down of assets in order to retain or initially qualify for benefits. When a beneficiary earns a dollar over the income threshold, he/she loses 100% of coverage. Medicaid eligibility rules also allow individuals to divest themselves of assets, by transferring to heirs and/or other family members. They can subsequently qualify for Medicaid within 36 months. While empirical confirmation of this problem is difficult to attain, burgeoning law practices in this area combined with ample anecdotal evidence suggest its presence is real.

Third, delivery of Medicaid services completely isolates consumers from the cost of care. Since health care is for practical purposes "free" for Medicaid beneficiaries, they consume until their marginal benefit equals zero, resulting in procedures that cost more than their value to patients. Managed care programs have attempted to reign in such spending, but savings thus far have been modest.¹³ Managed care also introduces

increased complexity for providers and beneficiaries, and while beneficiaries have been generally satisfied with the program, providers indicate high levels of dissatisfaction.¹⁴ Overall, these factors contribute to high Medicaid spending in Texas and in the U.S.

What Can Be Done?

In the face of such rising costs for an already expensive program, Texas has four options:

- **Do nothing.** While no one suggests that doing nothing is a viable option, with further delay this becomes the *de facto* course of action. The reality is that without change, as mentioned above, Medicaid will consume an ever increasing share of the state budget, endangering all other budgetary items.
- **Raise taxes.** Some argue that with increasing costs, Texas simply needs to increase tax revenues, and its reluctance to do so complicates the Medicaid issue. However, tax increases will not solve Medicaid's problems; it will only delay them. The delay would be extremely costly for taxpayers as well as unsustainable in the long-run. Since the foreseeable future points to double digit growth in Medicaid, tax increases would have to keep pace, with no end in sight. Thus, it is important to note that when it comes to Medicaid, opposition to tax increases is not a philosophical argument of big versus small government. Rather, it is a practical approach that recognizes Medicaid's current spending growth is unsustainable, and the legislature must pursue alternative measures for reform.

- **Cut spending.** As a federal entitlement program, spending cuts for Medicaid are by nature limited to optional coverage areas. In response to increasing costs, states have historically restricted their eligible Medicaid population, cut optional benefits, or reduced provider payments. The Kaiser Commission on Medicaid and the Uninsured reported that 49 states in 2003 planned to pursue one of these options. These traditional responses are undesirable in Texas for several reasons.¹⁵ First, restricting the eligible Medicaid population results in a higher percentage of uninsured residents.¹⁶ These residents remain without care while still not bringing about lower costs as “regions that spend less on Medicaid spend more on free care for the uninsured and vice versa.”¹⁷ Second, many of the optional benefits under Medicaid are substitutes for more expensive services, so no net savings result. Third, already low provider payments threaten to erode participation rates and additional cuts could jeopardize the entire system. So overall, cutting Medicaid spending hurts some of the most vulnerable populations in Texas with little savings as a result.
- **Reform Medicaid.** Significant Medicaid reform is the only viable option for Texas. The question, of course, is what kind of reform does Medicaid need?

Areas for Additional Research

The following research areas have been identified for potential Medicaid reform. They recognize the need to rein in Medicaid spending while also maintaining high levels of quality and

access to care.

- **Use of personal assets and risk transfer mechanisms to off-set costs of long-term care.** State policymakers should focus considerable attention on ensuring that individuals' assets are available and utilized for their care prior to receiving assistance from state and federal governments.
- **Managing the utilization of services.** As mentioned above, attempts have been made to manage the utilization of services primarily through managed care programs. These programs are only offered in urban areas as opposed to the fee-for-service model in rural areas. The fee-for-service model prevents the transfer of financial obligation to patients and creates incentives for providers to perform unnecessary procedures. Alternative delivery models exist and should be examined to better align patient and provider incentives with the taxpayers' interests.
- **Encouraging employer-sponsored health care programs.** Currently in Texas employer-sponsored health insurance covers 58% of the population compared to 64% nationally.¹⁸ Employer-sponsored programs hold perhaps the greatest potential for reducing Medicaid costs and decreasing the number of uninsured persons in Texas.
- **Ensuring state maximization of entitled federal share (FMAP).** State policymakers should continue to strive

for the most efficient system to deliver medical assistance to low-income populations. They should also examine ways to increase flexibility, increase local control, and ensure that taxpayers of the state and its political subdivisions are receiving fair treatment in terms of federal funds for low-income programs.

The problems posed by Medicaid challenge even the most experienced policy-makers of our state and nation. There are no easy answers. The stakes are high both for the over 50 million people nationally who depend on Medicaid for their health insurance and the taxpayers who fund the program. While the task is difficult, there is no alternative to reform because Medicaid as we know it cannot be sustained.

Originally from Houston, Beau Egert graduated from Baylor University in 2001. He served as President/CEO of Faith Covenant Support Services, Inc., a faith-based non-profit specializing in affordable housing, before returning to graduate school in fall 2002. He is currently a graduate student at Harvard's John F. Kennedy School of Government, with a Masters in Public Policy expected in June 2004.

ENDNOTES

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A Labor of Love

Colorado's School Voucher Program

By Pamela Benigno

Last spring, after more than a decade of toil expended and vast financial resources spent, Colorado's school choice activists and supportive policymakers celebrated the passage of the Colorado Opportunity Contract Pilot Program. The school voucher program, sponsored by State Representative Nancy Spence (R-Centennial), will provide qualifying low-income students residing in 11 school districts with poor-performing schools with the choice to attend private and parochial schools.

Now the labor has tremendously increased as school choice activists and the public school system work to implement the program. For some it is a labor of love, while to others it is a labor of disdain. For many it is simply resigned cooperation – after all, it is the law.

The State Board of Education has astutely formed an advisory committee to assist in the implementation of the program. Made up of an exceptionally diverse group of individuals, including a free market think tank and the state teachers union, the committee has been charged with the task of designing policies and documents for the program. The word “cooperative” best describes the committee's personality, though reporters attend the meetings at the Department of Education hoping to catch one of the committee's spirited debates.

Such a debate took place on November 12th, as an attorney from the teachers union argued before a Denver district judge that the program is unconstitutional, while the State of Colorado and the Institute for Justice defended it. The judge's

ruling is expected in early December.

Outside the walls of government buildings, relentless grassroots activists of all colors and political affiliations have joined together from across 200 miles to meet the deadlines prescribed by the law.

This “alliance” has recruited and guided private and parochial schools in the application process. They have identified thousands of families who plan to apply for an Opportunity Contract. Some within the alliance are providing legal help, and others are contributing financial resources.

The Independence Institute is a partner in this undertaking, along with the Colorado Alliance for Reform in Education, directed by former congressman Bob Schaffer. Other school choice organizations such as the Black Alliance for Educational Options and the Coalition for Latino Children in Education are also a part of the effort to achieve success. To all of them, success means poor children, mostly minorities, will have the opportunity of a lifetime – to escape a failing school and receive a first-rate education.

Though lacking the activist’s passion, the Colorado Association of School Boards and the Colorado Association of School Executives have been extremely cooperative. However, the rubber meets the road at the local school district level. The 11 school districts mandated to participate in the program have either expressed their annoyance with the program by creating obstacles, or hidden their annoyance by being politely professional.

Three school districts in Adams County (suburban Denver) denied the applications of several well-established Catholic schools that mostly serve low-income minority children. The districts claim the reason for denial was that the

schools discriminate on the basis of disability. Such practice would be a legal reason for preventing a non-public school from participating in the program, but these particular Catholic schools serve many students suffering from a broad range of physical and learning disabilities. The denials will be appealed to the Colorado State Board of Education.

On the other hand the two largest school districts in the state, Denver Public Schools and Jefferson County Public Schools, have given non-public schools an opportunity to make amendments to their applications or to submit required documents past the deadline.

With both private secular and religious schools able to participate in the program, 128 schools applied by the October 1st deadline. Results vary weekly on the number of schools that have been accepted or denied. In many cases, a school will be accepted by one district but denied in another.

In the fall of 2004, the Opportunity Contract Pilot Program will begin serving approximately 3,300 students, and the fruits of the labor will be evident. By the fall of 2007, approximately 20,000 low-income students will have experienced educational freedom.

School districts claiming they only want the best for children need to understand the manner in which Colorado now educates the public has changed.

Pamela Benigno is the director of the Education Policy Center at the Independence Institute, a Colorado free market think tank. She serves on the state advisory committee and works with grassroots organizations to implement Colorado's new school voucher program.

Learn more about the
Independence Institute
at www.i2i.org!

Common Sense Budgeting *Could It Be Coming Soon?*

By Bob Williams

We're used to bad news: For many years, governors of Washington State and most others have been increasing the size and cost of government without proper regard to its burden on families and businesses. The results are predictable: the slightest whiff of economic trouble, and the shaky foundation begins to crumble.

Our state now has one of the highest unemployment rates in the nation, and we're facing a \$2.5 to \$3 billion deficit in the coming biennium. Economic troubles plague other states as well, but we have been particularly hard hit. Forecasters tell us we are at least two years—and a slow climb—from recovery.

So how about some good news? With 34 states facing collective deficits that total nearly \$60 billion, Governor Gary Locke and his budget team have come up with what may be the most innovative solution in the nation.

Used properly, their new budget model would lay the foundation for responsible state spending, not only now, but in the future—and not only here, but in any state.

Conventional thinking says there are only two ways to balance a budget: raise taxes or cut important services. It says budgeting is all about maintaining the status quo. But the governor and his budget director, Marty Brown, say there's a third approach: budgeting based on results, without raising taxes.

Instead of blindly struggling to maintain the state's existing budget by adjusting for inflation and caseload increases and cutting or taxing to

make up the difference, Locke and Brown have wiped the chalkboard clean and started by answering four very basic questions:

1. How much money does the state have?
2. What does the state want to accomplish?
3. What is the most effective way to accomplish the state's goals with the money available?
4. How will the state measure its progress in meeting those goals?

Once the governor and his team determined what they believe to be the state's ten core governing responsibilities, they identified measurable outcomes and prioritized agency programs *within existing resources* based on how effectively they would help meet those goals.

Of course, legislators from both parties and the governor are not likely to immediately agree on what the state's core functions should be. Some Republicans don't like the model because Democrats came up with it. Some Democrats are furious with the governor because they think he just pushed the hard decisions off to them. Others are ready to throw the whole thing away because they don't like the ten goals. So change them!

What the governor's model provides is a *valuable new set of tools*. It asks the right questions, provides a logical process for determining the answers, and prioritizes spending accordingly.

Legislators now have a legitimate place to begin the debate and either ratify or modify these ten functions. And they shouldn't do it arbitrarily. Lawmakers should keep in mind Article 1, Section 1 of the Washington State Constitution: "All political power is inherent in the people, and governments derive their just powers from the

consent of the governed, and are established *to protect and maintain individual rights.*" [emphasis added]

The following questions should be asked about potential core functions of state government:

1. What should government do, in a broad sense?
2. What should it not do?
3. What essential services are required of government, if it is to successfully fulfill its proper functions?

Once the legislature has determined the state's core functions, they will serve as the litmus test for the hundreds of agencies, boards, commissions and programs currently funded. If an agency or program is not advancing one of the agreed-upon core functions of government, it should be eliminated.

Of course, you can probably imagine the wailing and anger from currently protected special interests! The governor and legislators will be pressed hard on all sides to throw this idea in the dumpster. But if they embrace Washington's new budget tools, the state will be a pioneer in responsible state budgeting. This model breaks from the status quo and recognizes a sensible, responsible approach. Throw in independent, comprehensive performance audits from the state auditor and taxpayers may finally have the accountability they've justly been demanding.

Bob Williams is president of the Evergreen Freedom Foundation, a non-profit public policy research organization based in Olympia, WA.

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What's Money Got To Do With It? ***School Finance and Student Learning***

By Chris Patterson

Texans are ready to change the \$25 billion system that has funded public schools over the past decade.

Often described as “Robin Hood” because local school taxes are redistributed from property “rich” to property “poor” districts, the state school finance system is widely criticized by groups across the political spectrum.

At the same time, Texas’ school finance system has once again been drawn to the courts, this time to prove it does not violate a constitutional prohibition against a state property tax.

Since the conclusion of the 78th Legislature’s regular session, school finance has undergone intense scrutiny. Special committees have been formed to examine alternatives to the current school finance system; state and national experts have been commissioned to research questions about school finance. Testimony has been heard from educational associations, business leaders, policy groups, academics and citizens. The issue has been extensively covered in the media, and is regularly the focus of discussion in community meetings around the state.

Additionally, Texas Governor Rick Perry has pledged to call a special session on school finance in the spring of 2004 if legislators can reach consensus on reforms.

The school finance system presently faces the most serious litigation since the system was devised in 1993. The Texas Supreme Court recently returned a lawsuit filed by four property-rich school districts back to trial court (*West*

Orange-Cove Consolidated I.S.D. v. Alanis). Ruling the state school finance system would be unconstitutional if even one school district is forced to tax at a maximum rate in order to meet state educational requirements, the Supreme Court decision provides additional impetus for reform.

Policy leaders are pressing for reform believing the Texas Legislature would craft a far better system of school finance for Texas public schools than the courts could impose.

Many elected officials have a laundry-list of objectives:

- reduce local property taxes,
- increase the state's portion of public school funding,
- define the state's required program of instruction,
- strengthen the state's accountability system, and
- fund a substantial portion of what the court or legislature might identify as an "adequate education."

As dissatisfaction with the method and level of public school funding grows, there are also signals of an impending taxpayer revolt.

Property taxes have increased from \$2.8 billion in 1980 to \$13.6 billion in 2000 – a 367.1 percent increase (comparable to 8.5 percent compounded annually). Because rising revenues from property taxes have increased the share of school funding shouldered by local communities while decreasing the state share, some policy leaders are calling for the state to provide more money for public schools.

Although support for school finance reform in Texas is widespread and fueled by a variety of criticisms, there is currently little evidence of agreement on what reforms should be introduced,

or even how a new system of school finance should be constructed.

Given the geographic, demographic, and economic diversity of Texas, this is not surprising. The readily-apparent differences between school districts and the enormous size of a state system of public education diminish the likelihood of constructing a universal structure to effectively meet the diverse needs of Texas' children.

Despite such challenges, there is broad commitment for school finance reform evident among legislators, and even interest in using the finance system as a vehicle to introduce fundamental changes in public education.

Across the political spectrum, there is agreement on the four primary goals of school finance reform: higher student achievement, adequate funding for public schools, appropriate distribution of education funds, and tax reform.

Student achievement is clearly the foremost goal of school finance reform. Policy leaders recognize the urgent need to raise academic performance and eliminate achievement gaps between students groups.

Linking funding with educational outcomes will allow public schools to be held more accountable for all students to demonstrate high levels of academic achievement (effectiveness) and wise allocation of resources (efficiency). From around the nation, experts have identified ways the state can link school finance with the existing accountability system to build incentives for encouraging, supporting and rewarding effectiveness and efficiency.

Adequate funding is the second goal of reform. Public schools say more money is needed to provide the required program of instruction, and even more is needed to raise student performance

to the higher levels established by the new state assessments, new graduation requirements, and standards set by the federal *No Child Left Behind Act*.

The legislature has commissioned research to determine the cost of an adequate educational program. Assuming funding is related to educational outcomes, some policy leaders are seeking to determine the right amount of funding for public schools – with the underlying belief that more money is needed and costs can be determined.

This assumption has been challenged by two national experts: Dr. Caroline Hoxby (a professor of economics at Harvard University, who serves as a member of the House Select Committee on Public School Finance) and Dr. Eric Hanushek (professor of economics at Stanford University, who was invited to testify before a subcommittee of the Select Committee). Both experts cite the extensive body of scientific research, as well as their own research, demonstrating little or no relationship between education funds and student achievement.

In fact, when schools get new funds they generally do not invest money in core instruction – one of the few resources associated with student achievement.

Distribution of educational funds is another key goal of school finance reform. The redistributive aspect of the current school finance system is criticized by all groups. There is widespread support for a system that allows local communities to keep their local tax dollars in their schools, with fierce advocacy for financial equity between school districts that ensures all children have equal access to an “adequate” education.

Some policy leaders support student-centered

funding – improving schools by incorporating school choice into the school finance system. The effectiveness of school choice in improving public schools and student achievement is backed by scientific research. When competing with private schools for students, public schools improve student achievement significantly without additional spending.

Tax reform is by far the most contentious goal of school finance reform. It is also the goal that, if done wrong, can critically injure Texas' economy. Some are calling for increased taxes, and even new taxes, to increase funding for public schools. Others identify a “structural deficit” in the state tax system and call for a complete tax overhaul.

A variety of approaches to state tax “reform” have been suggested including:

- a personal income tax,
- a flat education tax,
- a business activity tax,
- a state property tax,
- expanding the sales tax,
- modified gross receipts tax,
- expanded franchise tax, and
- taxing video lotteries.

But Texans must carefully consider any changes to the way revenues for education are collected. School finance is intimately related to the state economy, with taxes having a direct impact on capital investment, job creation, and personal income.

Generally, states experience a negative relationship between taxation and economic growth. An income tax has the most adverse impact on state economies, bar none. States with income taxes have less capital investment and personal income declines.

The average Texan has a good understanding

of income taxes; a voter survey conducted in June 2003 by Baseline and Associates indicates only 19 percent favored adoption of a state income tax.

In the recent economic downturn, states relying heavily on income taxes have experienced more fiscal difficulties than states, like Texas, that are primarily reliant on sales taxes.

If the standard of adequacy for a state tax system is to track growth in adjusted gross income and gross state product, Texas' tax system is adequate, according to testimony provided by the Texas Taxpayers and Research Association to the 78th Legislature's Joint Select Committee on Public School Finance. The current tax system generates more than enough revenue to keep pace with the growth in education costs caused by enrollment and inflation.

In practice, however, the amount of money spent on public education is not fully related to enrollment and inflation, but rather tracks how much money the tax system is able to raise. In other words, *the cost of public schools is historically whatever money is available.*

This is not to say Texas' tax system could not be improved. Equalizing the corporate tax burden, and making the corporate tax burden commensurate with the educational benefit that businesses derive from public schools, would provide economic benefits for all Texans.

Close examination of the school finance debate indicates two fundamental problems.

The first problem is spending.

Texas public schools spend whatever amount of money is available without discernable progress toward state education goals – preparing students for higher education or skilled employment.

There is no real evidence that Texas public schools need more money, and certainly no

evidence more money would improve their performance. Absent the need to increase public education funding, there is no real reason for significant tax reforms.

The second problem is productivity.

Texas public schools are not meeting public expectations for student performance or school completion. The way Texas funds public education today does not recognize or reward schools for educational quality, equity and efficiency.

Nor does the finance system provide schools with incentives or assistance to achieve these goals.

Texas needs a results-based system of school finance that links funding with educational performance. The state must develop a system that focuses public schools on end-goals; something that is not currently done.

This effort will challenge Texans to clearly define what public schools should accomplish, and what our taxes should fund. A results-based school finance system will allow Texas to create the most efficient, most equitable and most adequate system of education in the nation.

School finance reform offers all Texans a tremendous opportunity to improve the quality of public education for generations to come.

Chris Patterson is director of research for the Texas Public Policy Foundation. She is the editor of the Foundation's latest report, Putting the Sides Together, a compilation of authors examining the issue of public school finance in Texas.

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Telecommunications

An examination of how archaic rules and regulations are stifling innovation.

Medicaid Reform

A look at how to curb costs while still improving services to the neediest of Texans.

Pass It On: Telecom Matters

By Kent Lassman

Children can teach us the darndest lessons. Have you ever witnessed a group of children playing a game of telephone? One child whispers a message to a second. The second child whispers to a third until the message has been passed in this fashion to an entire group. Without fail, the message becomes confused oftentimes with hilarious results.

The rules of the game are designed to sow confusion. A long line of relays, *sotto voce* transmissions, a gaggle of giggling children and a perverse incentive for each child to mangle or tangle the words just a bit in order to make the message more fun without raising doubts of the listener. The rules that bind participants' behavior – the rules of the game, if you will – are of paramount importance.

In children's games, just as in vital sectors of the economy, the lesson holds: rules matter.

By logical extension, we typically take great care with the development of rules for the important parts of our life. The rules of the road govern driving; there are stacks of books and legal precedent to explain the rules of contracts.

However, policymakers in Austin do not always make the connection between the laws and regulations that govern communications and the relative importance that communications technologies have in the lives of Texans.

Quite simply, communications and information technologies matter a great deal to Texans and as a result the legal rules are also very important. In the marketplace, unlike in a game, good rules provide clarity and incentives for good behavior.

Readers of a journal like *Veritas* might be

inclined to examine the economic import of sectors like telecommunications, computing and software. There is no doubt that the strong productivity gains in the national and regional economy are tied closely to both the advances in communications technologies and in the adoption of more networked systems into the workplace.

Workers today accomplish more than ever before. How?

Through the innovation that results in desktop computers replacing the typewriters in an office pool and deliveries that are tracked with global positioning satellites and wireless inventory systems rather than with carbon paper and a clipboard. The effect is better and lower-cost products and services for consumers.

While connectivity is certainly found in the Internet and other computer networks, plain old-fashioned telephone networks are also a key ingredient to economic growth.

Important information is exchanged and agreements are made over the telephone before we engage in a wide range of buying and selling. Everything from placing an advertisement in the local paper to ordering a pizza for dinner is handled more efficiently and with less cost on the telephone rather than in person.

There are more than 13 million traditional telephone lines served in Texas. In addition, there are millions of subscribers to wireless services. Now more than ever, consumers are cutting the cord and taking their communications services with them wherever they go.

As of the third quarter in 2002, more than one quarter of personal, non-business calling minutes in the United States was done on mobile phones. Altogether, more than 600 billion wireless minutes were used last year across the country.

One reason for this shift is certainly the ability of technologies to meet consumer demands.

But a second, important explanation is the relative difference in the regulatory burdens placed on the two types of telephone service.

Wired telephone calls are regulated by the state *and* the federal government.

Wireless, on the other hand, has neither the same type of price controls or regulatory barriers to entry and exit of the marketplace. Similar discrepancies exist when other technological platforms are compared.

Cable, satellite, and wireline or wireless telephone services are each regulated and taxed in wildly different ways despite the fact that they are all communications services and they all help Texans collect and share the information necessary to help the economy grow.

Understanding the essence of communications policy economics cannot be found exclusively in the numbers. Productivity figures, tele-density numbers, penetration and roll-out rates, as well as capital investments are all interesting data but they only explain the prevalence of communications technologies in our lives.

From the way most citizens interact with their government to the way we work, learn, play, travel, keep in touch with loved ones and even, in some cases, the way we worship, all are affected by digital communications technologies.

At the end of the day, economic data only reinforces common sense.

Communications policy is relevant because communications technologies are part of the fabric of our lives.

Therefore, when we apply the lesson about the importance of rules we must recognize that the development of modern, market-oriented

communications policies will affect and improve the lives of all Texans.

A second perspective to bring to the question is a straightforward public policy analysis. Do our laws and regulations provide the results that we want?

Many close observers of telecommunications policy would say no.

As one friend likes to explain, a person does not have to be an expert in the intricacies of telecommunications law to understand that this area of law and regulation is among the most dysfunctional of all in the public square. There are inherent contradictions, overlapping and unclear jurisdictions of authority, widespread entry into the private marketplace by public entities, steep excise taxes on services that policymakers seek to encourage, and uneven regulatory burdens across different technologies that provide similar services.

An optimist might go so far as to suggest communications policy is the area where the most good can be done because of the widespread effect of the policies – they reach everyone in most aspects of our lives – and because of the high degree of state intervention in the marketplace.

Each of these perspectives – economic and public policy analysis – is removed at least one step from individual consumers. The focus is typically on either the numbers or the law. But it is worth peeling back a layer to focus on individuals and their use of technologies like computing and telecommunications to see a moral case for more freedom in the marketplace for communications.

Markets allow individual consumers to make voluntary exchanges – my money for your product or my labor for your money – based on their own preferences. As a precondition, the rules that

govern the marketplace where we exchange valuable communications must respect individuals as sovereign and dignified decision makers.

The alternative would be to eliminate voluntary exchanges and to coerce people into state-preferred or centrally planned outcomes. By definition, communications technologies empower individuals with new and useful information.

Perhaps the most valuable information to the marketplace is found in prices because they allow individuals to cooperate.

Prices coordinate information from producers and consumers throughout the economy. They transmit information about quality, reputation and shortages. They also provide incentives to adopt the least costly means of production.

At the end of the day, the economy flourishes when price information moves readily and with minimal costs. Communications networks – and the policies we adopt for them – are a principle determinant in how costly it is to move the vast amount of information necessary for a modern economy.

The effect of communications law is ultimately on the quantity and quality of consumer choices.

The changes that began in information technology decades ago continue to cascade quality of life improvements throughout the economy.

Likewise, new technologies – from instant messaging to voice over the Internet to satellite radio services – challenge our policymakers to keep pace.

As long as government rules and regulations set prices, determine which firms are allowed to offer services to various consumers and fail to create the proper incentives for investment, Texas consumers are unnecessarily disadvantaged.

Unlike in the games that children play, there are very high stakes for the outcome of the rules made in Austin that shape the communications marketplace.

Healthy and vibrant communications networks are essential to attract capital, to promote research and to develop new goods and services in Texas.

Scientific and technological advances are strong drivers for progress. And, the measure of progress, of course, is the advance of liberty and freedom.

Kent Lassman is a research fellow at the Progress & Freedom Foundation, a market-oriented think tank that studies the digital revolution and its implications for public policy. The views expressed here are his own and do not necessarily represent the views of the Progress & Freedom Foundation, its Board of Directors, officers or staff.

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The Business of Government?

By Wendell Cox

From trash collection to telecommunications and printing to parking, Texas' local governments are bucking an international trend. Unfortunately, in this case that's nothing of which to be proud.

Today, Texas governments compete with the private sector in a number of consumer markets, producing services similar to those already commercially available.

While foreign governments have been steadily withdrawing from economic regulation and involvement since the 1980's, the commercial activities of governments in Texas and other states are expanding. There's a high cost to be paid when government competes with the private sector.

Economic efficiency is the biggest problem, not surprisingly. Government-run enterprises are neither as responsive nor cost-effective as private industry. The mindsets and bureaucracies needed to do one are rightly different from the other. Just as businesses shouldn't govern, neither should local government compete in the market.

When governments duplicate what is provided in the competitive market, government pre-empts competition, stifles entrepreneurial opportunity, destroys economic growth, and raises the price of doing business.

And every taxpayer pays the price.

Many will argue local governments currently providing these commercial services are doing so at a lower rate than "profit-hungry" corporations.

While the price-tag for the product might be visibly lower, consumers – taxpayers – pay extra when government is involved in business. This happens because taxpayers subsidize the tax-

exempt government “businesses,” eliminating the market incentives that produce economic efficiency and greater wealth for both buyers and sellers.

Texas government intrudes in all private industries, but most particularly in telecommunications – even though Texas’ Public Utilities Code strictly prohibits municipalities from providing telephone service. Indeed, a number of Texas communities are improperly providing internet service and fiber optic cable leasing – it’s improper because these services are widely available in the competitive marketplace.

Governments have also muscled into the business of selling utilities. Approximately \$3 billion are generated annually in Texas by municipally-owned electric utilities. And there’s more. Texas communities are in the natural gas, water and wastewater and solid waste disposal businesses.

Day-in and day-out, Texas governments are competing with private companies in a multitude of businesses: emergency medical services, natural gas supply, parking lots and golf courses, as well as airports, seaports, toll-roads, public transit, corrections facilities and convention services.

The businesses operated by Texas governments now command a sizeable segment of the commercial market. It is conservatively estimated that all Texas governments receive more than \$11 billion in revenue from consumer markets and spend \$8 billion annually on support services for which there are well-developed commercial markets.

Thus, government competition in Texas accounts for nearly \$20 billion, the equivalent of three percent of Texas’ gross state product.

Government business is bad business for

Texans. Many government services, such as public transit and school busing, can be provided more cost-effectively through competitive contracts with the private sector. Electric, gas and other utilities could be sold to the private sector, with proceeds used to balance local budgets or even provide a dividend to taxpayers. Each represents a community asset that can be converted to cash and less expensive service could be provided to consumers by private companies.

We should forbid government from entering the competitive market as a first principle; never should the brute force of government be allowed to bully its way into the marketplace.

For those markets in which government has already intruded, we must find ways to divest from the endeavor and allow competitive forces to operate in providing the services.

Finally, if government is going to compete in the marketplace, it should do so under the same tax-impositions and regulatory requirements as private industry.

Public policy in Texas should always favor marketplace competition over government-run business endeavors. Texas can improve the economic vitality of the state by taking government out of the business of business.

Wendell Cox is a senior fellow for the Texas Public Policy Foundation. He is principal of Wendell Cox Consultancy and a visiting professor at the Conservatoire National des Arts et Metiers in Paris.

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