

TEXAS PUBLIC POLICY FOUNDATION

2009-2010
LEGISLATORS'
GUIDE TO THE
ISSUES

Texas Public Policy
FOUNDATION



“*Underlying most arguments against the free market is a lack of belief in freedom itself.*”

~ MILTON FRIEDMAN

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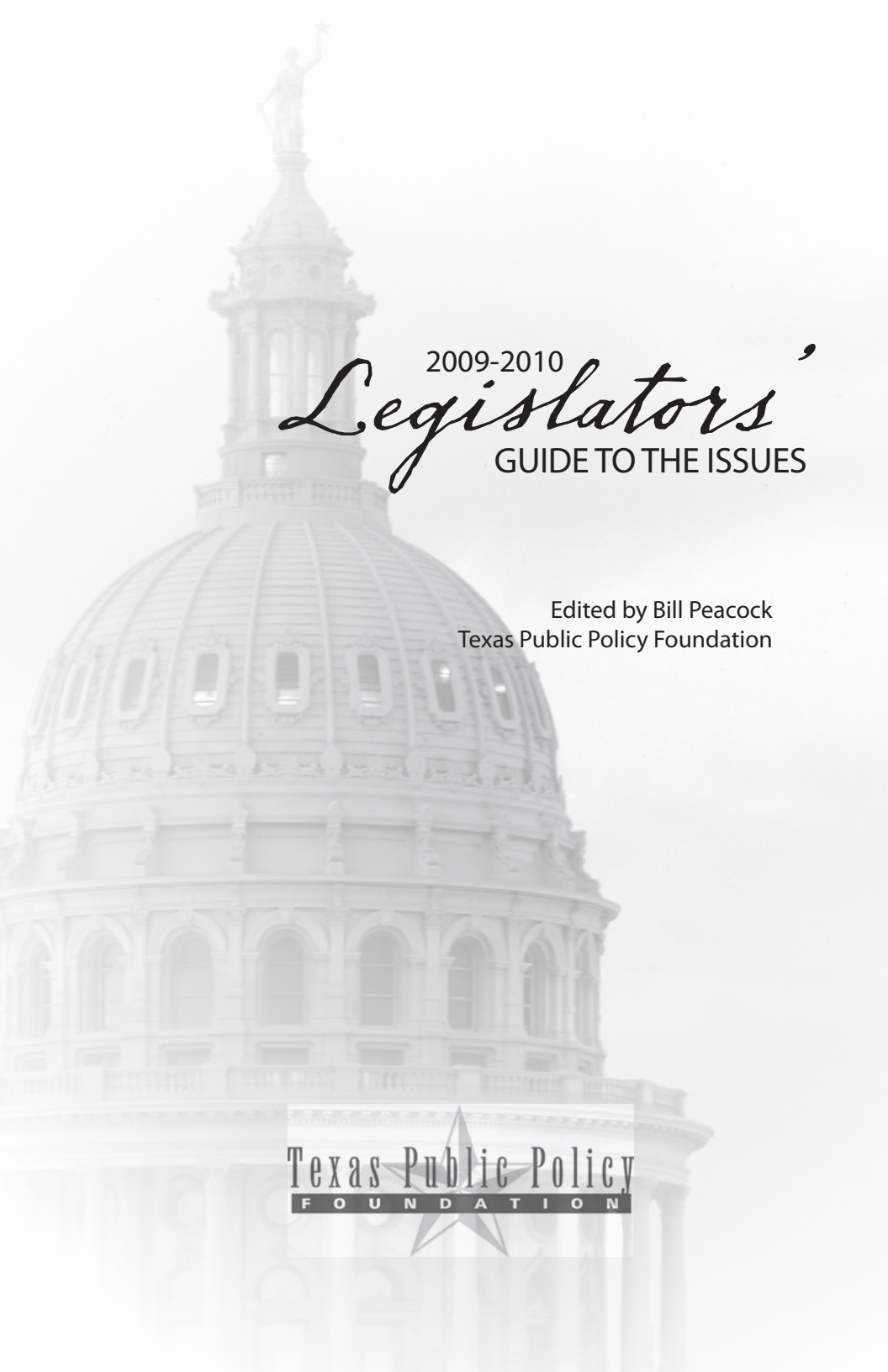
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2009-2010

Legislators'
GUIDE TO THE ISSUES

Edited by Bill Peacock
Texas Public Policy Foundation



Texas Public Policy
FOUNDATION

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“Life, liberty, and property do not exist because men have made laws. On the contrary, it was the fact that life, liberty, and property existed beforehand that caused men to make laws in the first place.”

~ FRÉDÉRIC BASTIAT

As the 2009-10 edition of our popular *Legislators' Guide to the Issues* goes to press, the Foundation is celebrating the 96th anniversary of Milton Friedman's birth.

If Dr. Friedman stood for anything, it was freedom. Like Bastiat, Friedman understood that life, liberty, and property are the cornerstones of freedom. In his book, *Free to Choose*, he says we must “understand the intimate connection between political freedom and economic freedom.”

That connection is too often overlooked today. Economic regulation is based on ignorance of the fact that “if an exchange between two parties is voluntary, it will not take place unless both believe they will benefit from it. Most economic fallacies derive from the neglect of this simple insight, from the tendency to assume there is a fixed pie, that one party can gain only from the expense of the other.”

Friedman continues, “If we continue down this path, there is no doubt where it will end. . . . If it is appropriate for the government to protect us from using dangerous bicycles and cap guns, the logic calls for prohibiting still more dangerous activities such as hang-gliding, motorcycling, and skiing.”

Back in 1980, Friedman was optimistic that we would avoid this end.

He concluded his book by writing, “Fortunately, we are waking up. We are again recognizing the dangers of an over-governed society, coming to understand that good objectives can be perverted by bad means, that reliance on the freedom of people to control their own lives in accordance with their own values is the surest way to achieve the full potential of a great society.”

We look forward to working alongside Texas policymakers and all Texans to build a future of freedom in the Lone Star State.



Taxes

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The Issue

Entrepreneurship and innovation characterize a vibrant Texas economy growing in spite of a national economic slowdown. Acting with fiscal discipline, state government has helped to create an investor-friendly economy that has elevated Texas to a place of national leadership. A fundamental part of the state's success has been the lack of a state personal income tax. Yet, big government advocates continually suggest taxpayers bear this extra burden.

Income tax proponents claim that the current tax structure fails to provide sufficient revenue for needed state expenditures. While it's true that a broad-based personal income tax has the potential to enhance short-term revenue performance, its destructive long-term impact creates disincentives for job creation, capital investment, and wage gains. This "triple-play" on Texas' economy would reverse all anticipated revenue gains and devastate prospective growth.

At a loss of 20,000 per day, current research shows taxpayers flee states with a personal income tax for one of the nine states without—further harming the economy. During the 1990s, a total of three million taxpayers voted with their feet by relocating to more income-friendly locations.

Encouraging government expansion through the creation of additional revenue sources will hurt the Texas economy. Studies consistently show that the size of government increases at a faster rate in states that tax income than states without this type of tax. Even though wages and income grow temporarily, the elasticity of the income tax allows government to increase spending permanently.

Empty promises of revenue increases based on higher taxes have been woefully misrepresented. Creating disincentives for work and productivity have never been realistic methods to maximize economic growth or remain globally competitive.

The Facts

- ★ Income taxes damage a state's economy more than any other tax because it creates disincentives for capital investment, productivity, job creation, wages, and economic expansion.
- ★ Texas is one of nine states that does not currently levy a personal income tax. Two of these states—New Hampshire and Tennessee—do tax dividends and interest income, but not income from labor.
- ★ Income taxes encourage government spending to increase at significantly higher rates as compared to states without an income tax.

- ★ Twelve states that implemented income taxes during 1957-1999 experienced an average 37.2 percent overall increase in taxes compared to 10.5 percent in states without income taxes.
- ★ Despite claims by income tax advocates that the current tax structure is progressive in nature, all taxes ALWAYS more negatively affect those with low incomes.

Recommendations

- ★ Prevent the creation of a broad-based personal income tax in Texas.
- ★ Lower the overall tax burden facing Texans to stimulate further economic growth.

Resources

- *Taxes Do Matter* by Michael Sullivan, Texans for Fiscal Responsibility (Feb. 2008) <http://www.empowertexans.com/node/433>.
- *Taxing Texans Part 1: The Worst Tax for Texans?* by Richard Vedder, Texas Public Policy Foundation (Feb. 2002) <http://www.texaspolicy.com/pdf/2002-02-28-tax-taxingtexans1.pdf>.
- *Taxing Texans Part 2: The Effect of Taxes on Economic Growth* by Richard Vedder, Texas Public Policy Foundation (Mar. 2002) <http://www.texaspolicy.com/pdf/2002-03-29-tax-taxingtexans2.pdf>.
- *Texas Tax Reform May Lighten Your Wallet* by Richard Vedder, Texas Public Policy Foundation (Oct. 2001) <http://www.texaspolicy.com/pdf/2001-veritas-2-3-wallet.pdf>.

The Issue

After several past productive regular and special sessions, Texas property owners anxiously await the arrival of the 81st Texas Legislature to see how lawmakers will provide additional property tax relief. Even though property taxes have always been a “hot-button” issue in the state, recent meteoric increases in appraisal values and taxation levels have made this subject particularly pressing this biennium.

As the property tax burden grows, more and more Texans are becoming frighteningly aware of how quickly their money is being spent on growing government expenditures. In fiscal year 2006, school property tax collections—which represent nearly 60 percent of all local revenue—increased 4 percent higher than the previous year alone. Even with appraisal and revenue caps, tax bills are rising faster than taxpayers can reasonably afford.

Generally, school property taxes represent the bulk of property tax bills with county, city, and special taxing units collecting the rest. However, taxes collected by the city, county, and special taxing units have a rational basis in that property ownership can be directly related to a demand for services from these entities. Property taxes collected for educational purposes have less of a rational basis because the value of real property owned bears little relationship to the demand for these services.

Complicating the matter are repeated lawsuits and litigation surrounding the tax system’s structure. Until recently, property value inequalities throughout the state and the Edgewood court decisions created the need for a “Robin Hood” school funding system. However, since the Texas Supreme Court ruled this system to be the unconstitutional equivalent of a statewide property tax, lawmakers have been hard-pressed to find a suitable alternative.

For these reasons—the lack of a rational link between school property taxes and educational services, the substantial school property tax burden, and the constitutional complexities surrounding the school property tax—many believe it is time to dramatically reduce, if not eliminate, property taxes altogether.

Many Texans familiar with the property tax structure point out that if the growth in state-funded expenditures were limited to the sum of population growth and inflation, and if school expenditures were similarly limited, the school M&O property tax could be reduced to zero within two decades. Using future surplus windfalls for property tax reductions would help the Texas Legislature achieve this goal even faster.

The Facts

- ★ From 1996 to 2005, Texas local governments saw a 95 percent increase in property tax collections.

- ★ For fiscal year 2006, Texas' 3,758 taxing units levied over \$35.5 billion in property taxes—a 6.2 percent increase over the previous year.
- ★ School district taxes accounted for 58.8 percent of all property tax bills issued.
- ★ Even though school tax rates decreased by 11.8 cents in 2006—as compared to 2005—actual levy collections increased \$725 million because of a 12.5 percent rise in property values.
- ★ In fiscal year 2005, Texas ranked 13th in per capita local property tax collections at \$1,325.

Recommendations

- ★ Use future state surpluses to fund reductions in school M&O property tax rates.
- ★ Make property tax rate reductions more substantial by implementing stricter expenditure limits at the state and local levels.
- ★ If any tax is increased in order to reduce property taxes, it should be the sales tax; no other tax should be created or increased for the sake of property tax relief.

Resources

- *Effective, Efficient, Fair: Paying for Public Education in Texas* by Richard Vedder and Joshua Hall, Texas Public Policy Foundation (Feb. 2004) http://www.texaspolicy.com/experts.php?auth_id=8.
- *Putting Taxpayers in Charge of Their Tax Bills* by Byron Schломach, Texas Public Policy Foundation (July 2007) <http://www.texaspolicy.com/pdf/2007-TEL-Report.pdf>.
- *State Spending—Still Growing and Growing* by Byron Schломach, Texas Public Policy Foundation (Mar. 2007) <http://www.texaspolicy.com/pdf/2007-03-PB14-TXspending-bs.pdf>.
- *The Case for Converting from Property Taxes to Sales Taxes* by Talmadge Heflin, Texas Public Policy Foundation (Mar. 2008) <http://www.texaspolicy.com/pdf/2008-03-PB04-propertytaxes-th.pdf>.

The Issue

For over two decades, sales taxes have been an important source of revenue for Texas government. The sales tax offers a number of unique advantages to both taxpayers and government, including: simplicity, transparency, equity, and a limited impact on the free market.

Since a conventional sales tax only charges the end-user, the system is relatively simple to administer. Businesses are only required to add the sales tax to the goods or services being purchased and then turn the proceeds over to government. This minimizes the need for additional bureaucracy and frees business owners from otherwise time-consuming paperwork. As a result of the tax's simplicity, compliance rates are typically much higher with the sales tax.

Taxpayers also benefit from the system's transparency. After each purchase, every consumer is provided with a receipt that clearly shows the amount of sales tax paid in addition to the price of the actual good. Manipulating the tax without public knowledge is virtually impossible meaning that government cannot arbitrarily raise tax rates without public consent.

Another important feature of a well-designed tax system is equity. Sales tax equality can be measured in two ways: horizontally and vertically. First, a tax is considered horizontally equitable if taxpayers with similar incomes pay comparable taxes. Since any two consumers purchasing the same good(s) pay the same tax, the sales tax easily achieves this measure. Vertically equity is achieved when the tax burden increases proportionally with income. In other words, the more money you make and spend, the more you pay in taxes. Many critics commonly cite this as a major flaw of the sales tax; however, our research shows that "progressive" tax policies damage a state's economy. In turn, the poor and middle class are left with fewer employment opportunities, lower wages, and a lower standard of living.

An ideal tax system raises needed revenue while minimizing market distortions and can be uniformly applied to a broad base. Put another way, the best tax system is the one that does not change consumer behavior or discourage private investment and taxes everyone equally. Limiting the amount of government in free market activity will create the kind of economy that benefits citizens at every income level because it will allow the private sector to create opportunities and become more productive.

Critics will often argue that Texas' sales tax revenue has not kept pace with the growing needs of its citizens—and they are partly right. Unbridled state expenditures have typically grown faster than sales tax revenue. However, a closer look at Texas government shows that the state doesn't have a revenue problem so much as it has a *spending* problem. Reigning in government spending is critical to maintaining both a healthy economy and a reasonable tax system.

The Facts

- ★ Sales taxes offer a system that is simple, transparent, fair, and causes the least amount of economic damage.
- ★ Since the sales tax only penalizes personal consumption, job creation, private investment, and wage gains are not significantly affected.
- ★ Only five states—Alaska, Delaware, Montana, New Hampshire, and Oregon—have no sales taxes.
- ★ Nineteen states don't allow local governments to levy their own sales taxes. Of those states that do, Chicago, IL has the highest total sales tax rate at 10.25 percent.
- ★ Texas has an above-average state sales tax rate at 6.25 percent and a local option of adding up to 2 percent.
- ★ Texas' active business climate has been bolstered by the state's reliance on the sales tax.

Recommendations

- ★ Texas government should continue to rely on state income from the sales tax; however, if it deems the revenue stream to be insufficient, the Legislature should broaden the base.
- ★ Due to the high property tax rates faced by taxpayers compared to other states, the legislature should consider lessening the property tax burden by widening the base of goods and services subject to the sales tax.
- ★ 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) <http://www.texaspolicy.com/pdf/2008-03-PB04-propertytaxes-th.pdf>.
- *Tax Policy and Economic Growth in the States* by Barry W. Poulson and Jules G. Kaplan, Texas Public Policy Foundation (Oct. 2007) <http://www.texaspolicy.com/pdf/2007-10-PP26-poulson.pdf>.
- *All Taxes are Not Created Equal* by Byron Schломach, Texas Public Policy Foundation (Mar. 2006) <http://www.texaspolicy.com/pdf/2006-02-PP-consumptiontax-BS.pdf>.

The Issue

When government levies a tax on a business, it does more than take money away from a company. Investment returns for shareholders are reduced; wages remain flat or are lowered to make up for the financial loss; and consumers are forced to pay higher prices for the products they need. In short, everyone is made poorer by higher taxes.

Nevertheless, taxes are a necessary “evil” since they pay for certain activities that only government can provide. The task then becomes identifying how much a state should collect in taxes and the most appropriate type of tax to apply.

Taxes, or the lack thereof, influence human behavior and the choices an individual makes. The greater the tax burden on a particular product or service, the more people will strive to avoid that particular activity. For example, income taxes penalize wage growth, so labor has less incentive to work harder. Property taxes penalize the ownership and improvement of property and, as a consequence, property owners are dis-incentivized from developing their own homes and businesses. But business taxes are especially harmful because they directly tax productivity.

The wealth and prosperity of every modern society is based on its productivity. Generally, the more industrious people are, the more goods and services they are able to produce. This in turn leads to job creation, wage gains, and capital investments which benefit the entire community. When government taxes business activities, it directly reduces all benefits earned by a productive society by removing money that the private sector would otherwise spend and/or invest.

In Texas, the state’s business climate has deteriorated slightly because of the new margins tax. Created as a 1 percent levy on every dollar a business handles, state government is expected to collect over \$12 billion dollars during the biennium—about twice as much as the old tax. This new tax has been particularly harmful to small businesses and entrepreneurs because they are forced to pay taxes even though they might not have made a profit. As a result of the increased tax burden, the Tax Foundation estimates that Texas’ business climate now ranks 8th nationally—down two positions from its 2007 ranking. Although the decline might appear minor, in today’s highly competitive global environment, labor and capital are extremely mobile and government should be aware that its actions are being closely monitored by the private sector.

The Facts

- ★ A business tax directly affects private sector productivity.
- ★ Private sector productivity is critical in creating jobs, wealth, and capital investment.

- ★ The margins tax is part of a trio of tax reform legislation passed last session that includes tobacco taxes and the “liar’s affidavit.”
- ★ The margins tax is expected to generate over \$12 billion in state revenue during this year and the next; essentially, doubling what the franchise tax brought in.
- ★ Texas is the only state in the nation with this type of tax.

Recommendations

- ★ The margins tax should be immediately eliminated.
- ★ Lost state revenue should be replenished using the “rainy-day” fund or with changes to the sales tax rate or application.
- ★ The Legislature should continue to use any revenues from the margins tax above that of the old franchise tax to provide property tax relief.

Resources

- *Tax Pyramiding: The Economic Consequences of Gross Receipts Taxes* by Andrew Chamberlain and Patrick Fleenor, The Tax Foundation (Dec. 2006) <http://www.taxfoundation.org/files/sr147.pdf>.
- *All Taxes are Not Created Equal* by Byron Schломach, Texas Public Policy Foundation (Feb. 2006) <http://www.texaspolicy.com/pdf/2006-02-PP-consumptiontax-BS.pdf>.
- *2008 State Business Tax Climate Index (Fifth Edition)* by Chris Atkins and Curtis S. Dubay, The Tax Foundation (Oct. 2007) <http://www.taxfoundation.org/research/show/22658.html>.
- *Phone Company Sends Message: Remit Payment for Services and Taxes* by William Ahern and Curtis S. Dubay, The Tax Foundation (Feb. 2007) <http://www.taxfoundation.org/commentary/show/2208.html>.



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The Issue

After several years of abusive government spending practices in the late 1970s, Americans across the country staged a “taxpayer revolt” to change the mindset of legislators everywhere. Shortly thereafter, Texas taxpayers lent their own voice to the cause by ratifying the *Texas Tax Relief Act of 1978*: a Tax and Expenditure Limit (TEL) designed to limit state spending to growth in the state’s personal income, except in emergencies. Regrettably, however, the amendment’s authors built in several loopholes that have allowed government to continue growing well beyond the measure’s original intention.

By directly tying state expenditures to taxpayers’ ability to pay for them, it was hoped that Texans would be shielded from hefty increases in state spending resulting in large tax increases. However, the TEL was designed to only limit the growth of non-dedicated tax revenue. Revenue from other sources—federal funds and non-tax proceeds (i.e., fees, fines, etc.)—does *not* count towards the TEL and these funds can be spent without limitation. Since non-dedicated tax revenue represents only half of all state spending, the TEL’s ability to control the total growth of government has been severely handicapped.

The Texas TEL is further weakened by the measurement the state uses to calculate its spending limit. By “dividing the estimated Texas total personal income for the next biennium by the estimated Texas total personal income for the current biennium,” the LBB projects the state’s rate of growth to determine the maximum amount the Legislature can spend. However, total personal income is an expansive and inaccurate measure of economic prosperity because it can be skewed by a relatively small number of affluent individuals. This can result in a growing government burden on a population that is not necessarily prospering. A more responsible alternative to the total personal income measurement is to limit total state spending to the sum of population and inflation growth.

In addition to its other design flaws, the constitutional spending limit has failed to control government spending. There are no provisions allowing lawmakers to look back at the accuracy of the adopted growth rate and make adjustments when the rate adopted was higher than actual growth. The long term effect is the same as if the statute were disregarded altogether. Furthermore, with only a bare majority of the Texas Legislature required to overrule the appropriations limit, political will is the only force hindering further government growth.

Thirty states currently have some form of tax and spending limit used to control government spending. Of these, Colorado’s Taxpayer Bill of Rights (TABOR) has been the most successful at limiting the growth of government and encouraging private investment. As the nation’s strictest state and local spending measure, Colorado’s economy has come to national prominence in a matter of just a few short years and has demonstrated how a state can flourish when it prioritizes its spending needs.

The Facts

- ★ Eighty-four percent of voters overwhelmingly cast their ballots in favor of the *Texas Tax Relief Act of 1978*, demanding government control its spending.
- ★ The Texas TEL applies to only half of the state budget and does not include local government expenditures.
- ★ Spending caps are based on biennial growth projections in personal income rather than the sum of population and inflation increases.
- ★ The Texas TEL fails to adequately limit expenditures because it can be easily avoided with enabling legislation.
- ★ Thirty states currently have a TEL in place, with Colorado's TABOR considered the most effective.
- ★ States with effective spending limitations experience lower tax increases in periods of recession than states without such limitations.

Recommendations

- ★ Reform the state's current TEL to apply to expenditures made from *all* state revenue.
- ★ Use the sum of population and inflation increases to base future state spending instead of growth in total personal income.
- ★ Enact an expenditure limit for *local* governments, limiting expenditure growth to inflation plus the growth of the population they serve.

Resources

- *Taming the Leviathan: Are Tax and Spending Limits the Answer?* by Dean Stansel, the CATO Institute (July 1994) <http://www.cato.org/pubs/pas/pa-213.html>.
- *The Texas Tax Relief Act in Retrospect* by David Hartman, Texas Public Policy Foundation (Fall 2000) <http://www.texaspolicy.com/pdf/2000-veritas-1-3-taxrelief.pdf>.
- *State Tax and Expenditure Limits—2005*, National Council of State Legislatures (Feb. 2006) <http://www.ncsl.org/programs/fiscal/tels2005.htm>.
- *Summary of Recommendations to the 80th Texas Legislature*, Texas Conservative Coalition Research Institute (Jan. 2007) <http://www.txccri.org/publications/80thSummaryRecommendations.pdf>.

The Issue

Every two years, Texas legislators are given the opportunity to decide how to best use limited taxpayer resources. Since public funds are finite and the demand for government is not, lawmakers must be vigilant in how they choose to use tax dollars. For every tax dollar the state allocates to one area of the budget, it loses the ability to spend it in another area.

Determining how much money and where to spend it has been anything but consistent in the state's budget development. There are constant pressures to add new programs not worthy of public funding to the budget or keep old programs that have outlived their usefulness. The end result is that government grows unnecessarily, tax dollars are wasted on bad programs, and taxpayers become discouraged with the system.

Developing a clear set of legislative spending priorities is crucial in evaluating the state budget in such a way that ensures taxpayer money is spent to achieve the greatest results with the least amount of resources. To begin setting funding priorities, there are fundamental questions lawmakers must answer.

First, lawmakers should ask themselves whether or not a program/agency should exist. To answer this question, legislators should evaluate each entity according to four criteria:

- *Clarity*: Does the program/agency clearly benefit everyone?
- *Consistency*: Do the goals of the agency match the goals of the state?
- *Necessity*: Can only the government fulfill this obligation?
- *Profitability*: Are the costs of a program outweighed by the benefits?

Should the answer to any one of these questions be no, then lawmakers should withhold funding. However, once worthy government programs and agencies have met this criteria, then legislators can begin determining the order in which agencies should receive *limited* funding by asking:

- Does the program/agency protect private property?
- Does the program/agency protect liberty?
- Does the program/agency enhance private enterprise?
- How difficult is it to measure the performance of a program/agency?
- How well does a program/agency's performance compare to others?
- How has the program/agency performed over time?
- Is there evidence that continued or increased funding will maintain or significantly improve outcomes?
- Are the general benefits of a program evenly distributed across the state?

- Does a program or agency exist only for the sake of gaining federal funds?
- Is the program/agency's existence owed to the fact that other states fund similar programs?

The Facts

- ★ The Texas Legislature has no clear, consistent budgeting principles in place to determine spending priorities.
- ★ Expenditure levels in the budget appear to be linked to whether or not federal funds can be gained from additional state spending.

Recommendations

- ★ Adopt a set of budgeting principles to guide budget decisions.
- ★ Do not fund a program/agency merely because it has received funds in the past.
- ★ Do not fund a program/agency simply to gain “free” federal funds—nothing from the federal government is ever free!
- ★ Fund only those functions which benefit all Texans.
- ★ The benefits of a program or agency must clearly outweigh its cost.

Resources

- *Principles for Determining Budget Priorities* by Talmadge Heflin and Byron Schломach, Texas Public Policy Foundation (July 2006) <http://www.texaspolicy.com/pdf/2006-07-PP-budgetpriorities-bsth.pdf>.
- *State Spending—Still Growing and Growing* by Byron Schломach, Texas Public Policy Foundation (Mar. 2007) <http://www.texaspolicy.com/pdf/2007-03-PB14-TXspending-bs.pdf>.
- *Four Principles of Budget Process Reform* by Brian M. Riedl and Alison Fraser, The Heritage Foundation (Apr. 2004) <http://www.heritage.org/Research/Budget/bg1746.cfm>.

The Issue

Public programs originate because the community identifies a need that the free market is either unable or unwilling to fill and government intervention is required to meet the demand. All too often, however, the demand for a particular public good or service is outlived by the program established to address the issue. So how do taxpayers decide if their money is being spent wisely on the right goods and services for their community?

Answering this question may seem like a simple and intuitive task, but for many years government has failed to do so. Gauging the value of public activities is often an ambiguous process that wrongly measures success by the resources used or quantity of goods/services produced. Simply because a public entity can produce a particular good or service does not mean it necessarily should—or that it has any intrinsic value. Ideally, the value of a government program should be determined by *measurable* results to enhance accountability and ensure efficient use of public resources.

Since resource allocation is key to an efficient government, agencies must be held accountable for the funds they use. Performance measurements are tools that are available to legislators to evaluate government programs; but, not all performance measures are equally important. Outcomes—the actual results of a program or agency—can best help legislators connect a program’s success with the appropriations it receives and determine the true value of the goods and services it provides.

For example, a drug treatment program can measure how many patients it treats or it can measure how its program has affected patients’ susceptibility to relapses. The former measures activity, while the latter measures results. Current performance measurements used by the Texas Legislature place too much emphasis on activity and not enough focus on whether results are being achieved. Legislators should instead demand measures that better assess why a program receives funding and the results that funding has produced.

By establishing clear and effective outcome-based performance measures, public officials can benefit from improved evaluation techniques and increased public confidence. Programs monitored from the “bottom up” also benefit from leaner, more effective programs with specific goals. In this fashion, taxpayers can be re-assured that their tax dollars are being spent wisely and they’re receiving the most “bang for the buck.”

The Facts

- ★ Performance measures are included for every agency in the current budget format, but many of them are not true indicators of a program’s value.
- ★ No historical context for outcome and efficiency measures is included in the current budget format, lessening their value to legislators.

- ★ Few of the outcome and efficiency measures in the Texas budget measure output per taxpayer dollar.

Recommendations

- ★ Create an addendum to the current state budget that provides separate references to historical performance data.
- ★ Refocus performance data on outcomes rather than activities of agencies; current “outcome” measures mainly measure goods or services produced.
- ★ Create outcome measures that put accomplishment in the context of cost.

Resources

- *Demanding Performance Part I: State and Agency Missions* by Talmadge Heflin and Byron Schломach, Texas Public Policy Foundation (Aug. 2006) <http://www.texaspolicy.com/pdf/2006-08-PP-demandperformanceI-bsth.pdf>.
- *Demanding Performance Part II: Outcomes and Efficiencies* by Talmadge Heflin and Byron Schломach, Texas Public Policy Foundation (Sept. 2006) <http://www.texaspolicy.com/pdf/2006-08-PP-demandperformanceII-bsth.pdf>.
- *Restoring Government Integrity Through Performance, Results, and Accountability* by Virginia Thomas, The Heritage Foundation (June 2000) <http://www.heritage.org/Research/GovernmentReform/BG1380.cfm>.

The Issue

As the old saying goes “everything’s bigger in Texas,” and that’s certainly true when it comes to the state’s transportation infrastructure. Texas currently has over 305,000 miles of public road and more than 3,200 interstate miles—the single largest interstate network in the country. In the past, taxpayers alone have had to bear the cost of roadway improvements and new construction, but increasingly transportation officials are turning to public-private partnerships (PPPs) to help ease the financial burden.

PPPs are a collaboration of government and private interests pooling their talent and resources to achieve the same goal. In and around Texas, transportation PPPs have been very successful in reducing congestion while minimizing the use of tax dollars to finance big projects.

Used for decades in European countries, large-scale toll financing projects only recently gained popularity in the United States during the 1990s. Since the turn of the century, however, PPPs have gained momentum in Texas and 20 other states as a tool to fill the financing gap. Differing from traditional methods of transportation finance, PPPs have distinguished themselves for several reasons:

- Access to capital resources—As the cost of motor fuel and construction soar to new heights, major transportation projects are becoming out of reach for many state and local governments. To counter this trend, private investment is quickly turning into the only feasible option to raise the massive sums needed to build new transportation projects.
- Taxpayers share less risk—Given the poor financial track record of many public projects, taxpayers risk less when the private sector is responsible for construction cost overruns and revenue shortfall, in most cases. This results in fewer tax dollars being wasted and allows more public money to be appropriated to other high priority transportation projects.
- Better motorist experience—Since businesses are typically more customer-service oriented than government, motorists benefit from a better overall experience.
- Private-sector innovation lowers cost—Leveraging the innovation and ingenuity of the private sector has the potential to create a toll road system that is efficient and well designed. Consequently, the costs of construction and operation can be dramatically reduced while simultaneously expanding roadway capacity.

Critics of PPPs often cite a number of examples detailing the supposed shortcomings of PPPs. One overused illustration suggests that in the distant future toll fees will increase. These critics fail to mention, however, that salaries will also comparably rise. Another argument against PPPs suggests that these agreements will lead to private companies owning the roadways or government

“give-aways.” In truth, government owns all the roads; under PPPs, companies merely purchase the right to lease the roadways from government for a set amount of time.

Like all public policies, strategies for funding transportation can be well crafted or poorly designed; the end result depends on the conclusions lawmakers decide. Combining the oversight of the public sector with the resources and expertise of the private sector, PPPs are a tool that helps lawmakers achieve the greatest results at the least amount of risk to taxpayers.

The Facts

- ★ As of 2006, Texas has over 305,000 miles of public road, more than any other state. Of these roads, 221,587 miles are located in rural areas, while the remaining 83,683 miles are in urban areas.
- ★ The total amount of Texas commuters using public roads to travel to work in 2006 numbered 10,514,531.
- ★ In 2006, the average commuter traveled 24.6 minutes (one-way) to work daily.

Recommendations

- ★ Reprioritize transportation funding to focus more on projects where the greatest amount of growth is anticipated.
- ★ Make greater use of public-private ventures to bring in additional revenue for large-scale projects.
- ★ Continue to pursue toll road financing for expansion of the state's road network.
- ★ Ignore the temptation to toll existing roads.
- ★ Resist calls to increase the state motor fuels tax.
- ★ Discontinue the practice of diverting Fund 6 dollars to purposes other than the design, construction, and maintenance of roadways.

Resources

- *Agenda 2005: A Guide to the Issues*, Georgia Public Policy Foundation (2005) http://www.gppf.org/article.asp?RT=16&p=pub/Transportation/transportation_frontpage.htm.
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Energy and Environment

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The Issue

As the nation deals with high energy prices, how to achieve a reliable supply of affordable energy is a highly debated topic. Proposed and enacted solutions run from higher taxes and subsidies to mandated production from renewable sources such as wind, ethanol, and biomass. However, these all miss the mark. A long-term solution for securing affordable, reliable energy supplies must rely on a proper understanding of our current situation and market-based innovations.

Texas has prospered in recent years as its population and economy has grown. One reason for Texas' economic progress is the reliable and affordable supply of electricity available to meet the state's growing energy needs. Thus our continued economic growth, and the prosperity it brings and spreads, relies upon continued growth in available power.

Texas' deregulated electricity market—the most competitive market in the United States—provides Texas with the infrastructure needed to meet this needed increase in energy supplies. However, current or future environmental regulations, market regulations, or mandates/subsidies for different energy sources that undermine the market will threaten the development of the necessary energy resources.

The Facts

- ★ Texas' population of 23.5 million is projected to increase to 28 million by 2020 and 35 million by 2040.
- ★ The Electric Reliability Council of Texas (ERCOT) estimates Texas' electricity demand will rise 20 percent by 2015 and 43 percent by 2025.
- ★ Given growth projections and possible retirement of fossil-fuel electric generating plants, ERCOT estimates Texas may need up to 66,000 MW of new peak generation capacity by 2020, an 85 percent increase from 2005.

Recommendations

Developing Future Energy Supplies

- ★ Make the marketplace the mechanism for determining the future energy mix given the state's environmental policy—the state shouldn't be in the business of picking what technologies or fuels should power Texas' future energy needs.
- ★ Remove/avoid regulatory impediments that interfere with the transmission of pricing information and efficient selection of fuel mix, including:
 - Mandates/subsidies for specific fuel use:

- requirement that 50 percent of new generation be natural gas, and
 - the Renewable Portfolio Standard (RPS).
 - Regulations that improperly inhibit use of certain fuels (new ozone standards, restrictions on carbon emissions, etc.).
- ★ Acknowledge the necessity and economic benefits of fossil fuels in meeting the future of Texas' base and peak loads.

Governance: Environmental and Market Regulation

- ★ The state's energy policy should focus on Texas' competitive advantages and our unique vulnerability to economic harm from regulation of the energy sector.
- ★ Texas should participate in carbon regulation talks at the federal level without encouraging the adoption of regulations; stay involved, and lead the way to market solutions to our environmental challenges. Do not adopt state-based regulations.
- ★ Utilize the market-based response to public concern about global warming that is allowing the U.S. and Texas to lead the world in reducing growth of CO₂ emissions.
- ★ Maintain and improve upon current pricing mechanisms that transmit energy and regulatory costs through the marketplace.
- ★ Maintain current regulatory structure of the Texas electricity market; resist temptation to regulate competitive behavior.
 - Avoid/eliminate restrictions or mandates on wholesale or retail market share.
 - Avoid/eliminate price caps on the wholesale and retail electricity markets.
 - Maintain Texas' successful energy-only market: do not revert back to even a limited-capacity market.

Energy Efficiency and Demand Management

- ★ The state shouldn't focus on the energy efficiency; the market should be the mechanism for achieving future energy efficiency gains given the state's environmental policy.
- ★ Discriminate between two potential sources of energy efficiency:

continued

- *market sector efficiency gains* that generate cost savings for consumers vs. *government-mandated efficiency measures* that increase consumer costs (i.e., building codes, mandatory smart meters, etc.).
- ★ Implement and maintain pricing mechanisms that allow efficiency gains and demand management to be based on market incentives (i.e., congestion pricing).

Infrastructure & Transmission

- ★ Maintain efforts to reduce congestion costs (i.e., nodal pricing and the day-ahead market).
- ★ Allow for the assignment of non-energy costs to the sources causing those costs to be incurred:
 - Ensure efficient placement of new generation by implementing market-based pricing/incentives into construction of transmission to reduce uplift of transmission costs.
 - Implement market-based pricing mechanisms that allow costs associated with the unreliability of wind power—such as ancillary services and faster ramp rate power plants—to be borne by wind generators.
- ★ Don't mandate technology for smart meters or socialize costs of deployment.
- ★ Assess full cost of alternative energy sources such as wind and other renewable.

Resources

- *Texas Electric Meter: Measuring the Effects of Electricity Deregulation* by Bill Peacock, Texas Public Policy Foundation (Mar. 2008) <http://www.texaspolicy.com/pdf/2008-03-RR02-ElectricMeter-proof.pdf>.
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- *Power for the Future: The Debate Over New Coal-Fired Power Plants in Texas* by Sterling Burnett, Texas Public Policy Foundation (Jan. 2008) http://www.texaspolicy.com/publications.php?cat_level=109.
- *Affordable Energy and Clean Air: Texas Can Have Both* by Joel M. Schwartz, Texas Public Policy Foundation (Nov. 2007) <http://www.texaspolicy.com/pdf/2007-09-PB35-AirPollution-schwartz.pdf>.
- *Q&A on the Texas Electric Market* by Bill Peacock, Texas Public Policy Foundation (Apr. 2007) <http://www.texaspolicy.com/pdf/2007-04-PB17-Q&A-bp.pdf>.
- *Competition in Texas Electric Markets: What Texas Did Right and What's Left to Do* by Robert Michaels, Texas Public Policy Foundation (Mar. 2008) <http://www.texaspolicy.com/pdf/2007-03-RR07-electric3-rm.pdf>.

The Issue

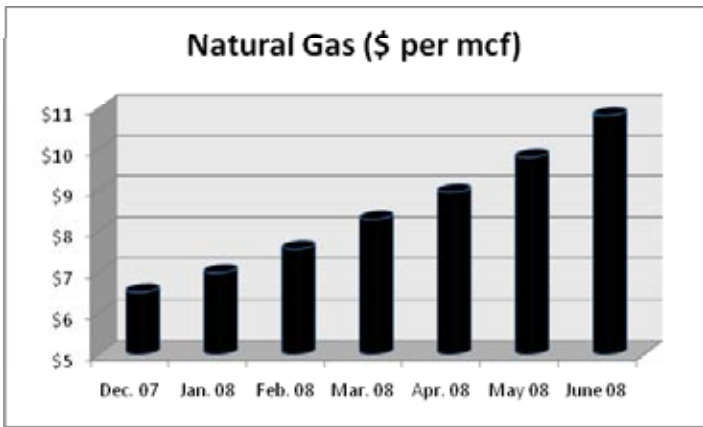
In bringing about competition in both the retail and wholesale electricity markets, Texas is the greatest success story in the United States, if not the world. That success is largely due to its willingness to let markets work and not manipulate prices or other policies for political reasons.

The transformation of American electricity has been dominated by a largely political competition to “design” markets for it. Texas did not “design” a retail market in any meaningful sense—it instead set general rules for Competitive Retail Electric Providers (CREPs) and Affiliated Retail Electric Providers (AREPs) and allowed them to compete.

The predictability of Texas policy may explain why the ERCOT territory has seen investment in volumes and announcements of new projects that will probably maintain adequate reserve margins.

Our research establishes conclusively that critics of the Texas electricity market spoke too soon. Using data from the still-regulated 2006 market, they claimed that deregulation wasn’t working.

The same pattern held true across the country. For instance, deregulation was widely blamed for causing California’s power crisis. However, the California electricity market was never deregulated. A poorly designed set of wholesale regulations combined with retail price controls led to that market’s collapse when natural gas prices skyrocketed.



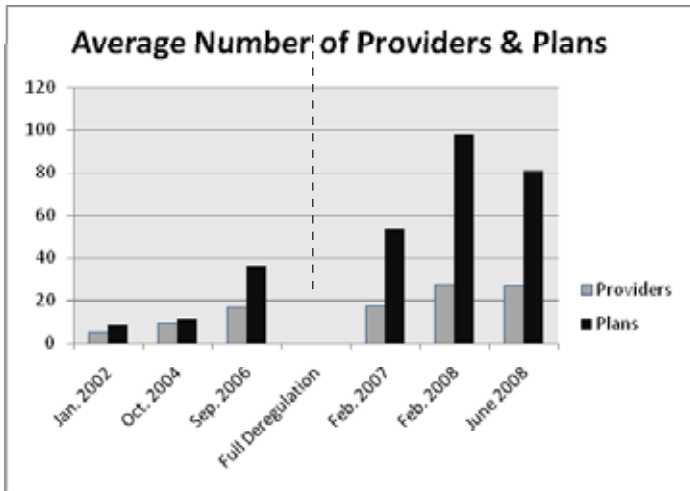
In Texas today, we also face increasing natural gas prices. As a result, electricity prices are increasing as well. The average offer for a one year fixed rate plan increased 21 percent from 14.05 cents in January 2007 to 17.3 cents in June 2008.

It is important to remember, however, that Texas electricity prices are high because energy prices are high everywhere, and because Texas is highly dependent

continued

dent on natural gas. But, unlike California, the design of Texas' electric market is allowing it to perform well and remain competitive in spite of high energy prices.

One area where this is obvious is in consumer choice. Consumers can lock in today's rate for the long term or let it float month-to-month. They can pick providers and rate plans based on their fuel sources.



This explosion in consumer choice is rooted in the highly competitive nature of the retail electricity market. The percentage of residential customers who chose competitive rate plans more than doubled to 81 percent as the state completed the transition into full deregulation. And, of course, the remaining 19 percent of the market can choose (or not choose) a new plan at any time.

Additionally, competition in the energy-only wholesale market has led to the construction of more than \$20 billion in new generation facilities in Texas since wholesale deregulation began in the 1990s. An additional \$25 billion is currently under construction or planned. This gives Texas the hope of enough electricity to meet its future energy needs plus helps support healthy retail competition.

Texas has experienced some problems lately with a few retail electric providers going out of business. But as of June, only 42,044 out of 5.4 million customers were dropped by their provider. And no one has lost service. The market is working as planned.

Some challenges do remain, however, especially in the wholesale and transmission markets. For instance:

- Congestion management in the zonal system has at times created artificial scarcity.
- Price caps may inhibit investment in peak capacity generation.
- Mandates on fuel mix (e.g., natural gas and wind) for generation create inefficiencies and increase retail prices,
- Environmental laws restrict coal and nuclear generation while increasing consumer costs, and
- Building transmission for wind energy from West Texas through the CREZ process could cost Texas consumers more than \$7 billion.

The Facts

- ★ In September 2006, the average Texas consumer in an area open to electric competition had access to about 17 retail electric providers offering about 36 different rate plans. Today, those same consumers can choose from 27 providers (on average) and about 80 rate plans.
- ★ Since competition began, the five former monopoly electric providers have lost between 56 and 80 percent of their market share.
- ★ As of March 2008, 74 percent of residential consumers had chosen a competitive rate plan, and 81 percent had made an observable choice of providers.
- ★ Deregulation has not caused a significant increase in Texas electricity prices. Prior to deregulation, Texas had the 14th highest average electricity rates in the country; as of December, we had slightly improved to 15th.
- ★ The 14 states that have higher electricity prices than Texas include New York, Massachusetts, California, Nevada, and Connecticut.
- ★ Among the nine states that rely most heavily on natural gas to generate electricity, Texas ranks 3rd lowest in prices.

Recommendations

- ★ Maintain the current practice in Texas of providing a framework for competition without prescribing how market participants should compete with one another.
- ★ Avoid unpredictable major alterations of the existing market structure that will dash expectations of future stability and ruin the climate for investment.
- ★ Continue support for scheduled improvements to the wholesale market, including:

continued

- Improvement to ERCOT’s management of the system;
 - Market Monitor;
 - 2009 Day-Ahead Markets; and
 - 2009 Nodal Pricing.
- ★ Look for ways to reduce consumer costs, including:
- Examine ways to reduce uplift (i.e., socialization of transmission costs);
 - Eliminate mandates on fuel mix:
 - Eliminate the renewable portfolio standard (RPS). At the least, do not expand it or target it for certain technologies; and
 - Eliminate requirement that 50 percent of new generation be natural gas.
 - Re-evaluate environmental restrictions that restrict generation capacity.
 - Reduce municipal franchise fees.
 - Avoid governmental new mandates such as:
 - More stringent building codes;
 - “Energy-efficient” building programs; and
 - Technology, equipment, and deployment standards.
- ★ Proceed with caution in implementing any requirements that might restrict market entry and competition, including:
- Certification of REPs;
 - REP disclosure to customers; and
 - Provider of Last Resort rules.

Resources

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- *Texas Electric Meter: Measuring the Effects of Electricity Deregulation* by Bill Peacock (Mar. 2007) <http://www.texaspolicy.com/pdf/2008-03-RR02-ElectricMeter-proof.pdf>.
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The Issue

Ozone is one of six federal criteria pollutants regulated by U.S. EPA under the *Federal Clean Air Act*. EPA sets a numeric standard for ozone, designates areas exceeding the standard, and mandates that states attain the standard. States must submit for federal approval a State Implementation Plan (SIP) for each non-attainment area. If the standard is not achieved at the specified date, EPA can impose sanctions such as withdrawal of federal highway funds and a freeze on road construction.

Ozone levels have long challenged Texas' two largest urban areas in the Houston-Galveston-Brasoria (HGB) and Dallas-Fort Worth (DFW) areas although continuous, dramatic improvement has occurred in the last 10 years. During the last five years, EPA has imposed three different standards. Within months after meeting the one-hour ozone standard in DFW, EPA switched to a stricter eight-hour 85 ppb standard. Shortly after the state submitted SIPs for the 85 ppb standard, EPA strengthened the standard to the current 75 ppb. Under this strict standard, five more urban areas in Texas would become non-attainment. Non-attainment status is a major barrier to economic growth.

Ozone is produced by a reaction of nitrogen oxides (NO_x) and volatile organic compounds (VOCs) in the presence of heat and sunlight. Unfortunately, Texas has optimal conditions for ozone formation. Ozone producing emissions predominantly derive from mobile sources and industrial point sources. Mobile sources include "on-road" vehicular traffic and "off-road" construction equipment and vehicles. The majority of emissions now are from mobile and not industrial emissions, even in the Houston region with its massive petrochemical complex.

Although required to attain the ozone standard, the state lacks legal authority to directly regulate mobile sources, i.e., engines and fuels. This is pre-empted authority of the federal government. The Texas Commission on Environmental Quality (TCEQ) has reduced mobile emissions through creative means and special exemptions: emission inspections, Texas Emission Reduction Program (TERP), Low-Income Vehicle Repair & Replacement, and Texas Low Emission Diesel (TXLED). At extraordinary cost, these measures yield only a portion of mobile emission reductions necessary for attainment.

Unlike many other states, Texas already has aggressively regulated industrial sources of ozone. In the Houston area, major sources must reduce NO_x by 80 percent and VOCs 50-70 percent. Federal engine standards coming online in the next few years will continue to lower mobile emissions without onerous, costly state regulation. Purchase of a new vehicle is an effective way to reduce ozone emissions.

continued

The Facts

- ★ Without timely federal action to reduce mobile source emissions, attainment of the new 75 ppb standard by state measures alone is likely impossible.
- ★ In addition to DFW and HGB, the new 75 ppb standard will trigger non-attainment for the Beaumont-Port Arthur, San Antonio, Tyler-Longview, Austin, and El Paso areas perhaps covering 34 counties. TCEQ will be required to submit seven instead of two SIPs at great cost to the state in financial and human resources.
- ★ Non-attainment is established by highest ozone levels at one monitor (the “design value”) and not by average ozone level across a region. The majority of monitors in the DFW and HGB areas attain the current standard. Thus, the majority of the population has air quality that meets the standard.
- ★ TCEQ has adopted regulatory controls and submitted an SIP to EPA for DFW demonstrating attainment in 2010. Already stringently regulated, HGB cannot reach attainment by 2010. A request to reclassify and extend the attainment date for HGB is pending before EPA.
- ★ In DFW, mobile sources emit 80 percent of NO_x; in HGB, mobile sources emit 62 percent of NO_x according to a 2005 TCEQ inventory. Mobile sources dominate ozone formation.
- ★ Texas citizens have made major financial investment in reducing ozone. As of April 2008, TCEQ has issued TERP grants of more than \$545 million for purchase of replacement vehicles and equipment or retrofit of diesel engines. The majority of the now annual \$200 million TERP fund derives from title fees.
- ★ Since 2004, the Legislature has appropriated \$30 million for air quality studies. TERP funds directed \$18 million to the New Technology Research and Development Fund. Additional appropriations of \$12 million support air quality studies and modeling needed to meet federal SIP requirements.
- ★ TCEQ models show that power plants account for an extremely small part of ozone in the DFW area. On average, the nine large East Texas power plants contribute only 1 percent of DFW ozone; plants inside the nine county non-attainment area contribute .7 percent; all power plants in Texas account for 2.29 percent of DFW ozone levels.

Recommendations

- ★ Demand EPA assume its responsibility to address mobile sources of ozone formation.
- ★ Urge EPA and the U.S. Congress to transform the convoluted, costly, ineffective SIP process imposed on states.
- ★ Challenge scientific justification and practicability of new 75 ppb ozone standard.
- ★ Avoid legislation that imposes growth inhibiting regulatory controls on counties that attain air quality standards, especially state-only permitting requirements.
- ★ Assure that state funded air quality studies and related research meet practical needs of TCEQ.
- ★ Avoid additional grant programs for mobile sources supported by fees on all Texans.
- ★ Avoid legislation mandating additional controls on industrial sources when mobile sources are the ozone drivers.

Resources

- *Adopted Eight-hour Ozone Attainment Demonstration State Implementation Plan (SIP) for the Dallas-Fort Worth Area*, Texas Commission on Environmental Quality (May 2007).
- *Adopted Eight-hour Ozone Reasonable Further Progress State Implementation Plan (SIP) for the Dallas-Fort Worth Area*, Texas Commission on Environmental Quality (May 2007).
- *Adopted Eight-hour Ozone Reasonable Further Progress State Implementation Plan (SIP) for the Houston-Galveston, Brasoria Area*, Texas Commission on Environmental Quality (May 2007).
- Legislative Briefing on Mobile Source Emissions, Office of the Chief Engineer, Texas Commission on Environmental Quality (Mar. 2008).

The Issue

After a roughly one-degree rise in global average temperature in the 20th century, fears of catastrophic “global warming” have proliferated in the mass media, classrooms, and legislatures worldwide. Now, with no warming since 1998—and after a drop in global temperatures in 2007—“global warming” is being replaced by “climate change” as the cause for concern.

A growing chorus of climate scientists are speaking out against the unsubstantiated gloom-and-doom predictions propagated by global warming alarmists. No link between man-made CO₂ emissions and accelerated warming has been proved, and there is, as a result, no scientific consensus on the causes of, or future consequences of, climate change.

Current legislative proposals to reduce CO₂ emissions—namely the Lieberman-Warner cap-and-trade bill—do not come with any guarantees of environmental benefit but do guarantee a multi billion dollar price tag, potentially eclipsing the trillion dollar mark. For evidence of the folly of a cap-and-trade regime, one need look no further than to the emissions performance of signatories of the Kyoto Protocol, a multi-nation agreement mandating drastic cuts in man-made CO₂ emissions.

For example, between 2000 and 2005, the CO₂ emissions of the original 15 nations of the European Union increased 3.8 percent, while the U.S.’ emissions went up 2.5 percent. According to the Sierra Club of Canada, since 1990, Canada’s greenhouse-gas emissions are up 24 percent, while the U.S.’ emissions are up only 14 percent; and according to data from the International Energy Agency, from 2000-06, the annual rate of increase for U.S. CO₂ emissions is approximately one-third that of the EU.

Therefore, the developing science of “global warming” and “climate change” is too unsettled and uncertain to justify legislation mandating reduction of CO₂ and other greenhouse gases. Without available technology to control greenhouse gases, governmental efforts to battle the earth’s climate have the potential to do more harm than good for the earth’s inhabitants.

The Facts

- ★ There is no scientific consensus on the causes of climate change.
- ★ A slight increase in global mean temperature—roughly one degree Celsius—has been observed over the last century. Yet, there is no proven causal link between increased human-created CO₂ emissions and increased global temperatures.
- ★ There is no proof that proposed climate-fighting measures will benefit the environment.

- ★ CO₂ is not a pollutant.
- ★ Drastic cuts in man-made carbon dioxide emissions will unduly harm Texas' growing economy, namely in the form of reduced gross state product, increased unemployment, reduced household incomes, and higher energy and electricity bills.

Recommendations

- ★ Avoid any state legislation mandating regulation of CO₂ and other greenhouse gases. The United States Congress and federal agencies are considering comprehensive national programs. Diverse state programs will not further Texas' interests.
- ★ Remove regulatory impediments to the free market mechanisms—private innovation, technological advancement, long-term focus on clean technologies, and businesses' responses to public demands—that are controlling CO₂ emissions more successfully than cap-and-trade regimes.

Resources

- *Global Warming: What Should Texas Do?* by Iain Murray, Texas Public Policy Foundation (Apr. 2007) <http://www.texaspolicy.com/pdf/2007-04-RR08-global-warming.pdf>.
- *Global Warming: Man-Made or Natural?* by S. Fred Singer, Texas Public Policy Foundation (Sept. 2007) <http://www.texaspolicy.com/pdf/2007-09-PP24-global-warming-singer.pdf>.
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Water

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Water Supply 46

The Issue

For more than a century, Texas case law has recognized a landowner's property right in the groundwater beneath the surface estate of the property. Decided in 1904, the landmark Texas Supreme Court Case, *Houston and Texas Central Railway v. East*, the court upheld a landowner's ownership in the groundwater under the land and the right to pump and capture that water even to the detriment of an adjoining landowner's wells. These rights to groundwater are recognized in Chapter 36 of the Texas Water Code and Chapter 21 of the Property Code (see section TWC 36.002 entitled "Ownership of Groundwater" and TPC 21.0421). Popularly labeled as the 'Rule of Capture,' Texas' primary legal doctrine governing groundwater is fundamentally different than the prior appropriation doctrine over surface water. For surface water, Texas law declares that the state owns title to the water and grants private rights to appropriate (use) water for stipulated beneficial purposes.

Since 1917, the Conservation Amendment (Article XVI) of the Texas Constitution provides state authority to regulate natural resources, including groundwater, for the preservation, conservation, and development of these resources. Over the last 10 years, landowners' private property rights in groundwater have been qualified by new additions to law. As early as 1949, Texas law established authority to create local Groundwater Conservation Districts (GCDs). Yet, it was enactment of SB 1 in 1997 and SB 2 in 2001 that enlarged the role and regulatory authority of GCDs, catalyzing creation of many districts now covering the majority of all Texas groundwater resources.

Additional authority over "privately owned groundwater" was enacted in the 79th Legislative session (see Chapter 35 of the Texas Water Code). The first state driven—not locally imposed—requirements include Texas Water Development Board (TWDB) formation of regional Groundwater Management Areas (GMA). The boards of the GMAs must establish 'a desired future condition' of the relevant aquifers subject to the approval of TWDB.

Texas groundwater law has become complicated now subject to three distinct legal rubrics: common law landowner property rights in groundwater upheld in a century of case law, local Groundwater Conservation Districts, and state administered Regional Groundwater Management Areas.

Legal ambiguity and uncertainty, created by these overlapping legal authorities, delay groundwater development projects in the regional water plans. If integrated, these multi-level authorities over groundwater may operate beneficially. Tensions, however, between deep rooted private rights and local-state authorities remain. Although the legislature has the authority to limit, or even abrogate, vested property rights in groundwater, it does so with implications of "taking" constitutionally protected rights for which the state would be liable to compensate the property owners.

In certain regions, conflicts have arisen between local district rules and landowner rights. In a May 2008 ruling, the Texas Supreme Court concluded that local districts could not use 'historic use' rules to grant export permits to irrigators while denying such permits to ranchers who historically used less groundwater.

The Fourth Court of Appeals in San Antonio recently clarified that a landowner's property right in groundwater can be severed from the surface estate in a warranty deed of sale. Although legislation gives local districts and the state the authority to limit exercise of groundwater rights, Texas courts consistently uphold private property rights to groundwater.

The Facts

- ★ Texas has abundant groundwater resources in many diverse aquifers: nine major aquifers and 20 minor aquifers.
- ★ Total groundwater availability in 2010, as measured by the regional water planning groups, is 12.7 million acre-feet per year. Availability may decline to 9.9 million acre-feet by 2060.
- ★ Texas has 95 local groundwater districts covering all or part of 144 counties.
- ★ The Texas Water Development Board has delineated 16 Groundwater Management Areas based on hydro-geological parameters.

Recommendations

- ★ Clarify that the landowner's property rights to groundwater underneath the surface estate vest with legal ownership of the surface and not only by capture or possession of the groundwater.
- ★ Incorporate Texas Supreme Court ruling in *Guitar v. Hudspeth County Underground Water Conservation District* in Chapter 36, Texas Water Code provisions on groundwater district rulemaking authority.

Resources

- *Houston and Texas Centennial Railway Co. v. East*, 98 Tex. 146, 81 S.W. 279 (1904).
- *Guitar Holding Company v. Hudspeth County Underground Water Conservation District No. 1*, Texas Supreme Court (May 30, 2008).
- *City of Del Rio v. Clayton Sam Holt Hamilton Trust*, Fourth Court of Appeals (Feb. 2008).
- "The Rule of Capture in Texas – Still So Misunderstood After All These Years" by D. Drummond, L. Sherman, & E. McCarthy, Jr., *Texas Tech Law Review*, Volume 37 (Winter 2004) No. 1.

The Issue

Surface Water Rights

Texas law has long recognized private property interests in surface water and groundwater. For surface water, Texas like most western states has adopted the prior appropriation system to allocate quantities of water through “use” rights. An exception to this legal system is landowners’ riparian rights for domestic and livestock use. Under a categorically different legal regime, Texas case law repeatedly upholds the landowner’s property interest in groundwater beneath the surface and the right to “capture” the privately owned groundwater.

For surface water, Texas law declares that the state owns the corpus of the surface water but grants private rights to use specific volumes of water for statutorily enumerated beneficial uses (Texas Water Code (TWC 11.0235(a))). TCEQ issues and administers surface water rights. Each water right is assigned a priority date. Earlier priority dates are legally entitled to appropriate water before rights with later priority dates in times of water shortage. This is the “first in time is first in right” principle of the prior appropriation system. The priority date of a water right is the holder’s most valuable property interest in the right. Infringement of a senior right is protected by TCEQ enforcement authority.

As a “use” right, a Texas surface water right is quite different than a private property right conferred by fee title ownership of land. The water right is a defeasible interest. The state can cancel the right if wasted, abandoned or not used under the stipulated beneficial use. Conservation of water is not a form of non-use. A Texas surface water right, however, does confer key property interests. A typical surface water right is held in perpetuity unless specified as a seasonal or term right. Most importantly, surface water rights are clearly fungible and thus can be sold with minimal state review.

Since the passage of the landmark legislation SB 1 in 1997, river authorities, municipalities, and water utilities grapple with plans to increase available water supply, urgently needed by our growing population. New water right appropriations, amendments, and reuse authorizations required by key projects, are indefinitely delayed if not precluded because of protracted legal disputes about fundamental provisions of the Texas Water Code. Legislative clarification of key sections of the Texas Water Code regarding water right amendments, re-use and environmental flows are needed to implement projects to increase water supply.

The Facts

- ★ Texas has abundant water resources: 191,000 river miles running through 23 major river basins, nine major and 20 minor aquifers, seven major and four minor bays and estuaries, as well as 2,125 miles of shoreline along the Gulf of Mexico.

- ★ Active water markets depend upon clearly defined property interests in water, efficient regulatory process and consistent agency decision.
- ★ A simple application for an amendment to add industrial use to a municipal use water right has been pending for eight years. Even after a Texas Supreme Court ruling, the legal parameters for this simple amendment are not clear.
- ★ New water rights applications for pure instream use, i.e., for the right in perpetuity to leave the water in the stream and not use it, still pend in Texas courts. Water at issue in these permit applications approximates all the remaining unappropriated surface water in the state—millions of acre-feet.

Recommendations

- ★ Clarify the ‘Four Corners Provision’ (TWC 11.122(b)) that a water right amendment application only for change or addition of a beneficial use is not subject to an administrative hearing.
- ★ Clarify the requirements for a bed and banks authorization in TWC 11.042 and 11.046 to facilitate indirect reuse of water, potentially the most cost-effective water supply strategy.
- ★ Further clarify in 11.042 that authorization for indirect use of ‘privately owned groundwater’ is not subject to the same requirements as indirect reuse of surface water.
- ★ Clarify that instream use is not an expressly authorized purpose of appropriation (i.e., beneficial use) in a new water right application and that TCEQ cannot issue a new water right for pure instream use.
- ★ Enunciate policy reinforcing the value of water marketing for efficient, timely implementation of water supply strategies in the State Water Plan.

Resources

- *Rights to Use Surface Water in Texas*, Texas Commission on Environmental Quality, GI-228.
- *Science Advisory Committee Report on Water for Environmental Flows* (Oct. 26, 2004) prepared for Study Commission on Water for Environmental Flows.

The Issue

As time passes, Texas faces an ever more urgent challenge to provide sufficient water to meet rapidly growing demand. This is one of the most critical, long-term policy issues facing the Texas Legislature. Policy decisions made—or not made—in the present will impact the future of Texas’ water supply.

Texas has one of the fastest growing populations and economies in the country. Although Texas has completed nationally acclaimed water plans designed to help meet water demands, legal and financial constraints stall actual implementation of planned projects. Texas has fallen well behind schedule in meeting the challenge to increase available water.

Not only will a much larger population need more water; the existing water supply of 17 million acre-feet also may significantly decline due to groundwater depletion and siltation in reservoirs.

As required by SB 1 in 1997, Texas has completed detailed water plans carefully measuring available water and future demand. Sixteen Regional Water Groups across the state have developed comprehensive plans then compiled by the Texas Water Development Board (TWDB) into the official State Water Plan (SWP). In 2002, the TWDB issued the first SWP developed through the bottom up, rigorous regional requirements of SB 1. In 2007, TWDB issued a revised SWP. The Regional Water Plans carefully identified 4,500 strategies to augment annual supply by 9 million acre-feet of water by 2060. Strategies include municipal and irrigation water conservation, re-use, desalination, new reservoirs, increased use of groundwater, and diverse surface water management.

Although no comprehensive assessment of implementation status yet exists, a partial review by the TWDB revealed only 9 percent of strategies were operational and only 5 percent had begun construction. Most large-scale water supply projects minimally require 10 years for completion. Large reservoirs have required 20 or more years if necessary federal authorizations and financing could ever be secured. TWDB estimates the total capital cost for projects necessary to meet future demand in 2060 exceed \$30 billion.

As stipulated in SB 1, more than half of the water supply strategies in the regional plans envision “voluntary redistribution” of existing water supply. Such redistribution assumes a well functioning water market which facilitates change of use, e.g., from irrigation to municipal, or change of location (i.e., water transfers). Except in a few areas, water marketing has been far more limited than anticipated. Regulatory constraints on interbasin transfers, indirect reuse and water rights amendments, legal questions about the property interest attaching to a surface water right, and landowners’ groundwater rights preclude an efficient water market in Texas. Enacted in the last legislative session, major

new law to protect environmental flows complicates many water supply projects.

The Facts

- ★ Texas' current population of 23 million is projected to double to 46 million by 2060.
- ★ The 2007 State Water Plan (SWP) estimates Texas needs an additional 9 million acre-feet to meet demand in 2060 during drought conditions.
- ★ Future water demand widely varies among the 16 water planning regions. The Dallas-Fort Worth metroplex (Region C) has the greatest short-term water needs.
- ★ Implementation of the 4,500 water supply strategies in the 16 regional water plans has an estimated capital cost of \$30 billion.
- ★ Water conservation strategies could generate 23 percent (2 million acre-feet) of increased supply needed by 2060.
- ★ Agricultural conservation accounts for 1.4 million acre-feet of conservation strategies. Capital cost for the irrigation conservation is estimated at \$929 million.
- ★ A highly cost-efficient strategy—water reuse strategies are recommended in 14 of the 16 regional plans—could meet 14 percent (1.3 million acre-feet) of additional demand in 2060.
- ★ Surface water strategies in the 2007 SWP could produce 4.4 million acre-feet by 2060, accounting for almost 50 percent of new supply at an estimated capital cost of \$18 billion.
- ★ Fourteen recommended new reservoirs account for 1.1 million acre-feet annually at an estimated cost of \$5 billion.
- ★ Multiple management strategies for existing surface water could generate 3.3 million acre-feet.
- ★ Legal ambiguity in Texas water rights law, a cumbersome administrative process, and uncertain financing constrains efficient, timely implementation of planned water projects. A simple water right amendment application to add an industrial use to a municipal use surface water right has been pending for eight years and still lacks final approval.
- ★ Water markets depend upon clearly defined property interests and a predictable administrative process.

continued

Recommendations

- ★ Examine a broad range of private and public-private financing mechanisms to fund water supply projects.
- ★ Remove legal barriers to private investment in water supply projects.
- ★ To facilitate water marketing, clarify the property interest in surface water rights and landowners' groundwater rights.
- ★ Strengthen the importance of voluntary redistribution of existing water as articulated in Chapter 16 of the Water Code.
- ★ Amend TWC 11.122.b to simplify the process for TCEQ approval of a water right amendment for a change or addition of beneficial use.
- ★ Simplify the requirements for bed and banks authorization needed for indirect reuse projects, the most cost efficient of water supply projects.
- ★ Legally integrate regional water planning process with now separate bay/basin environmental flows standard process.

Resources

- *Water for Texas 2007*, Volumes I, II, III, Texas Water Development Board (Jan. 2007) <http://www.twdb.state.tx.us>.



Property Rights

Restoring Property Rights in a
Post-Kelo Texas 50

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The Issue

The *Kelo* decision exposed significant problems with Texas eminent domain law. Before *Kelo*, the property rights of Texans were somewhat shielded from the inherent weaknesses in Texas law. Whatever the law might have said, there was no general understanding that the U.S. Constitution's Public Use Clause allowed the government to take any property from any person for any public purpose and give it to someone else. There were limits in place. However, post-*Kelo*, everyone's property is up for grabs.

The Texas Municipal League understood this when it embraced the *Kelo* decision. It said that *Kelo* "simply confirms what cities have known all along: under the Fifth Amendment to the U.S. Constitution, economic development can be as much a 'public use' as a road, bridge, or water tower." Not everyone, however, understood this to be the meaning of the Fifth Amendment.

Former Texas Agriculture Commissioner Jim Hightower said, "In plain words, government officials have just been cleared to turn over your property to companies that'll pay more in taxes. As one of the home-owners put it: 'It's basically corporate theft.'" U.S. Representative John Conyers said, "The concept of ... using private takings for private use should not be allowed. ... [T]hat is wrong. That is a misuse. That is an abuse."

Texas has taken some steps since *Kelo* in moving toward protecting its citizens from eminent domain abuse. SB 7 improved the situation somewhat, but served only as a starting point during a busy session on school finance. HB 1495 provided important information to landowners. HJR 30 was important, but needs enabling legislation. However, the veto of HB 2006 and the failure to pass HB 3057 last session have left much to be done in restoring Texans' property rights.

The Facts

- ★ The Institute for Justice examined claims that eminent domain reforms would harm the ability of cities to enhance economic development, finding:
 - There appears to be no negative economic consequences from eminent domain reform. State trends in all three key economic indicators—construction jobs, building permits and property tax revenues—were essentially the same after reform as before.
 - More importantly, even states with the strongest reforms saw no ill economic effect compared to states that failed to enact reform. Trends in all three key economic indicators remained similar across all states, regardless of the strength of reform.
 - Large-scale economic development can and does occur without eminent domain.
- ★ The City of El Paso is actively taking steps to protect its ability to employ eminent domain in the implementation of its Downtown Revitalization Plan.
 - In December 2007, the El Paso City Council expanded the

boundaries of the Tax Increment Reinvestment Zone through which it can exercise eminent domain.

- In January 2008, the El Paso City Council rejected 3-4 the same property rights protections contained in HB 2006.

Recommendations

- ★ **Define Public Use.** Public use in Texas has been construed as including the concepts of public purpose and benefit. The meaning of public use should be restored to its traditional meaning through a definition in statute.
- ★ **Eliminate the Blight/Slum Loophole.** An exception to SB 7's ban on takings for the purpose of economic development allows takings when "economic development is a secondary purpose resulting from municipal community development or municipal urban renewal activities to eliminate an existing affirmative harm on society from slum or blighted areas." This allows *Kelo*-style takings under scenarios like El Paso's Downtown Revitalization Plan. This loophole should be eliminated along the lines contained in HB 3057.
- ★ **Restore the Balance on Determinations of Public Use and Necessity.** Challenges by property owners to determinations of public use and necessity are uncommon because current Texas jurisprudence puts on property owners the burden of proof regarding these determinations. As long as a government entity follows proper procedures, it is very difficult for a property owner to challenge these determinations in court. The burden should be put on the condemning authority.
- ★ **End The Use of Eminent Domain for Land Speculation.** 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. If a government entity doesn't use a condemned property for the public use for which it was taken within five years, it should be offered by to the original owner at the price for which it was taken.

Resources

- *Securing Texans' Private Property Rights: HB 2006, HB 3057, HJR 30 & HB 1495* by Bill Peacock, Texas Public Policy Foundation (May 2007) <http://www.texaspolicy.com/pdf/2007-05-PP13-ED-bp.pdf>.
- *Private Property and Public Use: Restoring Constitutional Distinctions* by Bill Peacock, Texas Public Policy Foundation (Sept. 2006) <http://www.texaspolicy.com/pdf/2006-09-RR-eminentdomain-bp.pdf>.
- *Restoring Justice: Protecting Private Property Rights from Eminent Domain Abuse* by Clark Neily (May 2006) <http://www.texaspolicy.com/pdf/2006-05-PP-ED-cneily.pdf>
- *Doomsday? No Way: Economic Trends and Post-Kelo Eminent Domain Reform*, Institute for Justice (Jan. 2008) <http://www.ij.org/publications/other/doomsday.html>.

The Issue

When a state or municipality takes title to private property, the private property owner must be compensated for the property condemned by the government. The United States Constitution calls for “just compensation” to be paid to the landowner, while the Texas Constitution calls for “adequate compensation” to be paid. At issue is what constitutes “adequate compensation” when private property in Texas is condemned by the State of Texas or a Texas municipality under the constitutional takings authority known as “eminent domain.”

The very nature of eminent domain puts the government and landowners on unequal footing. Condemnations are not voluntary sales but rather forced takings of one’s private property. The Latin term “eminent domain” means “supreme lordship,” clearly an indication that one party—the government—has superior power and leverage over the other.

Because of government’s constitutional condemnation authority, landowners do not have the luxury of choosing to keep their property, if they are unhappy with the amount of the government’s offer. At some point, the landowner must accept what is offered by the government or awarded by the judiciary. Therefore, true FMV does not occur in condemnations, as market transactions are voluntary exchanges between willing buyers and willing sellers. The Independent Institute’s Anthony Gregory writes that “victims of seized assets have never consented, otherwise a pure exchange could take place that requires no police power. No such coerced transaction can be said to entail ‘just compensation,’ since compensation is only just when the party being compensated agrees to the deal.”

Additionally, even for those who are willing and have the financial resources to appeal a condemnation award, a portion of the increased award to prevailing landowners is taken by attorneys to cover their fees. Thus, even prevailing landowners do not receive full compensation.

There was much concern about HB 2006, last session’s eminent domain bill, over increases in compensation costs. However, careful analysis by the Foundation and the Institute for Justice showed that the cost estimates might have been overstated. We recommend that the committee look more closely at these costs. Though the State should always be mindful of government spending of taxpayer dollars, fully compensating landowners for condemned property is a proper government expense and is the right thing to do.

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.”

- ★ For entire takings, the guiding case law is the 1936 Texas Supreme Court ruling in *State v. Carpenter*, which held that “all circumstances which tend to increase or diminish the present market value” of the condemned property should be considered. This is known as “fair market value (FMV).”
- ★ Determining adequate compensation for partial takings, as opposed to entire takings, is a two-part process:
 - First, FMV is always paid for the condemned tract, regardless of the taking’s effect on the non-condemned portion of the taking (i.e., remainder property).
 - Secondly, once FMV is paid for the condemned tract, compensation for the remaining tract of land must be calculated. This step is a more complicated process, as certain damages to remainder property are non-compensable: community damages (diversion damages and loss-of-access damages) and lost business profits/goodwill.

Recommendations

- ★ Landowners should be made as whole as possible, being compensated in the amount of FMV loss, factoring “all circumstances which tend to increase or diminish the present market value” of the condemned property. Whatever factors would be considered in voluntary, private-market exchanges should be considered when determining the amount of compensation for condemned property. These include:
 - All injuries suffered by condemnees, whether considered special injury or community injury. Any injury a condemnation inflicts upon parties other than the condemnee does not take away from the loss suffered by the condemnee. Regardless of a condemnation’s effect on third parties, condemnees deserve compensation for their entire injury. The proper method for computing and awarding remainder damages is to compute the market value of the property pre- and post-condemnation. If the land is more valuable after the condemnation, neither the government nor the landowner is liable for payment. If the land is less valuable, the appropriate compensation to the landowner is the difference between the pre- and post-condemnation FMVs.
 - Loss of access, when computing remainder compensation.
 - Lost business profits and lost goodwill, even when a condemnation does not force them to discontinue business.
- ★ Reform the eminent domain process, such that the process is as clear and least subject to abuse as possible. Increased transparency in the takings process will lead to a fairer and more transparent compensation process.

continued

Resources

- *Article 1, Section 17, Texas Constitution*, <http://tlo2.tlc.state.tx.us/txconst/sections/cn000100-001700.html>.
- *The Trouble with 'Just Compensation,'* Mises.org (Dec. 5, 2006) <http://mises.org/story/2379>.
- *State v. Carpenter*, 89 S.W. 2d 194 (1936).
- *State v. Schmidt*, 867 S.W. 2d 769 (Tex. 1993).



Education Policy

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The Issue

Preschool enrollment has rapidly increased in Texas and around the country over the past several decades. States such as Oklahoma, Georgia, and Illinois have implemented taxpayer-funded pre-kindergarten for every 4-year-old. While Texas does not offer universal pre-k, approximately 85 percent of the state's 4-year-olds attend public or private preschool, meaning Texas actually has higher participation rates than most states offering universal pre-k.

Pre-k advocates cite studies claiming positive returns from taxpayer investments in pre-k, due to increased future wages and lower welfare and prison costs. For example, a Texas A&M study claims that every dollar invested in universal pre-k in Texas will return \$3.50 to Texas communities. However, this study overestimates benefits and underestimates costs, and is based on a Chicago program that not only included schooling, but also incorporated parent training and involvement—aspects which would *not* be part of universal pre-k in Texas, but which many experts believe contributed substantially to the benefits realized in Chicago.

Research has found long-term academic gains *only* for the most disadvantaged children; these children—and more—are already eligible for Texas pre-k and federal Head Start programs. To qualify for free pre-k in Texas, students must be low-income, homeless (including foster children), children of military personnel, or have limited English proficiency.

The research is clear: pre-k benefits generally fade out by the 3rd grade, particularly for non-at-risk children. If the goal is to increase kindergarten readiness, pre-k is already helping those children who may benefit from it. But if the goal is to improve graduation rates and academic achievement in the later grades, pre-k is not the solution for failing public schools.

The Facts

- ★ In 1965, only 16 percent of U.S. 4-year-olds enrolled in school; that number rose to 69 percent by 2004. Over the same period, student performance has been little better than stagnant.
- ★ Forty-four percent of Texas 4-year-olds participate in state pre-k, 9 percent in Head Start, and 4 percent in public special education. When including private preschool, an estimated 85 percent of Texas 4-year-olds are enrolled in some type of center-based care.
- ★ According to the National Center on Education Statistics, between 1985 and 2005, enrollment in prekindergarten increased by 585 percent compared to a 25 percent enrollment increase for other elementary grades.
- ★ A substantial body of research shows that formal early education can actually be detrimental to the behavioral development of mainstream children (non-special education children).

- ★ The vast majority of Texas kindergartners are appropriately “developed” according to results of the Texas Primary Reading Inventory (TPRI), a test administered in the state’s public school kindergarten classes.
- ★ U.S. 4th-graders routinely outperform their counterparts in most developed countries—including France, a country well known for its nearly universal preschool model. By 12th grade, however, U.S. students are outperformed by 86 percent of countries in math and 71 percent in science.
- ★ Full day pre-k in Texas public schools cost taxpayers \$7,300 per child last year.
- ★ Researchers estimate that universal pre-k would cost Texas taxpayers an additional \$1.8 billion each year.

Recommendations

- ★ Assess the impact on kindergarten readiness of the more than \$1 billion spent each year on early childhood care and education (funds include state pre-k, childcare, Head Start, TEEM, and private pre-k tuition).
- ★ Increase transparency to current spending by tracking the amount of federal, state, and local preschool spending on a per-student basis.
- ★ Ensure that all children who qualify for state pre-k are able to access it.
- ★ Transform all current early childhood education spending into grants that allow parents to choose the appropriate preschool setting for their child.

Resources

- *Do Small Kids Need Big Government? A Look at the Research Behind Government Preschool* by Darcy Olsen with Jamie Story, Texas Public Policy Foundation (Feb. 2008) <http://www.texaspolicy.com/pdf/2008-02-RR01-PreK-js.pdf>.
- *Questions to Ask Regarding Senate Bill 50* by Jamie Story, Texas Public Policy Foundation (May 2007) <http://www.texaspolicy.com/pdf/2007-04-PB19-SB50-js.pdf>.
- *Myths and Facts About Pre-K in Texas* by Jamie Story, Texas Public Policy Foundation (Jan. 2007) <http://www.texaspolicy.com/pdf/2007-01-PB02-preK-js.pdf>.
- *No Magic Bullet: Top Ten Myths about the Benefits of Government-Run Universal Preschool* by Lance T. Izumi and Xiaochin Claire Yan, Pacific Research Institute (May 2006) <http://www.pacificresearch.org/pub/sab/educat/2006/magic-bullet.html>.

The Issue

A large number of public schools in Texas are not adequately preparing students for success in college or the workforce. Too many students graduate from Texas high schools deficient in basics and need remedial education courses in college to be ready for college-level work. The disconnect between high school preparation and college expectations costs students, parents, higher education institutions, and taxpayers.

The need for remedial coursework makes the attainment of a college degree less likely. Research finds the leading predictor that a student will drop out and not finish their college education is the need for remedial reading coursework. Data from the National Center for Education Statistics reveals that only 17 percent of students who enroll in a remedial reading course receive a college degree within eight years compared to 58 percent of students who did not need remedial courses. When students take remedial courses in college, taxpayers are charged for the same education twice.

Coupled with these issues is an overly complex state accountability system that is not aligned with the federal accountability system nor is it easily understood by parents and the public. In the 2006-07 school year, 26 schools did not meet federal Adequate Yearly Progress but were rated either *Exemplary* or *Recognized* by Texas' accountability system. This lack of alignment is confusing to parents and makes it difficult for them to determine the quality of their child's school. In addition, the system lacks rigor and does not give schools and districts credit for student improvement if they miss the benchmark. Hopefully, Texas' Select Committee on Public School Accountability will have recommendations to improve and simplify Texas' accountability system.

Texas lawmakers took a step in the right direction by eliminating the Texas Assessment of Knowledge and Skills (TAKS) tests in high school and replacing them with end-of-course exams. End-of-course exams test students at the end of each course directly after they have studied the material and, if designed properly, provide a more in-depth assessment of skills and concepts than a cumulative multi-subject exam. Beginning in the 2011-12 school year, Texas students will no longer need to pass a cumulative high-stakes test to graduate; instead they will be assessed over the course of their high school career in the core subject areas of math, science, English, and history.

The Facts

- ★ A 2006 survey found that 81 percent of employers viewed recent high school graduates as “deficient in written communications” needed for letters, memos, formal reports, and technical reports. (Conference Board)
- ★ Only 19 percent of Texas high school graduates were “college ready” for math, science, reading, and English in 2007. (ACT)
- ★ Over 162,000 college freshmen at Texas public higher education institutions took remedial education courses in the fall of 2006. (Texas Higher Education Coordinating Board)

- ★ The Texas Legislature appropriated \$206 million in General Revenue funds for the instructional cost of developmental education at public higher education institutions for the 2006-07 biennium.
- ★ For a public school to be rated *Academically Accepted* in 2008, only 45 percent of students must pass the science TAKS and only 50 percent must pass the math TAKS.

Recommendations

- ★ Incrementally raise the passing standard on end-of-course exams to give students and teachers time to adjust to the new standards and exams.
- ★ Add essay questions to all three history end-of-course exams and adopt foreign language end-of-course exams.
- ★ Have a panel of teachers from another school district grade each exam to prevent cheating.
- ★ Use end-of-course exam scores in assessing high school performance and high school accountability ratings.
- ★ Hold high schools accountable for the number of students they graduate that require remedial education in college.
- ★ Include a growth measurement in the accountability system to track improvement at the school and district level.
- ★ Make the accountability system transparent and easier for the public to understand.
- ★ Ensure that parents have the ability to respond to educational results reported by the accountability system by allowing them to remove their child from their current school to the school of their choice.

Resources

- *The Cost of Remedial Education* by Brooke Dollens Terry, Texas Public Policy Foundation (Sept. 2007) <http://www.texaspolicy.com/pdf/2007-09-PP25-remediation-bt.pdf>.
- *Implementing End-of-Course Exams: The New Testing System at the High School Level* by Brooke Dollens Terry, Texas Public Policy Foundation (Aug. 2007) <http://www.texaspolicy.com/pdf/2007-08-PB29-EOCexams-bt.pdf>.
- *Rethinking Public School Accountability: Using End-of-Course Exams to Measure and Improve the Quality of a High School Education* by Brooke Dollens Terry, Texas Public Policy Foundation (Feb. 2007) <http://www.texaspolicy.com/pdf/2007-PP02-EOC-bt.pdf>.
- *Texas School Accountability Standards 101* by Brooke Dollens Terry, Texas Public Policy Foundation (Jan. 2007) <http://www.texaspolicy.com/pdf/2008-01-PP03-accountability-bt.pdf>.

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 percent 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. As large numbers of economically-disadvantaged and minority students continue to fall behind academically and drop out of school, it is vital that policymakers focus on improving teacher quality.

At the same time, fewer high-ability individuals are choosing to teach. With numerous career options now available to women, many bright female students choose to become lawyers and doctors over a career in teaching. Research finds that teachers with strong academic credentials—such as strong verbal scores on the SAT or ACT or attendance at a selective college—are more likely to produce large gains in student learning. Yet college graduates with the lowest SAT or ACT scores are more than twice as likely as those with top scores to choose teaching as their profession according to the National Center for Education Statistics.

Money can be a powerful incentive in attracting and retaining the best teachers. However, most public school districts in Texas, and nationwide, pay their teachers off of a rigid salary schedule. This schedule, designed in 1921, rewards longevity over effectiveness in the classroom. Contrary to popular belief, teachers do not improve every year in the classroom after the first few years. Nonetheless, after each year of teaching, teachers move a step up the salary schedule and gain a corresponding pay raise.

Another misconception about teacher quality is that possession of a master's degree leads to a more effective teacher. Many school districts encourage their teachers to get an advanced degree by subsidizing the tuition and then paying those teachers higher salaries. Surprisingly, research finds no correlation between possession of an advanced degree and higher teacher effectiveness. Therefore, paying for the attainment and possession of an advanced degree seems to be an ineffective way to improve student learning.

Across-the-board pay raises are also touted as a way to increase teacher quality. Research suggests that selective and targeted pay raises are more effective at increasing teacher quality and improving student learning. School districts need to use local discretion not a "one-size-fits-all" method for determining teacher compensation. Many of Texas' locally designed incentive pay plans show promise for attracting and keeping the best teachers.

The Facts

- ★ The likelihood that a highly talented female (one ranked among the top 10 percent of all high school students) will become a teacher fell roughly from 20 percent in 1964 to just over 11 percent in 2000. (National Bureau of Economic Research)

- ★ Texas' minimum single salary schedule acts as a type of minimum wage for teachers requiring school districts to pay at least the specified salary at each step on the 20-step schedule.
- ★ Roughly 50 percent of teachers nationwide have a master's degree. (National Center for Education Statistics)
- ★ The average Texas teacher made \$44,897 during the 2007-08 school year. (Texas Education Agency)
- ★ Texas has the largest incentive pay system in the country.

Recommendations

- ★ Eliminate Texas' minimum salary schedule to allow more freedom at the local level for merit and differentiated pay based on local needs and conditions.
- ★ Target resources where the money will be most effective, such as:
 - Paying higher salaries or stipends for teaching in shortage areas such as math, science, bilingual education, and special education;
 - Paying higher salaries or stipends for working in low-performing schools;
 - Tying pay raises to positive performance reviews; and
 - Rewarding large student gains with bonuses or raises.
- ★ Discourage school districts from paying teachers more for possession of a master's degree.
- ★ Do not give teachers a raise if they received a negative performance review.

Resources

- *Bringing Teacher Compensation into the 21st Century* by Brooke Dollens Terry and K. Emma Pickering, Texas Public Policy Foundation (Mar. 2008) <http://www.texas-policy.com/pdf/2008-03-PP08-teacherpay-bt.pdf>.
- *Better Salaries For Teachers In Texas Public Schools* by Chris Patterson and Jamie Story, Texas Public Policy Foundation (Nov. 2005) <http://www.texaspolicy.com/pdf/2005-11-teacherpay-rr.pdf>.
- *Lifting Teacher Performance* by Andrew Leigh and Sara Mead, Progressive Policy Institute (Apr. 2005) www.ppionline.org/documents/teachqual_0419.pdf.
- *Increasing the Odds: How Good Policies Can Yield Better Teachers* by Kate Walsh and Christopher Tracy, National Council on Teacher Quality (2004) www.nctq.org/nctq/images/nctq_io.pdf.
- *Better Pay for Better Teaching: Making Teacher Compensation Pay Off in the Age of Accountability* by Bryan Hassel, Progressive Policy Institute (May 2002) http://www.ppionline.org/documents/Hassel_May02.pdf.

The Issue

In Texas, 86 percent of school-aged children attend public schools, giving the government a virtual monopoly over k-12 education. While entities operating in a free market have an incentive to meet the needs of their customers—or lose business and possibly face bankruptcy when their customers choose different providers—a monopoly does not face the same pressures since they have a captive customer base. In the world of education, parents and students are the customers. Students are typically assigned a government-run school by their zip code leaving them little choice in which school they attend. Faced with a low-performing or secular school, a family's only alternatives are to move, homeschool, or send their child to a private school. The private school option is cost prohibitive for many parents as they have to pay for both private school tuition and taxes that fund public schools.

As rising property taxes—the primary form of financing public schools—continue to burden Texas homeowners, it is instructive to examine the cost of public education and the results. Over the past 10 years, per-student costs have almost doubled—growing from \$5,282 per student in 1995-96 to \$9,629 in 2005-06—with little to show for it in student achievement and thousands of students dropping out of school. Expensive reforms such as across-the-board teacher pay raises and class size reductions have done little to improve student learning. Since public schools do not have to compete with each other for students, it is no wonder they resist change and have failed to significantly improve. Competition, not more money, is the ultimate means to improve public education and can include vouchers to private schools, transfers within a public school district, education scholarships, magnet schools, virtual schools, and charter schools.

Competition among schools and education models leads to real improvement in education. By allowing students to move to different schools whether they are traditional public schools, private schools, or charter schools, there is a greater incentive for schools to serve the individual needs of students and to operate efficiently. In a school choice program in Edgewood ISD in San Antonio, the academic performance of students who went to private school improved, as it did for the students who stayed in public school. In addition, the graduation rate at Edgewood ISD improved from 59 percent to 75 percent.

Charter schools are another form of school choice. Charters are public schools funded with tax dollars that are subject to fewer government regulations. They are held accountable for student academic performance just like traditional schools. Students and parents *choose* to attend a charter school. Charters do not have to hire certified teachers, are not subject to collective bargaining agreements, and have the freedom to try various teaching strategies, school structure, and hours of instruction to meet student needs. Texas charter schools serve a higher proportion of economically-disadvantaged and minority students than traditional public schools. Some charters are so popular with students and parents that they have long waiting lists and determine attendees by lottery. State law limits the number of open-enrollment charters to 215 and the cap may be reached later this year.

There is growing consensus that students with special needs require individualized education services that not all traditional public schools are equipped to provide. As a result, momentum is growing around the country for better options for parents of special needs children. In 1999, the state of Florida passed scholarships to children with special needs that allow them to choose the school that best meets their educational needs, public or private. Research on the program has found “extraordinarily high parental satisfaction, reduction in student harassment, and improvement in academic performance.” Arizona, Georgia, Ohio, and Utah have followed Florida’s lead. Texas should do the same and provide more and better options to students with special needs.

Another school choice method worthy of more study is the education tax credit. As lawmakers consider making changes to the business tax, one option is to allow organizations and businesses to make contributions to a non-profit education scholarship fund and receive a tax credit. The scholarship fund would help students receive an education at the school of their choice, public or private.

The Facts

- ★ In San Antonio’s Edgewood ISD, a school choice program led to improved academic performance for both students at private schools and traditional public schools.
- ★ A Harwood Group study found that 80 percent of African-American families would choose private schools if tuition were not an issue.
- ★ The Urban Institute found that African-American students showed greater improvement with each year spent in a private school compared to their public school peers.
- ★ Texas charter schools serve students that are 80 percent minority and more than 60 percent economically-disadvantaged.
- ★ Over 100,000 Texas students attend a charter school comprising approximately 2 percent of all public school students.
- ★ Under the special needs scholarship program in Florida, parents are more satisfied (92.7 percent parental satisfaction in schools they chose versus 32.7 percent for the assigned public school) and students receive more needed services (86 percent of students received all the services they required versus 30.2 percent of students in traditional public schools) according to the Manhattan Institute.
- ★ According to the CATO Institute, implementing a public education tax credit could save Texas \$15.9 billion in the first 10 years of operation.

continued

Recommendations

- ★ Move toward student-centered education funding and allow parents and students to choose which school they attend (public, charter, or private).
- ★ Create open-enrollment school district policies that allow students to pick which school in their district they want to attend.
- ★ Improve student transfer policies within school districts and with neighboring districts so that students are not trapped in low-performing schools.
- ★ Give students more options within their school district by creating more magnet schools with a specialized and rigorous curriculum.
- ★ Eliminate the cap on open-enrollment charter schools.
- ★ Create scholarships for students with special needs to allow them to choose from a variety of education settings that can better meet their unique needs.
- ★ Create an education tax credit against the franchise tax for purchasing education scholarships for students to use in receiving an education at the school they choose.

Resources

- *School Choice Delivers High Marks for Students, Parents, Teachers, and Taxpayers* by Jamie Story and K. Emma Pickering, Texas Public Policy Foundation (Apr. 2008) <http://www.texaspolicy.com/pdf/2008-04-PP10-schoolchoice-js.pdf>.
- *Charter School Reform: Past, Present, and Future* By Jamie Story, Texas Public Policy Foundation (Sept. 2007) <http://www.texaspolicy.com/pdf/2007-09-PP22-charter-js.pdf>.
- *Should Texas Adopt a School Choice Program? An Evaluation of the Horizon Scholarship Program in San Antonio* by John W. Diamond, Texas Public Policy Foundation (Mar. 2007) <http://www.texaspolicy.com/pdf/2007-03-RR03-education-diamond.pdf>.
- *The Public Education Tax Credit* by Adam B. Schaeffer, Cato Institute (Dec. 2007) <http://www.cato.org/pubs/pas/pa-605.pdf>.
- *School Choice* by Herbert J. Walberg, Cato Institute (2007) Cato Institute: Washington D.C.
- *Vouchers for Special Education Students: An Evaluation of Florida's McKay Scholarship Program* by Jay P. Greene, Ph.D. and Greg Forster, Ph.D., Manhattan Institute (June 2003) http://www.manhattan-institute.org/html/cr_38.htm.
- *The Fiscal Impact of a Large-Scale Education Tax Credit Program* by Andrew Coulson and Anca Cotet, CATO Institute (1 July 2008) http://cato.org/pub_display.php?pub_id=9515.

The Issue

The U.S. leads major industrialized nations in public spending on higher education, allocating \$9,629 per student compared with \$8,502 in the United Kingdom and \$4,830 in Japan. Texas exceeds the national average in higher education appropriations after cost of living and enrollment mix are accounted for. Enrollment mix takes into consideration that graduate students are more costly to educate. In 2006, Texas state and local higher education appropriations with these adjustments were \$7,125 per student compared with the national average of \$6,325, according to the State Higher Education Executive Officers.

Similarly, in 2005, combined state and local support for higher education per \$1,000 of income was \$7.92 in Texas, compared with the national average of \$7.08. Moreover, Texas ranks third among all states on the share of state taxes spent on higher education. While Texas allocates 14.3 percent of tax revenues to higher education, the national average is only 9.5 percent

State appropriations per headcount student for all institutions have remained relatively constant while operating costs per student have soared:

Years	Appropriations (in 2008 dollars)	Operating Costs (in 2008 dollars)
1970-71	\$5,640	\$10,997
1980-81	\$6,430	\$11,843
1991-92	\$5,552	\$10,665
2000-01	\$6,394	\$13,653
2007-08	\$5,828	\$17,506

This data obscures increases in appropriations for individual flagship schools such as the University of Texas at Austin. In recent decades, enrollment has dramatically increased at non-flagship institutions, some of which were created after 1970, while UT-Austin’s enrollment has barely risen. Institutions such as UT-Brownsville receive significantly less appropriations per student and their costs are half to a third of UT-Austin. In real dollars, UT-Austin’s appropriations have increased from \$7,225 in 1999 to \$7,627 per full-time student equivalent (FTE) in 2008.

The problem in higher education finance is not relatively insignificant changes in appropriations, but spiraling increases in operating costs. As shown above, the difference between real appropriations and real operating costs has more than doubled from about \$5,400 in 1970-71 to nearly \$11,700 in 2007-08. Not surprisingly, higher tuition has filled this bulging gap. Texas tuition rates have risen an average of 8.96 percent annually since 1997, and the increase was actually greater prior to tuition deregulation in 2003.

Why are higher education operating costs skyrocketing? First, administrative costs have exploded. UT-Austin expenditures on administration have increased

continued

52 percent in real dollars from 1999 to 2008, more than five times the rate of increase on instructional expenditures. Second, faculty productivity is declining as research and governance activities displace teaching. A Texas Performance Review found faculty at research universities teach only 1.9 courses per semester and, nationally, 21.7 percent of faculty do not teach a single course.

These rising costs, and the resulting tuition increases, reduce affordability and access. A Texas 9th grader has only a 33 percent chance of going to college, less than the national average of 38 percent. The Higher Education Coordinating Board aims for an additional 630,000 Texans attending college by 2015, which would bring enrollment to 1.65 million.

The Facts

- ★ The total cost per FTE student at the UT-Austin in 2008 dollars increased from \$21,251 in 1980 to \$36,769 in 2008.
- ★ Non-teaching staff at universities nationwide as a percentage of total employees has increased from 44 percent in 1976 to 79 percent in 2005.
- ★ Tenure-track professors account for 64.9 percent of positions at Texas universities, but teach only 39.3 percent of courses.

Recommendations

- ★ **Transition to student-centered funding.** Texas can create a market in higher education that incentivizes universities to minimize costs and maximize instructional quality by putting state appropriations in the hands of students who can choose from competing public, non-profit, and for-profit institutions. Since Colorado implemented this policy in 2005, net tuition revenues, which takes into account the vouchers and financial aid, have gone up only 14.6 percent compared to 37.2 percent in Texas.
- ★ **Expand share of state appropriations based on incentives.** In 2007, the Legislature tied \$100 million of higher education appropriations to outcomes, but 99 percent of appropriations to institutions are not linked to results such as number of degrees issued, student satisfaction, employment outcomes, and student assessments.
- ★ **Require universities to submit with their budget request the percentage of funds spent on instruction.**

Resources

- Materials from Texas Public Policy Foundation Higher Education Summit (June 2008) <http://www.texaspolicy.com/pdf/2008-05-21-HigherEdSummit2.pdf>.
- *Texas' Higher Education System: Success or Failure?* by Richard Vedder, Texas Public Policy Foundation (May 2008) <http://www.texaspolicy.com/pdf/2008-05-RR05-highered-vedder-final.pdf>.



Health Care

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The Issue

Corporate Practice of Medicine

As the cost of health care in Texas rises, the prohibition on the corporate practice of medicine has become a hotly contested topic. Questions have been raised about whether physician employment compromises a physicians' ability to make medical decisions that are in the best interest of their patients. Hospital districts and some health care facilities argue that employing physicians provides underserved areas—and facilities competing for physicians—a leveraging tool to attract and retain physicians.

However, court cases as recent as 2004 and concurring opinions issued by the Attorney General have concluded that it is a violation of doctrine for a corporation of laypersons to employ licensed physicians and receive fees for the services rendered by the physician. An exception is provided to hospitals, which are allowed to employ physicians because they are licensed entities approved to treat and provide medical services to patients. However, the option is not extended to other medical facilities or hospital districts.

Allowing corporations to employ physicians not only creates a competitive market for physicians, but physician employment also reduces physician liability by transferring a significant portion of responsibility to the entity employing the physician—thereby reducing liability insurance costs for physicians allowing them to pass the savings on to their patients through lower prices.

Additionally, forbidding corporations from employing physicians makes it difficult to utilize less expensive and more convenient health care facilities. Although corporations can staff facilities with providers who work as independent contractors, retail corporations in Texas cannot open a health service center inside their building and hire physicians to staff the clinic as their employee.

Scope of Practice

Scope of practice regulations limit the availability of health care providers by restricting the services health care professionals are allowed to provide. For example, Texas operates one of the most highly regulated environments for nurse practitioners in the country, greatly restricting the ability of these qualified medical professionals to operate effectively and provide health care services to Texas consumers.

Texas statute requires that a nurse practitioner collaborate with a licensed physician in order to operate in a separate facility. Additional Texas statute requires a physician to work onsite with the nurse practitioner 20 percent of the time and requires that the physician's primary site be no more than 60 miles from the facility where the nurse practitioner works. Further regulation limits the number of nurse practitioners that a physician can collaborate with to three—a regulation that impedes the number of nurse practitioners allowed to offer services in the state.

Bills filed last session by Rep. Rob Orr and Sen. Dan Patrick would have increased the number of Advanced Practice Nurses (APNs) or Physician Assistants (PAs) a physician could collaborate with and would have eliminated the requirement that physicians be on the premise at least 20 percent of the time. However, both bills failed to pass and as a result the development of retail clinics that utilize these health care providers has lagged the rest of the country.

The Facts

- ★ Texas has 226 regions designated as Medically Underserved Areas (MUAs) or as Medically Underserved Populations (MUPs) and nearly 90 percent of rural Texas counties are partially or completely designated as medically underserved.
- ★ Twenty-five counties in the state have no physician at all, and nearly 20 percent of Texans—or 3.2 million people—do not have 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.
- ★ Texas has one of the most highly regulated environments for nurse practitioners, which makes it difficult to provide alternative, more affordable health care services.

Recommendations

- ★ Repeal state statutes that prohibit the employment of physicians by corporations other than hospitals.
- ★ Repeal regulations that dictate the collaborative relationship between physicians and nurse practitioners; look at the state of Arizona's guidelines for nurse practitioners.

Resources

- *Comparing State Regulation of Nurse Practitioners* by Mary Katherine Stout and Jonathan Elton, Texas Public Policy Foundation (2007) <http://www.texaspolicy.com/pdf/2007-11-PB34-nursepractitioner-mks.pdf>.
- *Corporate Practice of Medicine Doctrine* by Mary H. Michal, Meg Pekarske, Mathew K. McManus, and Reinhart Boerner Van Deuren (2006) <http://www.nhpco.org/files/public/palliativecare/corporate-practice-of-medicine-50-state-summary.pdf>.
- "State Law Hinders Health-Care Clinics" by David Hendricks, *San Antonio Express-News* (6 Feb. 2008) <http://www.mysanantonio.com/news/metro/stories/MYSA020708.01E.hendricks.2eb2466.html>.
- *Fellowship in Rural Family Medicine and Obstetrics*, University of Texas Medical Branch, <http://fammed.utmb.edu/fmr/ruralmed.asp>.



Health Insurance

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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 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; require access to specific health care providers; and mandates that guarantee coverage to particular individuals. Of course, there are many motives behind legislation that mandates specific aspects of health care, not the least of which include guaranteeing reimbursement for providers, insuring coverage for individuals with chronic conditions or diseases, and extending health benefits to more individuals.

These mandates ultimately harm consumers by making health insurance more expensive and requiring individuals to buy health benefits that they would not choose 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, many of which consumers never use. A prime example is the Texas law requiring all insurance policies to cover in-vitro fertilization, a service that costs around \$10,000 and increases the price of insurance plans by as much as 5 percent.

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, Cadillac health plans with few alternatives to the expensive, heavily mandated plans.

The impacts of these policies are most noticeable in the price of the health insurance premiums Texans must pay. For example, in Texas a 25-year-old male would pay \$248 for a basic health insurance plan that he could get in Alabama for only \$77 a month; the difference is that Alabama imposes only 19 mandates compared to Texas' 55.

The increasing costs force many people out of the market by pushing the cost of health insurance out of their reach, a fact demonstrated by the dramatic difference in Texas' and Alabama's uninsured rate, 23.9 percent and 13.5 percent respectively.

Thus far, Texas has avoided the destructive, community-rating mandate and the guaranteed issue mandate both of which have a crippling impact on the individual health insurance market. Community rating forces healthy individuals to subsidize the health care costs of more risky consumers by redistributing the cost of insuring more expensive, unhealthy individuals to the less expensive individuals who do not use as much health care. Similarly, guaranteed issue forces insurers to approve coverage for all individuals. The incurred cost of insuring everyone, regardless of health status, eliminates the risk-based aspect of health insurance and again forces the healthy consumer to compensate for the expense of less healthy individuals. However, these onerous mandates have

been imposed on the small group health insurance market and, as a result, small employers are struggling to provide affordable health insurance for their employees.

Although all of the 55 mandates were passed with the intent of making health care accessible to more people, they have actually contributed to the growing uninsured population across the state.

Texas Mandated Benefits		
Alcoholism Alzheimer's Bone Mass Measurement Breast Reconstruction Cervical Cancer or HPV Screening Colorectal Cancer Screening Contraceptives Dental Anesthesia Diabetes Self-Management	Diabetic Supplies Drug Abuse Treatment Emergency Services Hearing Aid HPV Vaccine Home Health Care In-Vitro Fertilization Mammogram Mastectomy Stay	Maternity Stay Mental Health Parity Newborn Hearing Screening Off-Label Drug Use PKU/Formula Prostate Cancer Screening TMJ Disorders Well Child Care
Texas Mandated Providers		
Acupuncturists Chiropractors Dentists Dieticians First Nurse Assistant Marriage Therapists	Nurse Practitioners Occupational Therapists Optometrists Physical Therapists Physician Assistants Podiatrists	Professional Counselors Psychologists Public or Other Facilities Speech or Hearing Therapists
Texas Mandated Covered Persons		
Adopted Children Continuation Dependents Continuation Employees	Conversion to Non-Group Dependent Students Grandchildren	Handicapped Dependents Domestic Partners

The Facts

- ★ Texas' insurance plans are subject to 55 mandates, ranking the state as one of the five most heavily regulated states in the country.
- ★ Insurance premiums in Texas increased 40 percent in five years, the third highest rate of increase in the nation.
- ★ The combined effect of mandates drive up the cost of a basic health plan by as much as 50 percent.
- ★ One out of four uninsured individuals does not have health insurance because of the inflated prices resulting from insurance mandates.

continued

Recommendations

- ★ Resist recent policy efforts that require individuals to carry health insurance via an individual mandate (i.e., Massachusetts).
- ★ Eliminate small group health insurance requirements that force insurers to guarantee issue and effectively community-rate policies, focusing instead on efforts to make health insurance a more attractive product and a better value.
- ★ Eliminate unnecessary state regulations—such as mandated coverage for in-vitro fertilization—that inflate the cost of health insurance plans.
- ★ Amend the Texas Insurance Code to allow the purchase of health insurance policies regulated by other states.
- ★ Protect mandate-light plans, like the Texas Consumer Choice Plans, from additional mandates.
- ★ Consider making truly mandate-free policies available as Arkansas, Colorado, Florida, Montana, North Dakota, and Utah have done.

Resources

- *Health Insurance Mandates in the States 2008* by Victoria Craig Bunce and JP Wieske, Council for Affordable Health Insurance (2008) http://www.cahi.org/cahi_contents/resources/pdf/HealthInsuranceMandates2008.pdf.
- *Mandating Expensive Health Insurance in Texas* by Kalese Hammonds, Texas Public Policy Foundation (Mar. 2008) http://www.texaspolicy.com/commentaries_single.php?report_id=1809.

The Issue

Consumer-driven health care has become a popular term with the creation and wide spread adoption of personal health accounts, such as Flexible Spending Accounts (FSAs), Health Reimbursement Arrangements (HRAs), and Health Savings Accounts (HSAs). However, as the popularity of these accounts has grown, so have issues that impact the ability of individuals to make 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 that time, the use of HSAs has grown rapidly around the country, offering greater patient control and more flexible features than even the other similar accounts offer.

HSAs refer to the savings account portion of the combination between a high deductible health plan (HDHP) and a savings account to pay for health care with pre-tax dollars. An HDHP requires participants to meet their deductible by paying medical bills out-of-pocket (presumably with funds in the HSA), rather than co-payments and co-insurance. Premiums are often lower than traditional health insurance plans that feature high premiums and low—or no—deductibles or cost sharing. The average annual premium for a single person age 30-54 was \$2,278 (\$189/month).

In September 2004, there were 438,000 people enrolled in HSA-qualified HDHP that number has rapidly increased to cover 6.1 million Americans in January 2008. Nationwide, balances in the accounts reached almost \$3.2 billion in 2008, up 60 percent from \$2 billion at the beginning of 2007. Recent studies show that roughly a third of the people purchasing an HSA-qualified HDHP in the individual market were previously uninsured, perhaps attracted by the low premiums and tax benefits.

HSAs are frequently criticized as being only for the healthy and wealthy, but much of the 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 a per person deductible 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) would realize from purchasing a high deductible plan, rather than a plan with low or no deductible and co-payments.

Critics also claim that individuals with an HSA will forego needed care in an effort to save money, which studies have shown to be true, but only in minor circumstances. In fact, it is more reasonable to expect that individuals respon-

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sible for making choices about their health care would receive screenings or adhere to treatment regimens more closely if failure to do so results in higher out-of-pocket costs.

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 use of 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 untaxed dollars and give employers 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 subsidizing the cost of premiums 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 like 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.

Recent clarification of the Texas Insurance Code qualifies reimbursements for premium payments as de facto small group policies that are 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 and may very likely force many small employers to drop health coverage all together.

The Facts

- ★ In September 2004, 438,000 people had an HSA-qualified HDHP and by January of 2008, 6.1 million lives were covered by HSA-qualified HDHPs.
- ★ By February 2006 combined account balances in HSAs reached \$1 billion.
- ★ In 2008, 358,000 Texans were enrolled in HSA/HDHP, the fourth highest in the nation.

- ★ Small businesses are strongly embracing HSAs—HSA enrollment in the small group market increased 70 percent over the past year.

Recommendations

- ★ Offer state employees an option to enroll in an HSA/HDHP.
- ★ Clarify existing state statute so that the purchase of individual health insurance, through an HRA, is not subject to small group requirements

Resources

- *Consumer-Driven Price Transparency: Making Health Care Prices Transparent Through the Free Market* by Mary Katherine Stout, Texas Public Policy Foundation (June 2006) <http://www.texaspolicy.com/pdf/2006-06-PP-hctransparency-mks.pdf>.
- *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./Sep. 2006) <http://www.texaspolicy.com/pdf/2006-09-PP-HSAsforstate-mks.pdf>.
- *Health Savings Accounts: Affordable, Portable, and Accessible Health Insurance* by Mary Katherine Stout, Texas Public Policy Foundation (Mar. 2005) <http://www.texaspolicy.com/pdf/2005-03-pp-hsa.pdf>.
- *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, the National Center for Policy Analysis, Brief Analysis Nos. 544, 545, and 546 (Mar. 2006) <http://www.ncpa.org/pub/hea.html>.

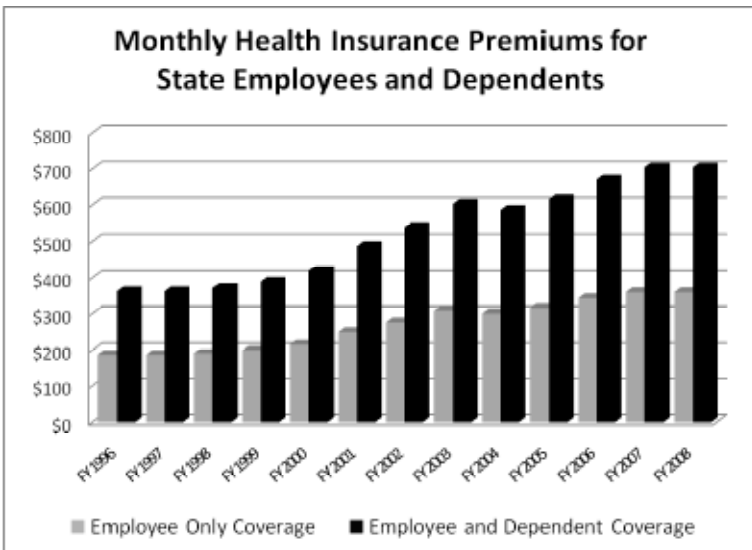
The Issue

The Employees Retirement System of Texas (ERS) oversees the retirement and insurance benefits of state employees across Texas. ERS operates five retirement plans: state employees, elected officials, law enforcement, and two judicial plans, making up the 53rd largest pension fund in the United States in 2005. In addition to retirement benefits, ERS provided insurance benefits to more than half a million state employees, retirees, and their dependents in FY 2007.

The cost of providing health benefits to Texas’ state employees has been climbing for years, increasing by 5 to almost 9 percent a year, each year from Plan Year 2004 to Plan Year 2007. For Plan Year 2008, the monthly premium for state employees and their dependents remained unchanged from the previous year.

In an effort to control mounting costs and combat a \$10 billion budget shortfall, the 78th Texas Legislature directed significant changes in employee health benefits, including added cost sharing and a 90-day waiting period for new hires. Yet the cost of health benefits for state employees continues to be the full obligation of the state; the state covers the entire cost of state employee’s health benefits, and 50 percent of the cost for dependent premiums established by the ERS board.

While individual state employees have not realized any increase in the cost of their coverage, those who share in the cost of dependent coverage have seen their monthly cost rise every year. In addition, the Legislature passed a state employee pay raise in 2005—the first wage increase since the Legislature passed one in 2001. However, their total compensation increased every year with the increase of their benefits, crowding out funds that might have been used for a pay increase in between.



The Facts

- ★ In FY 2005, ERS provided insurance benefits to more than a half million state employees, retirees, and their 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 \$2.1 billion for the 2006-07 biennium. Texas is among only a handful of states that cover the full cost of health insurance for state employees.
- ★ Texas state employees also have the option of participating in the TexFlex program, providing employees a Flexible Spending Account to make pre-tax savings deposits for out-of-pocket health and child care expenditures.
- ★ Overall increases in the cost of health care, running roughly 12 percent, fueled an increase of almost \$200 million in appropriations for the state employees' group health insurance over the 2004-05 biennium.
- ★ In Plan Year 2004, the premium for employee-only benefits was \$298/month, for Plan Year 2007 the monthly cost for the employee-only benefit increased 21 percent to \$361/month, and remained the same for Plan Year 2008.
- ★ The Federal Employee Health Benefits Plan began offering federal employees the option of a high deductible health plan (HDHP) coupled with a Health Savings Account (HSA) in January 2005; federal employees choosing the HDHP/HSA option had more than a dozen different plans from which to choose.
- ★ A survey of state health benefits in May 2007 found that state employees in Arkansas, Colorado, Florida, Georgia, Indiana, Kansas, Mississippi, South Carolina, South Dakota, and Utah all had an HDHP/HSA option for state employees.
- ★ In some states, state employees who smoke pay a higher health insurance premium than their non-smoking co-workers; Georgia charges state employee smokers a surcharge of \$40/month.
- ★ In many states, the state employees receive a considerable contribution from the state to the employee's HSA. For instance, for certain HSA enrollees, Indiana may contribute as much as \$1,400 annually on the state employee's behalf.

Recommendations

- ★ Readjust cost sharing for state employees, requiring state employees to pay a portion of the monthly premium.

continued

- ★ Offer state employees the option of a high deductible health plan and health savings account to control cost and allow employees to share in the premium savings.
- ★ State employees should have the choice of enrolling in a high deductible health plan with the minimum high deductible allowed under law and a plan with an even higher deductible, in order to give state employees the most choice.

Resources

- *Surveying State Employee Health Benefit Plans* by Mary Katherine Stout, Texas Public Policy Foundation (Oct. 2006) <http://www.texaspolicy.com/pdf/2006-08-PP-statebenefitsurvey-mks.pdf>.
- *Facts About Health Savings Accounts* by Mary Katherine Stout, Texas Public Policy Foundation (May 2007) <http://www.texaspolicy.com/pdf/2007-05-PB25-HSAfacts-mks.pdf>.
- *Survey of State Employee Benefits* by Mary Katherine Stout, Texas Public Policy Foundation (May 2007) <http://www.texaspolicy.com/pdf/2007-05-PP10-HSA-mks.pdf>.
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The Issue

When Medicaid was established by Congress in 1965—and in Texas in 1967—the program was originally focused on providing health care benefits to recipients of certain cash assistance programs. However, more than four decades of incremental policy expansion have created the largest government health program, providing benefits to more people and at a higher cost than even the Medicare program.

In Texas, Medicaid has become the significant budget driver in health and human services spending, as well as the budget in general. According to the Legislative Budget Board, spending on Article II (health and human services) grew by 10 percent, or roughly \$4.5 billion between the expended/budgeted for 2004-05 and what was appropriated for 2006-07. Of that, appropriations for Medicaid constituted almost 76 percent of the growth in health and human services spending. Texas Medicaid did not exceed \$2 billion in annual expenditures until 1987, 20 years after it was created, though it has grown rapidly since and will exceed \$20 billion in annual expenditures when the 81st Legislature convenes in 2009.

Much of this growth is driven by the growth of the caseload as a result of policy decisions in Washington and in Austin that have added expanded eligibility for the program. According to the Health and Human Services Commission, the Medicaid caseload grew by more than 1 million people between 1990 and 1995, and added roughly another million people from 2000-05. Children make up the majority of the caseload, with enrollment of non-disabled children growing 80 percent between 2000 and 2005 to just under 2 million, with the aged, blind, and disabled populations accounting for the majority of the spending. However, the share of children enrolled in the Medicaid program is declining as aging “Baby Boomers” fuel an increase in enrollment.

The Facts

- ★ Medicaid *is* an entitlement program—Texas must provide medically necessary care to all eligible individuals who seek services.
- ★ Health and human services spending represents roughly 31 percent of the state budget, with Medicaid accounting for approximately three quarters of health and human services spending.
- ★ For the 2008-09 biennium, the Texas Legislature appropriated approximately \$40 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 and state tax revenues according to the Federal Medical Assistance Percentages (FMAP), which varies between states and usually changes yearly. Historically, Texas pays roughly 40 percent of Medicaid costs and the federal government pays roughly 60 percent, 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.

- ★ Health and human services agencies account for just more than 60 percent of all of the state's federal funds, and federal Medicaid funding accounts for more than 75 percent of federal spending for Texas health and human services.
- ★ In 2009, it is estimated that the Texas Medicaid program will cover almost 3 million Texans, including 2 million children.
- ★ Children are declining as a share of total Medicaid enrollment as a result of shifting demographics including, most significantly, the aging “Baby Boom” generation.
- ★ In 2008 and 2009, Medicaid costs will be equal to more than \$800/year for every man, woman, and child in the state of Texas.
- ★ 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

- ★ Seek a federal waiver for 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 Medicaid program.
- ★ Strengthen cost sharing in the Medicaid and SCHIP program to the fullest extent allowed under federal law. Use a sliding scale that ties the out-of-pocket cost of medical care to the recipient's income.
- ★ Reject efforts to extend the period of Medicaid eligibility—including 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) <http://www.texaspolicy.com/pdf/2007-11-06-Medicaid%20letter.pdf>.
- *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) <http://www.texaspolicy.com/pdf/2006-03-RR-medicaid-mks.pdf>.
- *Ending the Forty Year Entitlement* by Mary Katherine Stout, Texas Public Policy Foundation (July 2005) http://www.texaspolicy.com/commentaries_single.php?report_id=888.
- *Medicaid's Unseen Costs* by Michael Cannon, CATO Institute (Aug. 2005) http://www.texaspolicy.com/commentaries_single.php?report_id=888.

The Issue

When Congress established the Children's Health Insurance Program (CHIP) in 1997, it did so in response to mounting pressure to address the number of uninsured children in the United States. Proponents of the plan argued that CHIP would deliver health insurance coverage to half of the nation's 10 million uninsured children by 2000. Through federal FY 2005, however, the CHIP program had never reached enrollment of even 4 million children at any given time.

The Texas Legislature established the CHIP program in 1999, though the new program did not begin to enroll children until June 2000. Texas' CHIP program is limited to children under age 18 in families whose incomes fall below 200 percent of the federal poverty level (FPL) and who are not eligible for Medicaid. Some states have tried to extend eligibility to children in families whose incomes meet or exceed 400 percent FPL, but those efforts have been denied and Congressional SCHIP reauthorization in 2007 failed to allow for such expansion. Some states also extend CHIP benefits to CHIP parents who meet income eligibility requirements.

From its implementation in June 2000, to its peak enrollment of 529,211 in May 2002, the CHIP caseload steadily increased; but the declines that followed prompted lawmakers to reverse course on state law passed in 2003 that required enrollees to prove their continued eligibility every six months, as well as pass an assets test, and a 90-day waiting period before enrollment took effect. Due to the CHIP expansion passed by the Texas Legislature in 2007, the state expects roughly 500,000 children to be enrolled in the CHIP program in 2009. 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), and many people are already advocating Medicaid expansion to match the new, longer CHIP eligibility period.

While the CHIP program is for all intents and purposes an expansion of the Medicaid program, it does have fundamental policy differences in comparison to the Medicaid program. There are two main differences: CHIP, unlike Medicaid, 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 is NOT an entitlement program—Texas can limit enrollment, require cost sharing among participants, and exercise flexibility in designing the benefits package.
- ★ In 2005, the Legislature approved expanding CHIP to include a new perinatal benefit to cover pregnant women up to 200 percent FPL; Medicaid currently covers pregnant women up to 185 percent FPL.

- ★ For the 2008-09 biennium, CHIP funding totaled \$2.03 million in All Funds, a 99 percent increase over the previous CHIP budget; state general revenue funds account for \$622 million of the CHIP budget.
- ★ The CHIP caseload peaked in May 2002 shy of 530,000 children enrolled and then steadily declined—in part due to policies intended to verify and limit eligibility to the truly eligible children—until lawmakers expanded the program to boost enrollment to cover 500,000 children in 2009.
- ★ Health and human services agencies account for just more than 60 percent of all federal funds in the state budget due to the matching funds for the Medicaid and CHIP programs.
- ★ Although CHIP is said to be budget certain, it has required supplemental appropriations to prevent budget shortfalls, and the budget has steadily grown since its inception.
- ★ Despite the creation of the CHIP program and coverage of more than 2.2 million children between Medicaid and CHIP, the state's uninsured rate remains relatively unchanged.

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.
- ★ Reinstate the reforms passed in 2003 and reversed in 2007, including the 90-day waiting period for benefits, the assets test, and the six 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

- *Funding SCHIP with Tobacco Taxes* by Mary Katherine Stout, Texas Public Policy Foundation (Sept. 2007) <http://www.texaspolicy.com/pdf/2007-09-PP23-SCHIP-tobaccotax-mks.pdf>.
- *What SCHIP Reauthorization Means for the States, A Presentation at the American Legislative Exchange Council's Annual Meeting* by Mary Katherine Stout and Tarren Bragdon (July 2007) <http://www.texaspolicy.com/pdf/2007-07-Stout-BragdonPresentationALEC.pdf>.
- *CHIPing Away at Reform* by Mary Katherine Stout, Texas Public Policy Foundation (Mar. 2007) <http://www.texaspolicy.com/pdf/2007-03-01-CHIP-mks.pdf>.

The Issue

In 1996, the United States Congress passed sweeping legislation to reform the nation's welfare through the *Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA)*. PRWORA ended welfare as an entitlement, instead creating a system of reciprocal obligation, requiring welfare recipients to be engaged in work activities and time-limiting the receipt of benefits. In addition, welfare reform changed the name for the welfare program from Aid to Families with Dependent Children to Temporary Assistance for Needy Families (TANF), and funded TANF through a federal block grant to the states.

Texas has been a leader in welfare reform, passing its own version in 1995 and receiving a waiver to grandfather the state's system until 2002 when the state was forced to fully comply with PRWORA. In addition, the 78th Legislature continued the work of welfare reform, establishing stricter sanctions for non-compliance with work requirements and the states Personal Responsibility Agreement. The full-family sanction terminates the entire family's TANF grant and is not restored until the adult recipient becomes compliant. Similarly, the state terminates the Medicaid benefit for TANF adults who do not comply with work requirements.

The results of the stricter sanctions have been dramatic. The percentage of adults under sanctions every month has dropped dramatically, while the percentage of adults participating in work activities has climbed. The stronger sanctions have created an incentive for more responsible behavior, driving greater compliance with work requirements to ensure clients earn the full benefit for their family.

As a result of welfare reform and the emphasis on work, Texas has been a leader among the states for moving people off welfare and into the workplace. A July 2006 *USA Today* article shows the number of families receiving welfare in Texas declined by 68 percent between August 1996 and December 2005.

Through the *Deficit Reduction Act of 2005 (DRA)*, Congress has continued to drive welfare reform, tightening definitions of work activities and recalibrating the way states demonstrate their success in reducing their welfare caseload. States are required to have 50 percent of all TANF families participating in work activities and 90 percent of two-parent families participating in work activities. The DRA changed the benchmark year for giving states credit for reducing their caseload from 1995 to 2005, thereby forcing states to more closely meet the 50 percent and 90 percent participation rates for all families and two-parent families, respectively. In 2008, Texas is expected to receive \$539 million in federal funds to support the state's approximate 48,000 enrollees.

The Facts

- ★ Between August 1996 and December 2005, Texas reduced the number of families on welfare by 68 percent.
- ★ Stricter state sanctions established by the 78th Legislature have improved compliance.

- ★ The percent of TANF adults participating in work activities increased by 62 percent from 2003 to July of 2007.
- ★ The number of individuals sanctioned for non-cooperation with work requirements declined by 92 percent from August 2003 to April 2006.
- ★ The number of families sanctioned for non-cooperation with the state's Personal Responsibility Agreement dropped by 89 percent between September 2003 (11,478) and July 2007 (1,256).
- ★ TANF recipients are exempt from work requirements under state law if they are the caretaker for an ill or disabled child, or a single parent/caretaker with a child under age one (applies only to the first child). In addition, TANF recipients are exempt from work under HHSC rules if they are age 18 or younger, an adult unable to work due to a mental or physical disability (lasting more than 180 days), age 60 or older, an adult caring for a disabled adult, a pregnant woman not able to work, or a single grandparent age 50 or older and caring for a child under age three.

Recommendations

- ★ Maintain the full-family sanction for non-compliance with work requirements and the Person Responsibility Agreement.
- ★ Maintain the adult Medicaid sanction for non-compliance with work requirements.
- ★ Review exemptions in state law and in agency rule that exempt TANF clients from engaging in required work activities.
- ★ Remove exemptions that impede the state's ability to engage recipients in work and prepare them for self sufficiency

Resources

- *Continuing Welfare Reform in Texas* by Mary Katherine Stout, Texas Public Policy Foundation (July 2006) <http://texaspolicy.com/pdf/2006-07-PP-welfarereform-mks.pdf>.
- "How Welfare Reform Changed America" *USA Today* (18 July 2006) 1A
- *The Impact of Welfare Reform*, testimony of Rober Rector to the Committee on Ways and Means, United States House of Representatives, The Heritage Foundation (19 July 2006) <http://heritage.org/Research/Welfare/tst071906a.cfm>.
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Homeowners' Insurance

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The Issue

Reform of the Texas homeowners' insurance market in 2003 called for a file-and-use regulatory system. However, five years into the reforms, the Sunset Review Commission's Staff Report (Staff Report) on the Texas Department of Insurance (TDI) rightly concludes 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 pre-market and post-market regulatory tools. The Insurance Code also bears much of the blame, as it grants TDI authority to reject rates before and after being used in the marketplace. Failure to implement file-and-use is a major problem facing the Texas homeowners' insurance market, because pre-market regulation hinders timely entry of rates into the marketplace and disrupts market pricing.

Another major issue confronting the Texas homeowners' insurance marketplace 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 sunset review process of TDI presents an excellent opportunity to address today's problems with the regulation of homeowners' insurance and to bring a consumer-friendly regulatory system to the Texas homeowners' insurance marketplace.

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.
- ★ 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 almost \$900 million.
- ★ After TDI allowed insurers to use non-standard forms in 2002, mold claims plummeted and rates stabilized. TDI acknowledged that, without the deregulation of forms, rates could have increased at least 20 percent more than they did.

Recommendations

- ★ Mandate a full and timely transition to a true file-and-use system, thus 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, in order to save time and money for consumers.
- ★ Allow the Commissioner to place under prior approval only those companies whose financial positions warrant increased supervision, in order to maintain solvency.
- ★ Limit the supplementary information insurers may be required to submit to TDI in a rate filing.
- ★ Eliminate OPIC and its functions, along with TDI’s pre-market regulatory functions, so consumer-protection efforts are dealt with through complaint-and-enforcement functions. As opposed to having a consumer representative within TDI, a better approach is to craft a regulatory process that is inherently consumer friendly.

Resources

- *Modernizing the Texas Insurance Marketplace* by Bill Peacock and Machir Stull, Texas Public Policy Foundation (Aug. 2007) <http://www.texaspolicy.com/pdf/2007-08-PP21-insurance-bp-ms.pdf>.
- *Q&A on Homeowners’ Insurance Regulation in Texas* by Drew Thornley and Bill Peacock, Texas Public Policy Foundation (Feb. 2008) <http://www.texaspolicy.com/pdf/2008-02-PP05-Q&A-Sunset-dt-bp.pdf>.
- *Insurance Regulation 101—Higher Risks Generally Mean Higher Rates* by Bill Peacock, Texas Public Policy Foundation (July 2007) http://www.texaspolicy.com/commentaries_single.php?report_id=1575.
- *Consumer Sovereignty: Time to Bring Consumer Regulation into the 21st Century* by Bill Peacock, Texas Public Policy Foundation (Sept. 2007) http://www.texaspolicy.com/commentaries_single.php?report_id=1609.
- *Missing the Big Picture in Homeowners’ Insurance Debate* by Drew Thornley, Texas Public Policy Foundation (Mar. 2008) http://www.texaspolicy.com/commentaries_single.php?report_id=1833.
- *A Better Homeowners’ Insurance Market Awaits* by Drew Thornley, Texas Public Policy Foundation (June 2008) http://www.texaspolicy.com/commentaries_single.php?report_id=1997.
- Sunset Advisory Commission Hearing Material (June 2008) http://www.sunset.state.tx.us/81streports/tdi/tdi_hm.pdf.

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.

The current funding system was designed in 1993, when TWIA had about \$6.5 billion in exposure. As of the end of July 2008, TWIA's total exposure was \$66.1 billion. However, TWIA member assessments and the Catastrophe Reserve Trust Fund can only cover about \$2.3 billion of losses, much less than the potential losses from major hurricanes. Any additional losses would be paid from unlimited assessments against insurers, in return for premium tax credits. This would place a serious strain on the state's general revenue fund. In 2005 alone, property and casualty insurers paid \$472 million in premium taxes.

The Facts

- ★ The number of TWIA policyholders increased from 68,756 in 2001 to 224,452 at the end of July 2008.
- ★ As of July 31, 2008, TWIA had \$66.1 billion in total exposure (\$60.4 billion in direct exposure with an additional \$5.7 billion in indirect exposure).
- ★ TWIA member assessments and the Catastrophe Reserve Trust Fund can only cover about \$2.3 billion of losses.

Recommendations

- ★ Fully implement a file-and-use system for TWIA rates, allowing TWIA members to get rates to the windstorm insurance market more quickly due to their not having to haggle over rates with the commissioner prior to using the rates. The commissioner could reject only rates already in use.
- ★ Specify that TWIA coverage is available only if an applicant cannot obtain coverage in the private marketplace. The Insurance Code should be amended to reflect the language in the TDI Rule stating TWIA's purpose is to be the state's windstorm insurance provider of last resort.
- ★ Eliminate many of the rate-setting requirements related to windstorm insurance.
 - Change Texas law to require TWIA to use updated catastrophe modeling methods to calculate rates. The current method of relying

on historical storm data means that TWIA offers rates that leave consumers at risk in the event of the next big storm. Texas should, thus, update the methods by which TWIA calculates its rates to include catastrophe modeling.

- Allow a larger benchmark within which TWIA insurers may adjust rates without commissioner approval. Under the current system, TWIA must file for rate changes annually. However, rate changes cannot exceed 10 percent, unless they are approved by the commissioner. This statutory 10-percent cap should be eliminated. Increased rate flexibility will create a more solvent and financially responsible organization better benefiting consumers in the event of a major storm.
- Allow TWIA to differentiate rates based upon actual risk, rather than offering uniform rates in all first-tier coastal counties, as required by the Insurance Code. This reform will allow TWIA insurers to charge higher rates in higher-risk locations, while charging lower rates in lower-risk locations. In addition to being more fair, allowing rate variation within coastal areas to reflect actual risk (i.e., territorial rating) will create a system whereby rates reflect sound insurance principles, rather than uniform pricing.

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) <http://www.texaspolicy.com/pdf/2008-08-RR06-TDISunset-dt-bp.pdf>.
- *Texas' Windstorm Challenge: Unprepared for the Worst* by Bill Peacock, Drew Thornley, and Machir Stull, Texas Public Policy Foundation (Dec. 2007) <http://www.texaspolicy.com/pdf/2007-12-PP31-windstorm-CEF.pdf>.
- *A Better Homeowners' Insurance Market Awaits* by Drew Thornley, Texas Public Policy Foundation (June 2008) http://www.texaspolicy.com/commentaries_single.php?report_id=1997.
- *Can't Compete*, Letter to the Editor by Drew Thornley, Texas Public Policy Foundation, *Corpus Christi Caller-Timers* (Apr. 2008) <http://www.texaspolicy.com/pdf/2008-04-08-CCCT-DT.pdf>.
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- *Homeowners' and Windstorm Insurance in Texas*, PowerPoint presentation by Bill Peacock, Texas Public Policy Foundation (Oct. 2007) <http://www.texaspolicy.com/pdf/2007-Homeowners-Windstorm-presentation-bp.pdf>.



Telecommunications

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The Issue

Municipal franchise fees are levied on a variety of consumer services by cities for the use of the public right-of-way (ROW). These fees, which are levied on retail services such as telephone, cable/video, gas and electricity, have cost Texas consumers more than \$4 billion over the last 10 years. Franchise fees are projected to raise \$25 million in FY 2008 for Texas’ 10 largest cities.

Franchise Fee Revenue from Texas’ 10 Largest Cities			
Type	2007	2006	2005
Electric	\$236,851,499	\$229,251,958	\$205,422,778
Telephone	\$141,391,076	\$144,361,848	\$142,542,190
Cable	\$48,048,485	\$37,772,017	\$34,690,791
Gas	\$60,938,070	\$61,039,728	\$48,793,771
Other	\$32,310,483	\$44,011,326	\$40,458,873
Total	\$519,539,613	\$516,436,877	\$471,908,403

Though some courts (and local governments) have said that franchise fees are “essentially a form of rent: the price paid to rent use of public right[s] of way,” it is wrong to think of them in this way. Governments are not private landlords seeking to extract maximum profits from private property, but guardians of the public interest. As such, governments should not seek to extract maximum rents from the public for the public’s use of the ROW. High rates cost consumers money, disrupt the most efficient use of the ROW, and reduce the quality and availability of services to the public.

The monopoly position of local governments has long allowed them to extract revenues far in excess of the cost of managing the ROW, along with costly in-kind services unrelated to the management of the ROW. The Texas Legislature has noticed this problem and repeatedly stepped in to change the way cities manage the ROW and the way cities collect revenue. The Legislature has passed separate laws regulating the various franchise fee agreements, most recently for cable/video franchises in 2005.

While the Legislature has improved the franchise process, it has left franchise fees at high levels. So while the process is now more efficient, consumers still pay fees that provide revenues for cities far above what it costs to manage the public ROW.

For instance, the most recent budget for the City of Dallas shows approximately \$723,000 budgeted for street cut permitting and ROW construction oversight. Yet Dallas estimates that it will receive \$125 million in FY 2008 from franchise fees. While there may be some other costs associated with ROW management, even a doubling of the ROW expenses listed in the city budget would bring ROW management costs to only a little more than 1 percent of the revenue from franchise fees.

In addition to franchise fees, companies pay for the use of the ROW in various other ways that can at times rival the expense of franchise fees. These charges and expenses are the ones that relate directly to the costs of operating in the ROW. In fact, for the majority of services provided in the ROW, 100 percent of the franchise fees go directly into general revenue and have nothing to do with management of the ROW.

The Facts

- ★ Franchise fees have cost consumers in Texas' 10 largest cities more than \$4 billion over the last 10 years.
- ★ Franchise fees have become divorced from paying for the cost of managing the ROW and have instead become just another revenue source for cities.
- ★ Franchise fees are separate from the actual costs incurred of occupying and managing the public ROW. These include 1) pole attachment charges, 2) construction costs associated with the relocation and expansion of roads and other government facilities, 3) make-ready engineering and construction costs, 4) relocating, removing, or altering facilities in the ROW, and 5) permitting costs.
- ★ Local governments, which have many other sources of revenue, have sufficient “budget bandwidth” to accommodate a reduction in franchise fees.

Recommendations

- ★ To maximize the availability of services available to consumers through the public rights-of-way, franchise fees should be based on the marginal costs cities incur for managing the ROW.
- ★ Franchise fees should generally be levied only on the entity that owns the poles or conduits that occupy the ROW.
- ★ Entities that use poles or conduits owned by other entities should pay for the use of the ROW through pole connection charges and associated fees, rather than through franchise fees.
- ★ The reduction of franchise fees under the marginal cost model should be phased in over a period of several years in order to give cities time to adjust their budgets.
- ★ In return for the reduction of franchise fees, entities that occupy the ROW should bear full responsibility for relocation costs associated with municipal projects.

continued

Resources

- *Testimony Presented to the House Committee on Regulated Industries: Regarding Telecommunications Taxes and Technology Deployment* by Bill Peacock, Texas Public Policy Foundation (June 2008) <http://www.texaspolicy.com/pdf/2008-07-HRI-Testimony-bp.pdf>.
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- “Tax Match: The States vs. the Services” by Marvin Kirsner, *Telecommunications Online: Americas Issue* (Oct. 2005) <http://www.gtlaw.com/pub/articles/2005/kirsnerm05c.pdf>.

TELECOM TAXES

The Issue

Texas consumers are burdened with high tax rates on telecommunications services. The average consumer who subscribes to telephone, cable, and cellular service pays annual taxes of around \$318. Texas' tax rate on landline telephone service is the third highest in the nation.

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).

These average tax rates are representative of the tax burden on a bundle of services. Landline telephone service faces the highest rates, then cellular service, cable/video service, and, finally, satellite service.

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

But there is some good news.

Legislative and regulatory changes have led to the elimination of the Telecommunications Infrastructure Fund (TIF) tax (about \$210 million annually) and a reduction in the USF charges (about \$140 annually). Texas consumers will see their tax bill lowered by about \$350 million per year when these changes are fully implemented.

The Facts

- ★ Landline telephone customers paid an average of \$11.12 per month, or 22.30 percent on an average monthly telephone bill. Telephone subscribers in Presidio face the lightest taxation, \$10.13 per month, while those in Dallas are taxed the heaviest at \$12.24.
- ★ Wireless telephone customers paid \$9.49 per month in taxes, an average effective rate of 19.25 percent.
- ★ Cable video customers paid an average of \$5.90 per subscriber per month, or 14.33 percent of an average monthly bill of \$41.17.
- ★ All satellite television customers in Texas face a 6.25 percent tax on an average monthly bill of \$50.71 (\$3.17 per month).
- ★ VoIP customers paid an average monthly tax of \$5.31, or 16.40 percent of an average monthly bill of \$32.40.
- ★ Consumers who subscribe to cable television and wireline and wireless voice services pay, on average, a total monthly tax burden of \$26.51, or 18.89 percent. This equates to an annual tax bill of \$318.
- ★ The elimination of the TIF tax and changes in the USF fee will save Texas consumers about \$350 million a year when fully phased in over the next four years.

continued

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 once the current reductions are phased in over the next four years.

Resources

- *Testimony Presented to the House Committee on Regulated Industries: Regarding Telecommunications Taxes and Technology Deployment* by Bill Peacock, Texas Public Policy Foundation (June 2008) <http://www.texaspolicy.com/pdf/2008-07-HRI-Testimony-bp.pdf>.
- *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) <http://www.texaspolicy.com/pdf/2007-03-RR06-telecomtaxes-BHill.pdf>.
- *Q&A on the Texas Universal Service Fund* by Bill Peacock, Texas Public Policy Foundation (Aug. 2006) <http://www.texaspolicy.com/pdf/2006-08-PP-USF-Q&A-bp.pdf>.
- *Texas Telecommunications Taxes: An Overview* by Bill Peacock, Texas Public Policy Foundation (Feb. 2006) <http://www.texaspolicy.com/pdf/2006-02-PP-telecom1-BP.pdf>.
- *Texas Telecommunications: Everything Is Dynamic Except the Pricing* by Robert W. Crandall and Jerry Ellig, Texas Public Policy Foundation (Jan. 2005) <http://www.texaspolicy.com/pdf/2005-01-telecom.pdf>.

The Issue

For most of the last century, cheap and universally available local residential phone service was the primary telecommunications goal of policymakers across the country. The resulting regulatory regime kept competition at bay in order to maintain an elaborate web of subsidies that supported artificially low local service prices.

In the 1970s, when it became clear to everyone that consumers were demanding services that the regulated system couldn't deliver, the country began to move into the new era of telecommunications deregulation.

Texas has recently been one step ahead of the rest of the country, 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.

But there is still room for improvement. Even though more than 15 million Texans live in areas where telephone service has been significantly deregulated, only three incumbent phone companies serve those people and there are still price controls in effect in those areas. For instance, companies must apply rates evenly across a deregulated market, consistent with pricing flexibility that was available on August 31, 2005. Companies are also subject to price floors for all services set at the service's long-run incremental cost. Finally, they are also subject to applicable PUC rules relating to "discriminatory" and "predatory" pricing under Chapter 60 of the Public Utilities Code.

The vast majority of phone companies continue to operate in regulated markets serving over 7 million Texans located mostly in rural Texas. In these areas, companies are subject to price caps, price floors, and/or tariffs.

The Facts

- ★ Competition ALWAYS brings consumers the best products at the best prices. The history of telecommunications deregulation proves this time and again.
- ★ When the telecommunications equipment market was deregulated in the 1970s, the prices for phone handsets, key telephones, and private branch exchanges declined at a real rate of between 6 and 7 percent per year between 1972 and 1987.
- ★ From 1984 to 1995, when there were just two cellular providers per market, inflation adjusted rates fell by an average of only 3 to 4 percent annually. However, in 1993, the government allowed up to six competitors in each market, resulting in declines in wireless rates averaging 17 percent annually from 1995 to 1999. A cellular phone call that averaged 50 cents per minute in 1984 has declined to 8 cents per minute today.

continued

- ★ Upon deregulation, interstate long distance rates fell 68 percent from 1984 to 2003, while intrastate rates fell 56 percent. 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.
- ★ The urban/rural digital divide could have a significant impact on taxpayers as it builds political pressure to increase, rather than decrease, telecommunications subsidies through the Texas Universal Service Fund.

Recommendations

- ★ The relics of monopoly regulation—such as price caps and floors—should be removed from the current system. Texas telecommunications policy should reflect the ongoing vibrant competition in many markets by immediately removing all price controls in deregulated markets to provide a positive incentive for companies to choose deregulation.
- ★ Firm timelines should be set for the deregulation of the currently regulated suburban and rural telecommunications markets. It is clear that technology brings real competition in telecommunications to every part of the state. A phased-in approach to deregulation in mid- and small-sized markets would encourage competition by ensuring that market participants (current and potential) understand that competition is inevitable.
- ★ Pricing flexibility that comes with deregulation should be paired with reductions in subsidies.

Resources

- *Texas Telecom Deregulation* by Bill Peacock, Texas Public Policy Foundation (Apr. 2006) <http://www.texaspolicy.com/pdf/2006-04-27-testimony.pdf>.
- *Texas Telecommunications: The Road Ahead* by Bill Peacock, Texas Public Policy Foundation (Oct. 2005) <http://www.texaspolicy.com/pdf/2005-11-telecom-pp.pdf>.
- *A Telecommunications Policy Primer* by Dianne Katz, Texas Public Policy Foundation (Jan. 2005) <http://www.texaspolicy.com/pdf/2005-01-tele.pdf>.
- *Texas Telecommunications: Everything Is Dynamic Except The Pricing* by Robert W. Crandall and Jerry Ellig, Texas Public Policy Foundation (Jan. 2005) <http://www.texaspolicy.com/pdf/2005-01-telecom.pdf>.
- *Communications Without Commissions: A National Plan for Reforming Telecom Regulation* by Braden Cox and Clyde Wayne Crews, Jr., Competitive Enterprise Institute (Oct. 2005) <http://www.cei.org/pdf/4911.pdf>.



Effective Justice

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The Issue

Texas has the most prisoners of any state and the second highest incarceration rate. From 1985 to 2006, Texas' incarceration rate ballooned 205 percent. Florida and New York have increased their incarceration rate at less than half that of Texas in the last 25 years, but have achieved greater crime reductions.

Today, Texas has 156,410 inmates, about half of whom are non-violent offenders. Texas has added 13,083 prison beds since 1997 and another 1,200 prison beds are being added in 2008 as two shuttered TYC lockups are converted to adult prisons.

Judges and prosecutors have attributed growing demand for prisons to the lack of capacity at facilities offering less costly alternatives to incarceration for nonviolent offenders. In 2007, the Legislature made historic changes to address this concern and respond to the Legislative Budget Board's (LBB) January 2007 projection that the state would need another 17,000 new prison beds by 2012, which would have cost a billion to build and operate.

The 2007 reforms included increasing the capacity of prison alternatives, like outpatient drug treatment slots and probation and parole treatment beds. These beds cost less per placement because a typical stay is shorter, though more rehabilitative, than it would be in prison.

In lieu of new prisons, 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. In February 2008, the LBB released a new forecast showing that no new prison beds will be needed through 2012, due in large part to the projected impact of these new diversion initiatives.

Yet, because the 80th Legislature did not make any major changes in sentencing, there is no assurance that the new diversion capacity will be fully utilized by prosecutors and judges. Also, some regions of the state may continue to overutilize incarceration—for example Harris County accounts for 16 percent of the state's population but more than half of those incarcerated for possessing less than a gram of drugs. While Texas should maintain tough laws that keep violent offenders, sex offenders, drug kingpins, and habitual home burglars in prison for long periods, narrowly tailored policy changes can control future incarceration costs by rerouting nonviolent substance abuse offenders who do not pose a threat to public safety.

The Facts

- ★ Prisons cost Texas taxpayers \$49.40 per inmate per day, which is \$18,031 per year. This is lower than the national average of \$24,656.
- ★ Each new state prison bed costs more than \$60,000 to build.
- ★ Parole costs the state \$3.51 per inmate per day, which is \$1,281 per year.
- ★ The criminal justice budget has increased from \$793 million in 1990 to \$2.94 billion in 2008.

Recommendations

- ★ **Require probation with mandatory treatment for most low-level drug possession offenders with no prior violent, sex, property, or drug delivery crimes.** SB 1909 passed by the Senate in 2007 would have made this change, applying only to offenders convicted of possessing less than four grams of drugs. 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—and have to pay for—mandatory probation and treatment. The sentence could include a residential facility or day treatment, or a combination of both, and 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 or revoked to prison for violating probation. The LBB estimated that SB 1909 would have saved taxpayers \$500 million by 2012, not including potentially avoided prison construction costs.
- ★ **Allow certain state jail confinees to substitute two months of parole for each month of jail time, up to one year of parole.** State jail felons are currently ineligible for parole and serve flat time up to two years. By permitting those with no convictions other than possessing less than a gram of drugs, who have already served at least six months with good behavior and are not identified gang members, to depart up to six months early in exchange for serving a year on parole with a work requirement, space can be freed up for more serious offenders. Also, the parole supervision may reduce recidivism. This would affect about 648 state jail confinees, saving \$4 million and possibly avoiding \$40 million in prison construction costs.
- ★ **Identify costliest infirm inmates who no longer pose a danger.** There are about 200 paraplegics and multiple-limb amputees in prison. The current medical parole program is so strict that less than six percent of eligible offenders are actually released and many die while under consideration. In one year, two elderly infirm prisoners cost the state \$1 million in health care expenses. If these inmates were released, possibly to a nursing facility as a condition of parole, most would be eligible for federal health benefits.
- ★ **Require inmates to watch videos featuring testimonials of crime victims.** While in-person victim-offender dialogue sessions such as the non-profit Bridges to Life program that is in 21 Texas prisons are ideal, they cannot reach most inmates. Video presentations can help fill the gap so that offenders better understand the impact of crime on victims.

Resources

- *Special Legislative Briefing on Criminal Justice* by Marc Levin (May 2007) <http://www.texaspolicy.com/pdf/2007-05-EF-briefinghandout-ml.pdf>.
- *How to Avert Another Texas Prison Crowding Crisis* by Marc Levin, Texas Public Policy Foundation (May 2006).

The Issue

The private sector can bring innovation and competition to the criminal justice system.

There are approximately 16,000 state inmates in private prisons and jails. Private prisons cost Texas taxpayers about 14 percent less to operate than their government-run counterparts.

Even within state prisons, some functions are outsourced. A private company will operate a new inmate telephone system through which inmates will pay for monitored calls, with the proceeds going to the Crime Victims' Compensation Fund and the state.

The Prison Industry Enhancement (PIE) program enables inmates at five Texas prisons to work for for-profit companies on the premises. The program enrolls between 250 and 450 inmates, who manufacture computer chips in Lockhart, windows in Coffield, and veneer products in Ellis.

Many community corrections facilities, including both residential and day treatment programs, are privately operated. For example, the non-profit Gateway Foundation runs Substance Abuse Felony Punishment Facilities (SAFPs) and Transitional Treatment Centers (TTCs), which house offenders with substance abuse problems who are diverted from prison or are sentenced to SAFP as a condition of parole. Over 80 percent of participants obtain employment and recidivism rates are lower than traditional prisons. Taxpayers save money because the length of stay is shorter than the prison sentence would have been.

Private companies have also developed technologies, such as GPS, that can help control correctional costs while protecting the public. For example, McLennan County is considering a GPS program to redirect low-risk misdemeanants from county jail. Offenders would pay for their own GPS supervision, which would save the County \$800,000 annually, not including avoided costs of new jail construction. GPS can verify whether an offender is at his job or attending treatment, and new crime scene correlation technology pinpoints whether the offender was at the location of a crime.

The private sector also plays a critical role in preventing and solving crimes, with 2 million private security guards in the United States compared with only 700,000 police officers.

The Facts

- ★ In 2006, state-run prisons cost \$40.06 per inmate per day, not including health care, while private prisons cost \$35.23.
- ★ From 1993 to 2007, PIE factories yielded about \$34 million in paychecks, with \$14 million going for room and board, \$5 million for child support, and nearly \$3 million for crime victim restitution.
- ★ Private security protects 80 percent of sites identified as possible terrorist targets.

Recommendations

- ★ ***Continue utilizing privately-run correctional institutions, but provide greater flexibility to innovate and tie funding to performance.*** Private prisons save taxpayers' money, but their ability to innovate is limited because they are contractually required to be nearly identical to state prisons. Texas should adopt a system similar to the one proposed by the British Conservative Party in which private prisons would receive two tiers of funding, one a flat amount per inmate and the other tied to outcomes such as recidivism and GED's and occupational certificates earned.
- ★ ***Empower parole board to order GPS monitoring and pass through funding based on the parole rate.*** When the Board of Pardons and Paroles meets or exceeds their own goals for paroling the lowest-risk, nonviolent inmates, they should be able to tap into a fund that reallocates some of the savings to the state to TDCJ's Parole Division by designating certain parolees for GPS monitoring, including active GPS with crime scene correlation.
- ★ ***Start work release program for nonviolent state jail inmates serving final months of sentence.*** Lubbock-based BoDart Recruiters, which places ex-inmates into jobs, has 350 jobs waiting for ex-inmates in fields such as oil and gas, construction, and trucking. GPS can be used to monitor offender compliance. Ex-offenders who are employed are three times less likely to re-offend.
- ★ ***Clarify that Sheriffs' departments can contract with a private provider to run a GPS program for pre-trial defendants not on probation.*** In June, McLennan County requested an AG's opinion on this question.
- ★ ***Enhance collaboration with private security.*** The Department of Public Safety should allow licensed private security guards to access state radio interoperability channels in emergencies, run warrant checks when a person seeks access to a power plant or other private property, and include private security when distributing alerts identifying fugitives.

Resources

- *Work Release: Con Job or Big Payoff for Texas* by Marc Levin, Texas Public Policy Foundation (Apr. 2008) <http://www.texaspolicy.com/pdf/2008-04-PP11-workrelease-ml.pdf>.
- *Prisons with a Purpose: Our Sentencing and Rehabilitation Revolution to Break the Cycle of Crime*, U.K. Conservative Party, <http://www.conservatives.com/getfile.cfm?file=SecurityAgendaScreen&ref=GENERALFILE/3585&type=pdf>.

The Issue

Criminal law is not just for criminals anymore—at least not criminals as we have traditionally defined them. Texas lawmakers have created over 1,700 criminal offenses. The traditional criminal offenses like murder, rape, and theft are found in the Penal Code, but there are over 1,500 offenses outside of the Penal Code, many of which relate to ordinary business activities in fields such as agriculture, health care, natural resources, and insurance. There are 11 offenses alone relating to oysters.

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, because it is assumed that criminal laws cover only those activities that are inherently wrong, no such balancing occurs in criminal proceedings. 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 mislabeling fruit under Chapter 93 of the Agriculture Code does not include anyone actually being harmed as an element of the offense. Finally, civil 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*.

The Facts

- ★ Examples of excessive Texas criminal laws include:
 - Under Agriculture Code, Chapter 76, it is a Class A misdemeanor (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 of the Water Code specifies that it is a second degree felony (up to 20 years in prison) for a person who “fails 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 (up to one year in jail) for violating “any rule” of any professional licensing board.

Recommendations

- ★ *Avoid creating new criminal offenses, especially for non-fraudulent business activities.* If a new law is necessary, civil fines and revocation of state permits and licenses can be used as enforcement mechanisms.
- ★ *Apply Water Code provision to other regulatory areas that allows state agencies to review local prosecutions.* Section 7.203 provides a safe harbor for business owners who come into compliance by giving the Texas Commission on Environmental Quality the ability to block local

prosecutions under the regulations it enforces. This safe harbor provision should be applied elsewhere to ensure that regulated businesses do not satisfy the state agency, rectify the problem, and pay administrative fines, only to face duplicative local prosecutions.

- ★ **Revise catch-all statutes.** Blanket statutes that allow agencies to create rules that have criminal penalties should be rewritten so that offenses are limited to violations of statute and non-compliance with rules is enforced by civil penalties and revocations of permits. In addition to Occupations Code, §165.151, other blanket statutes include:
 - Agriculture Code, Chapter 1611: Class C misdemeanor for violation of any animal identification rule promulgated by the Animal Health Commission. Class B misdemeanor (up to 180 days in jail) for multiple convictions.
 - Health & Safety Code, Chapter 143: A person engaged in industrial homework commits an offense if they “otherwise violate this chapter or any provision of the employer’s permit or violates a rule adopted by the board.”
- ★ **Eliminate possibility of jail time for first-time conviction of a regulatory misdemeanor.** Modify Sections 12.21 and 12.22 of the Penal Code to rule out jail time for first-time convictions of misdemeanors other than those offenses listed in the Penal Code, Controlled Substances Act of the Health & Safety Code, fleeing a police officer under Transportation Code § 545.421, and any others that involve inherent wrongs and/or actual victims. This would relieve counties of the cost of indigent legal representation, which is required by the U.S. Constitution only if jail time is possible.

Resources

- *Not Just for Criminals: Overcriminalization in the Lone Star State* by Marc Levin, Texas Public Policy Foundation (Apr. 2005) <http://www.texaspolicy.com/pdf/2005-04-pp-overcrim.pdf>.
- *Analyze Before You Criminalize: A Checklist for Legislators* by Marc Levin, Texas Public Policy Foundation (Mar. 2008) <http://www.texaspolicy.com/pdf/2008-03-PP03-criminalizechecklist-ml.pdf>.
- *Business Overcriminalization in the 80th Legislative Session* by Marc Levin, Texas Public Policy Foundation (Apr. 2007) <http://www.texaspolicy.com/pdf/2007-03-PP07-80thReforms-ml.pdf>.
- *Sometimes There Ought Not Be a Law* by Paul Rosenzweig and Steve Muscatello, Heritage Foundation (Apr. 2005) <http://www.heritage.org/Press/Commentary/ed040605a.cfm>.

The Issue

In 1989, Texas adopted a constitutional amendment now in Article I, Section 30 establishing the 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 and an oral statement after the sentence is pronounced.

TDCJ's 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 the victim, and it is usually a condition of probation. In 2005, HB 1751 became law, requiring trial courts that decline to order restitution to provide a written explanation.

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

Texas does not have a statewide pretrial victim-offender mediation program, although 11 Texas juvenile probation departments offer mediation. Victims 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 to 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 now 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 more successful in finding or retaining a job that enables them to pay restitution.

The Facts

- ★ 87,714 victims are registered with the state's notification system, informing them of the progress of the case and the offender's status.
- ★ A national study found 95 percent of cases resolved through victim-offender mediation result in a written agreement and 90 percent of these restitution agreements are completed within one year, far exceeding the average restitution collection rate of 20 to 30 percent.

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

Recommendations

- ★ ***Allow Victims to Present an Oral Impact Statement Prior to Sentencing.*** House Bills 338 and 442 in the 79th Legislature would have permitted this.
- ★ ***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. In the 80th session, HB2347 and HB2291 as originally proposed would have created a state framework for adult and juvenile mediation respectively, including a funding stream through an offender fee.
- ★ ***Give Victims a Seat at the Table in Plea Bargaining.*** Texas should follow Arizona in giving victims the right to participate in any plea negotiations with the accused and 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.*** The state should evaluate probation departments in part based on their success in collecting restitution and include the collection rate as an element of performance-based probation funding.
- ★ ***Expand Victims' Access to Offenders' Funds.*** Amend Constitution (HJR67 in 80th Legislature) to allow restitution to be garnished from wages, just as with child support. Also, when unpaid restitution orders are converted into civil judgments, lower exemption thresholds should apply than the \$60,000/\$30,000 married/individual property exemptions from other civil judgments.

Resources

- *Restorative Justice in Texas: Past, Present & Future* by Marc Levin, Texas Public Policy Foundation (Sept. 2005) <http://www.texaspolicy.com/pdf/2005-09-restorativejustice.pdf>.
- *Victim-Offender Mediation and Plea Bargaining Reform in Texas* by Marc Levin, Texas Public Policy Foundation (Apr. 2006) <http://www.texaspolicy.com/pdf/2006-04-PP-VOM-ml.pdf>.
- *Testimony on HB 2291-Juvenile Victim-Offender Mediation* (Mar. 28, 2007) <http://www.texaspolicy.com/pdf/2007-03-28-ML-testimony.pdf>.

The Issue

Approximately 450,000 Texans are on probation. Revoked probationers account for 37 percent of prison intakes, resulting in \$547 million in incarceration costs. Although three times as many Texans are on probation as in prison, 10 state dollars are spent on the prison system for every dollar spent on probation.

Since 2005, \$55 million in state probation funding has been incentive-based. Departments are eligible if they adopt progressive sanctions and pledge to reduce their technical revocations. Progressive sanctions involve utilizing graduated measures such as increased reporting, community service, curfews, electronic monitoring, mandatory treatment, and shock-nights in jail prior to revoking a probationer to prison for technical violations.

Most probation departments have participated in the incentive funding, and these departments have reduced their technical revocations by 16 percent while non-participating departments increased technical revocations by 8 percent. Had all departments increased their revocations by 8 percent, another 2,640 probationers would have been revoked at a cost of \$119 million, not including prison construction. Departments receiving the funding used most of it to reduce caseloads from 150 to about 110 probationers per officer.

Approximately 76,000 Texans are on parole. The parole revocation rate is 11 percent, including both new offenses and technical revocations. Parole costs \$3.51 a day compared with \$49.40 for prison.

Each year over 50,000 former prisoners re-enter Texas neighborhoods. While employed ex-offenders are much less likely to re-offend, Texas statutes and regulations restrict ex-offenders from obtaining more than 150 occupational licenses, and employers can face negligent hiring lawsuits for giving ex-offenders second chances.

The Facts

- ★ To help avoid spending over a billion dollars on building and operating new prisons, the 80th Legislature added 1,400 beds at probation and parole intermediate sanctions facilities. These facilities are typically located in urban areas, such as one across from Minute Maid Park; have average stays of 60 days; and primarily house probationers and parolees who would otherwise be revoked for technical violations or misdemeanors.
- ★ Texas has 121 probation departments and 40 percent of their budgets come from probationers' fees.
- ★ In 2006, the Department of Public Safety's Private Security Bureau denied 10,000 Texans the opportunity to work in the 16 occupations it regulates, including locksmiths and alarm salespeople, due to a prior offense, many of which were petty crimes that had occurred 10 or 20 years ago.

Recommendations

- ★ ***Institute system-wide performance-based probation funding.*** Given the success of the voluntary 2005 incentive funding initiative, this approach should be expanded. HB 3200 from last session, which would have linked a share of probation funding to technical revocations and early terminations, should be broadened to include weights for probationer risk levels, new offenses and their seriousness, employment rate, educational and vocational degrees and certificates earned, and restitution and child support paid.
- ★ ***Streamline parole decisionmaking.*** A common reason for denying parole is the “nature of the offense,” a factor that never changes. Consequently, it is redundant for different parole panels to continually consider this every year. Also, inmates cannot be accurately prioritized for pre-release programs since there is no way to anticipate parole decisions. By determining upon entry into the system whether parole-eligible inmates should ever be paroled and, if so, setting a date, which would be dependent on an inmate’s good behavior and completion of work and treatment programs, efficiencies can be achieved while also incentivizing inmates.
- ★ ***Allow nonviolent ex-offenders to obtain provisional licenses for most occupations.*** Provisional licenses provide a second chance for ex-offenders to earn a living while enabling the agency to summarily revoke their license if they violate any occupational rule or the terms of their probation or parole. SB 1750 in the 80th session would have authorized such provisional licenses.
- ★ ***Limit employer’s civil liability for hiring nonviolent ex-offenders.*** HB 2537 last session would have immunized employers from liability simply based on hiring nonviolent ex-offenders *except* for the following circumstances:
 - Sex offenders in jobs involving children or home visits
 - Employees who manage funds as a fiduciary with convictions for offenses related to misappropriation of funds.

At the least, punitive damages against employers should be disallowed, since there is a public policy interest in promoting the employment of ex-offenders.

Resources

- *Working with Conviction: Criminal Offenses as Barriers to Entering Licensed Occupations in Texas* by Marc Levin, Texas Public Policy Foundation (Nov. 2007) <http://www.texaspolicy.com/pdf/2007-11-PP28-licensing-ml.pdf>.
- *The Role of Parole in Solving the Texas Prison Crowding Crisis* by Marc Levin, Texas Public Policy Foundation (Nov. 2006) <http://www.texaspolicy.com/pdf/2006-10-PP-parole-ml.pdf>.
- *Laying the Foundation for Better Probation* by Marc Levin, Texas Public Policy Foundation (June 2006) <http://www.texaspolicy.com/pdf/2006-06-PP-probationreform-ml.pdf>.

The Issue

There are over 150,000 juveniles arrested every year in Texas, and more than 50,000 are incarcerated at Texas Youth Commission (TYC) and local detention and postadjudication facilities. The Texas Juvenile Probation Commission (TJPC) monitors these local lockups. Also, some 68,000 Texas youths are on probation or parole.

Another 7,000 Texas youths are in Juvenile Justice Alternative Education Programs (JJAEPs), which are non-residential educational facilities overseen by counties for students who have been expelled, committed certain criminal offenses, or engaged in serious and persistent misbehavior while at alternative schools called Disciplinary Alternative Education Programs (DAEPs). Under zero tolerance policies, Texas students have been expelled for accidentally bumping into an alarm and possessing prescription drugs and asthma inhalers that they were legitimately using but failed to register with school authorities.

In 2005, honor student and soccer team goalkeeper Pavlos Karnezis in Fort Bend ISD was expelled and banished for months to a JJAEP for a small knife used for a school-sponsored internship at Texas Instruments that was volunteered to a physics teacher when she asked for something to cut with. His graduation would have been delayed had his parents not moved him to a private school.

Additionally, more than 286,000 Texas students are placed in out-of-school suspension, resulting in more than 1 million school days missed. Texas students are 35 times more likely to commit a criminal offense while suspended.

Some 106,000 students are suspended and placed in DAEPs. All districts must have a DAEP, but smaller districts often share them with one or more neighboring districts. Most DAEPs are operated by school districts although several in Houston and Dallas are run by private entities that contract with school districts. DAEPs have five times the drop-out rate of regular campuses, and some 80 percent of Texas adult prisoners are drop-outs.

In 2007, policymakers addressed the crisis at TYC by enacting SB 103. Among other reforms, SB 103 instituted cameras, an inspector general, and an ombudsman to root out abuses, prevented sex offenders from working at TYC, ended the placement of misdemeanants at TYC, created a parental bill of rights, and required that youth at TYC be paroled or transferred to adult prison upon turning 19.

Also in 2007, the Legislature enacted measures requiring the Texas Education Agency to promulgate standards for DAEPs and that DAEPs, for the first time, provide a full school day and administer an intake and intake exam for students placed there for 90 days or more. The Iowa Test of Basic Skills is already administered to students placed at JJAEPs for 90 days or more. This has provided a barometer indicating that JJAEP students make academic progress that is more than commensurate with their placement period while also allowing for comparisons among different types of JJAEPs (classroom, military, and therapeutic) and JJAEPs in various counties.

The Facts

- ★ The number of youths incarcerated at TYC residential facilities, including institutions, halfway houses and contract facilities, has declined from 5,646 in 2000 to 4,709 in February 2007, and following SB 103, to 2,882 in February 2008.
- ★ DAEP placements have increased from 70,728 in 1999-2000 to 105,530 in 2005-06. Approximately 76 percent of DAEP placements are discretionary while the remainder are mandatory, because they involve conduct on or near the campus such as assault, drug or alcohol possession, and setting off a false alarm that automatically trigger suspension and DAEP placement under provisions in Chapter 37 of the Education Code.
- ★ Some 569 pre-kindergarten and at least 3,118 first-grade students have been referred to DAEPs.

Recommendations

- ★ ***Pool TYC and juvenile probation funds for nonviolent offenders.*** Ohio reduced recidivism two-to-six-fold and commitments to state youth lockups by 36 percent through its RECLAIM (Reasoned and Equitable Community and Local Alternative to Incarceration of Minors) program. This involves pooling state probation and incarceration funds for nonviolent offenders and remitting the money to counties based on population and delinquency levels. Counties can then purchase slots in state lockups or use the same funds for less expensive, but often more effective, local programs, such as day treatment. This funding approach could be initially applied in connection with the 300 youths referred annually to TYC for drug offenses.
- ★ ***Link a share of juvenile probation funding to outcomes.*** Some portion of juvenile probation funding should be linked to performance benchmarks for each department, such as the percent of probationers who successfully complete a program, the percent of probationers who commit additional crimes (with a greater weight for violent crimes), school attendance, academic and behavioral progress, employment for youth who are not full-time students, and percent and amount of restitution collected.
- ★ ***Streamline TYC facilities.*** Despite the costs of implementing SB 103, such as increasing juvenile correction officer training to 300 hours (the adult prison guard standard) and staffing the inspector general and ombudsman's office, TYC's operating budget declined from \$454.6 million in 2006-07 to \$445.3 million in 2008-09, largely due to fewer incarcerated youth and the reconversion of two facilities to the adult prison system. However, the cost per youth has increased from \$62,000 per year to over \$100,000. TYC in-

continued

stitutions are not being fully utilized and must be further consolidated to control costs. Unnecessary TYC lockups should be prioritized for closure based on their recidivism rate, the available local workforce, the number of current and recent staff vacancies, and the remaining lifespan, maintenance costs, and overall suitability of the physical plant.

- ★ ***Emphasize vocational training at TYC facilities.*** Given that the average youth committed to TYC has an IQ of 88, functions at a 5th to 6th grade level despite being 16 years old, and typically has few if any high school credits, high school graduation is often not realistic, particularly in light of the shorter confinement periods at TYC since SB 103. Moreover, most youths discharged from TYC have no source of financial support and thus do not re-enter school. Research indicates employment of ex-offenders substantially reduces recidivism. Consequently, TYC programming should emphasize earning a GED and obtaining vocational training in fields such as welding, automotive repair, and construction. While TYC has vocational programs, each type of program is not available at each facility. TYC should include as a performance measure the number of GEDs and occupational certificates obtained by incarcerated youths.
- ★ ***Revise Education Code Section 29.012 to allow juvenile probation departments to receive education funding directly from the state for youths in residential facilities.*** Currently, some school districts send over low-performing teachers to these facilities, and there is no principal or other instructional leader in charge. In 1999, the Dallas County Juvenile Probation Department and Dallas ISD agreed to put the county's residential facilities under a charter school operated by the Juvenile Probation Department, and student performance has dramatically improved. The state should allow counties to independently decide to receive state per-student funding along with the obligation to provide instruction for youth in postadjudication and detention facilities. These departments could then charter a school or contract with a school district or other provider. Such charters should be exempt from the state cap on charters, and their accountability evaluations should be based on customized criteria that reflect the uniquely challenging population and shorter period of enrollment prior to returning to a traditional campus. For the majority of juveniles who spend less than six months in a residential facility and its school, an intake and outtake diagnostic test, such as the Iowa Test of Basic Skills which is administered to students placed at Juvenile Justice Alternative Education Programs (JJAEPs) for 90 days or more, is much more useful than the TAKS test for assessing the efficacy of the educational program, because it solves the disaggregation problem by measuring the change in proficiency while in the new setting.

- ★ ***Make expulsion discretionary for students caught with prescription drugs and asthma inhalers.*** Expulsion is mandatory if a student is caught with Xanax or other legitimately prescribed medications that they have not registered with school authorities. Section 37.007 (a)(3) of the Education Code requires expulsion for any drug offense that is punishable as a felony, and drug offenses that would otherwise be misdemeanors are punishable as felonies under the Section 481.134 of the Health & Safety Code if they occur within 1,000 feet of a school. Schools should be free to exercise discretion in whether to expel such students based on their disciplinary history, intent, and other factors, as they may achieve better outcomes with such students through in-school discipline and/or suspension.
- ★ ***Make suspension to a DAEP discretionary instead of mandatory for possession of alcohol and abuse of volatile chemicals, such as glue and correction fluid.*** A high school student with a beer can in the trunk of his car parked in the school lot could be disciplined in ways other than being sent to a DAEP, which tends to disrupt academic progress. Principals, not state lawmakers, are best situated to make disciplinary decisions based on the unique facts in each case.

Resources

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- *Schooling a New Class of Criminals* by Marc Levin, Texas Public Policy Foundation (Mar. 2006) <http://www.texaspolicy.com/pdf/2006-03-PP-DAEP-ml.pdf>.
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- *Texas' School-to-Prison Pipeline: Dropout to Incarceration*, Texas Appleseed (Oct. 2007) <http://www.texasappleseed.net/pdf/Pipeline%20Report.pdf>.
- *Transforming Juvenile Justice in Texas: A Framework for Action - TYC Blue Ribbon Task Force Report* by David Springer (Sept. 2007) <http://www.dallasnews.com/s/dws/img/09-07/0913tycreport.pdf>.
- *Zero Tolerance Horror Stories* by George Clowes, Heartland Institute (June 2003) <http://heartland.org/Article.cfm?artId=12352>.



Tort Reform

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The Issue

Since 1995, no state has done more than Texas when it comes to restoring the trust of citizens in their court system. Tort reform has lowered liability costs for numerous occupations, reduced frivolous lawsuits, and reduced overall costs to businesses and consumers in Texas. Texas' efforts to reform its tort system have been successful in attracting physicians to Texas and in lowering medical malpractice premiums. However, Texas' tort climate still has problem areas, namely its number of jurisdictions considered "judicial hellholes," or areas with histories of large or excessive verdicts against tort defendants.

The Facts

- ★ Prior to tort reforms passed in 2003 by the Texas Legislature, frequent lawsuits against physicians and hospitals and escalating jury awards to plaintiffs drove doctors and insurers from the state, leading to physician shortages and higher costs for both doctors and patients.
- ★ Between 1996 and 2000, one of four Texas doctors was sued. In the 10 years following 1989, the average medical malpractice verdict skyrocketed from \$472,982 to \$2,048,541. The percentage of such awards attributable to noneconomic damages, which are intangible injuries like pain and suffering, increased from 35.7 percent to 65.6 percent. Between 2000 and 2003, 13 of the state's 17 medical insurance carriers pulled out of Texas.
- ★ Pre-reform, medical malpractice rates were rising 15 percent to 20 percent per year; post-reform, rates have fallen almost 40 percent. Texas Medical Liability Trust, the state's largest medical malpractice insurance carrier, has reduced rates the last five years, with a cumulative 31 percent rate reduction and about \$200 million in premium savings.
- ★ In May 2003, there were 35,723 in-state medical doctors. Today, there are 42,367, an 18.6 percent increase.
- ★ From May 2003 to March 2008, the number of medical doctors practicing in the counties of Bexar, Dallas, El Paso, Harris, and Travis increased 22.1 percent, 14.4 percent, 21.6 percent, 18.5 percent, and 23.3 percent, respectively.
- ★ As of May 12, 2008, the number of pending applications to practice medicine in Texas was 2,637.
- ★ Texas ranks 18th (1 = best) in the Pacific Research Institute's 2008 *U.S. Tort Liability Index*, which ranks states' tort laws and tort costs. Texas is ranked 5th in the category of monetary tort loss but 46th in the category of litigation risk. In PRI's last tort index (2006), Texas fared much better, receiving the top overall ranking.

Recommendations

- ★ Do not roll back the legal reforms passed since 1995 (e.g., reforms in the areas of venue shopping, punitive damages, medical malpractice, and asbestos and silica), as they have led to a fairer system of justice, a more attractive business climate, and a stronger economy. For example:
 - Do not increase caps on punitive damages, as doing so will inevitably lead to increased filing of lawsuits and increased seeking of large punitive-damage awards, both of which will place added strain on Texas' civil justice system.
 - Do not increase caps on non-economic damages in medical malpractice cases, as Texas' 2003 medical malpractice reforms have led to an enormous influx of physicians.
 - Do not allow *qui tam* actions, as 1) such actions, though well-intentioned, can lead to a private "bounty" system of justice that encourages the filing of frivolous lawsuits, and 2) Texas' Attorney General's Office is sufficient to bring actions on behalf of the state.
- ★ Award attorneys' fees to defendants in lawsuits found to be meritless.
- ★ Strengthen the standards for expert testimony, in order to ensure expert witnesses are qualified and unbiased.

Resources

- *A History of Lawsuit Reform in Texas* by Joe Nixon, Texas Public Policy Foundation (May 2008) <http://www.texaspolicy.com/pdf/2008-05-RR04-tortreform-jnixon-posting.pdf>.
- "Tort reform the right cure for Texas' doctor shortage" by Drew Thornley, *Houston Chronicle* (Nov. 2007) <http://www.texaspolicy.com/pdf/2007-11-24-HC-DT.pdf>.
- *Restoring Civil Justice in Texas: Finishing What We Started* by Bill Peacock, Texas Public Policy Foundation (Apr. 2006) <http://www.texaspolicy.com/pdf/2006-04-PP-tortreform-bp.pdf>.
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- *A Texas Turnaround: The Impact of Lawsuit Reform on Business Activity in the Lone Star State*, The Perryman Group (Apr. 2008) http://tlrfoundation.com/beta/files/Texas_Tort_Reform_Report_2008.pdf.
- *Don't Rollback Tort Reform in Texas: Oppose SB 1309*, Texas Civil Justice League (May 2007) http://tcjl.com/index.php/article_news/oppose_sb_1309/.

The Issue

The organizational structure of Texas' state court system was originally laid out in Article V of the State Constitution adopted in 1891. Piecemeal and ad hoc restructuring over the intervening years have resulted in an antiquated system full of irregularities, inconsistencies, and overlapping jurisdictions.

In order to bring simplicity and rationality to the legal process, the system's organization and administration should be reformed. A number of jurisdictional and area of specialization issues also need to be addressed.

In the 80th Legislative Session, the Texas Legislature considered SB 1204 and HB 2906, which would have modernized and simplified Texas' court system, namely through (1) improving the Texas Supreme Court's ability to manage the judicial system, (2) rationalizing trial courts and clarifying subject-matter jurisdiction, (3) creating a true small-claims system, and (4) assigning complex cases to judges most capable of handling them. These bills died at the end of session.

Similar legislation is needed to provide for a more efficient judicial system. Judicial reform will bring greater simplicity and fairness to an often byzantine and confusing system, allowing the system to function more efficiently and reducing the cost to those who must interact with the courts. As a result, it will not only spur economic growth but further rebuild citizens' faith in the court system.

Texans would benefit from a just and coherent civil justice system that effectively adjudicates disputes in an efficient and timely manner. Modernizing the court system will bring the clarity and rationality necessary for the state to build on the reforms of the last decade.

The Facts

- ★ As of March 2007, the Texas judicial system consisted of two high courts (the Supreme Court and the Court of Criminal Appeals, each with nine members); 14 intermediate courts of appeals (with a total of 80 justices); 437 operating district courts; 254 constitutional county courts; 222 operating statutory county courts; 18 operating statutory probate courts; municipal courts sitting in 915 cities with a total of 1,396 judges; and 821 justice courts.
- ★ Some counties fall within the jurisdiction of more than one courts-of-appeal districts. The Dallas and Texarkana courts share Hunt County, and the Texarkana and Tyler courts share Gregg, Rusk, Upshur, and Wood Counties.
- ★ Each justice of the peace sits as judge of the small claims court. All justices of the peace in Texas also serve as small claims court judges. Justice courts and small claims courts occupy the same facilities, have the same judge, and are served by the same staff.

Recommendations

- ★ Limit the number of peremptory challenges available during voir dire. Texas allows each side (plaintiff and defendant) 10 peremptory challenges during jury selection. Reducing the number of peremptory challenges available to attorneys will save the court system time and money yet maintain the integrity of the jury-selection process.
- ★ Create a uniform system for handling complex-litigation cases.
- ★ Strengthen standards for admission of expert testimony. Not all courts, particularly at the state level, have the resources needed to sift through the voluminous information presented in many trials in order to verify the accuracy of expert testimony and determine whether it should be allowed in the courtroom.
 - Give judges the necessary resources to use independent doctors and other professionals to help them determine whether expert testimony should be admitted in court.
 - Require that doctors who testify as expert witnesses be deemed to be practicing medicine, which would give the Texas Medical Board the authority to discipline those who fraudulently testify.
- ★ Consolidate justice-of-the-peace courts and small claims courts. Such streamlining will lead to a more efficient system for courts of inferior jurisdiction.

Resources

- *Restoring Civil Justice in Texas: Finishing What We Started*, by Bill Peacock, Texas Public Policy Foundation (Mar. 2006) <http://www.texaspolicy.com/pdf/2006-04-PP-tortreform-bp.pdf>.
- *Reforming Texas Courts*, by Kevin Holtsberry, Texas Public Policy Foundation (Mar. 2007) <http://www.texaspolicy.com/pdf/2007-03-PB15-Courts-kh.pdf>.
- *Recommendations for Reform: The Texas Judicial System*, Texans for Lawsuit Reform Foundation (2007) http://www.tlrfoundation.com/files/tlrf_courtad-min2007.pdf.
- <http://www.courts.state.tx.us/pubs/2007JudDir.asp>.
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Thinking Economically

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The Issue

What Is Economics? Economics is the scientific study of how humans adjust their behavior to seek happiness as they define it, in light of the fact that they can't have everything they want.

Once human beings are seen treated as thinking creatures with individual goals, then we can already conclude several important principles. For example, we immediately realize that because individuals are different, they (may) have different goals. That means the economic value of something isn't objective the way its mass or temperature is. On the contrary, value is subjective, because the usefulness (or "utility") of a good or service is in the eye of the beholder.

Another fundamental principle is scarcity. Simply put, people have a myriad of preferences, but not all of them can be satisfied. People have to choose, and such choices necessarily involve tradeoffs. The benefit of a particular choice is the value (or utility) of the alternative chosen, while the cost of a choice is the value placed on the next-best alternative that is now unattainable.

Straightforward stuff, and yet there are plenty of critics who despise this type of "thinking economically." These are the basics of what are known as "economic laws," among the most powerful—definitely the most important—laws that social scientists have discovered. Professional economists, like other scientists, do use empirical data to test particular theories, but fundamental economic laws are really just codified common sense.

Self-Interest versus Selfishness. The very starting point of economics is to identify the proper unit of analysis—the individual. Though some people object to this, to focus on the individual as the starting point of analysis is the only method that makes sense; "crowds" don't do anything, individuals within a crowd do. For an analogy with the physical sciences, chemists believe that all matter is composed of atoms. But that doesn't mean chemists are ignorant of the different ways those atoms behave when arranged in different molecules.

When an economist says that people act in their self-interest, or to "maximize utility," this is a purely formal statement that implies nothing about the value or propriety of the specific preferences of the individual. A heroin addict gets utility from his next fix, and Mother Theresa gets utility from helping poor children. Though both are acting in their own self-interest, one is being selfish, the other is being selfless. The economist can use his tools to explain both types of actions.

The Law of Diminishing Marginal Utility. A crucial economic insight is that people make decisions “on the margin.” This principle solves the classical “water-diamond paradox,” which poses the following riddle: If water is so important to human life, while diamonds are a mere frippery, then why are diamonds so much more expensive than water? The answer is that economic decisions are based on marginal utility. Nobody ever chooses between “water” and “diamonds” as abstract categories. Rather, the actual choice people face in everyday life is between a definite unit of water versus a certain unit of diamonds. And though water in general is essential, its relative supply is so great that (in normal circumstances) most people would much rather sacrifice one unit of water than one unit of diamonds.

The formal rule explaining all of the above is the law of diminishing marginal utility. Not only do people value goods according to their marginal (rather than total) utility, but this marginal utility declines as the supply of the good increases. Being rational, people assign the first unit of a good to its most important use—so the first gallon of water is reserved for drinking. But then successive units are assigned to goals of successively lower importance—the 20th gallon of water might be used for bathing, while the 1000th might be devoted to washing the car.

The Law of Increasing Marginal Costs. Just like consumers, producers make decisions on the margin and don’t ask, “Do I like money more than milk?” Rather, the question for producers is, “How many cartons should I produce at a given price?”

It is a technological fact that for any production process, at some level of output the additional cost (i.e., marginal cost) of producing one more unit begins to rise. It might be because of the difficulty of finding the additional materials and labor needed to increase production, or it might be that the equipment only works optimally in a certain capacity of output, or that transportation costs begin to rise as both inputs and outputs have to be shipped longer distances. But regardless of the specifics, at some point marginal costs have to rise. If they didn’t, it would mean a single factory could efficiently produce all of the world’s cars, or that the entire crop yield of Earth could be reaped from a single acre of farmland. No, at some finite level of output, at least one of the ingredients in the production process becomes overburdened, making additional units very costly to produce. Rising marginal costs explain why successful producers don’t sell an infinite amount.

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Immutability: The Law of Unintended Consequences. Economists have a duty to remind everyone as often as possible of the immutable nature of economic laws. Just like with the laws of physics, economic laws are simply descriptions of reality. Scarcity can no more be ignored than gravity. Policy-makers who think they can determine the proper price of a good better than the market will create no less a disaster than the captain of an ocean liner who believes his engines will allow him to pay no heed to momentum.

Economic laws cannot be broken—only ignored. Attempts to do so leave a convoluted trail of unintended consequences harming people who don't understand what went wrong or who caused the problem.

Mandates and subsidies for corn-based ethanol are a perfect example of this. Congress has ignored what market prices have been telling them about ethanol—it is too costly to be a substitute or additive for gasoline. Only now are the results of this becoming readily apparent. Corn prices have skyrocketed as the demand for corn increased. At first this was felt mostly by those who depend on corn tortillas as a food staple—large protest marches were set off in Mexico City when the price of tortillas doubled. But now the higher prices are being noticed here at home. The increased price of animal feed is leading to higher prices for poultry, pork, and eggs. Soft drinks, which rely on corn syrup, shouldn't be far behind. Another result of the ethanol policies is that the increased production of corn is putting heavy pressure on water supplies throughout the Midwest and West.

Policy Implications

- ★ “The art of economics consists in looking not merely at the immediate but at the longer effects of any act or policy; it consists in tracing the consequences of that policy not merely for one group but for all groups.”
–Henry Hazlett
- ★ There are limits to what can be accomplished in the political realm—efforts to “fix” a problem with a legislative solution usually run afoul of economic laws and human nature.
- ★ Efforts to regulate voluntary market behavior and prices always result in harmful unintended consequences.
- ★ Economic behavior is best regulated through voluntary, market-based transactions, the civil justice system, and—when fraud or theft is involved—the criminal justice system.

The Issue

In the late 1950s, the Ford Motor Company rolled out the Edsel automobile. Despite the company's \$400 million investment, the car was discontinued after its third model year in what *TIME.com* later described as “one of the autodom’s most hilarious pratfalls.” At the opposite extreme were the Cabbage Patch Dolls of the early 1980s. Children coveted these to the point that their parents would line up outside stores for hours and pay many times the suggested retail prices just to get their hands on them. So what do these two examples tell us about “The Value of Things?”

Value is determined by human choice. Even though objective realities such as resource supplies and technological know-how are important, in the final analysis even these objective realities are reflected in people’s subjective view of their worth.

Market exchange is a win-win proposition. To understand the market economy, we must remind ourselves that every activity is simply a voluntary exchange between two or more consenting parties. That’s why both parties to an exchange benefit—they wouldn’t have agreed to it otherwise!

The value of the output goods determines the value of the inputs. Why would a person be willing to trade away an orange for a handful of apple seeds? After all, you can’t eat apple seeds (or at least, it’s no fun to do so), and they’re not particularly pleasing to the eye. So why give up a perfectly good orange for them? The answer of course is that with enough time, soil, rainfall, etc., the directly useless seeds can produce the tasty apples. In a sense, the value of the apple is mentally transferred to the items that produce it.

The cost theory of value is wrong. People first value those goods (and services) that directly cater to their desires, and then use these evaluations to determine the relative importance of those goods (and services) that in turn can produce the first batch of items.

The labor theory of value is wrong. How much effort someone puts into a project does not automatically translate into the value of the finished product. If someone spends days preparing a literal mud pie, it will still taste awful and no one will pay a cent for it.

How the free market price is determined. At any price, producers want to sell a certain number of units, and at the market price consumers want to purchase the exact number of units producers want to sell. There is no force pushing the price higher or lower—because consumers and producers are perfectly matched.

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When the government interferes with prices, bad things happen. At the market price, supply and demand balance perfectly. So when the government pushes the price lower through its threats of fines, consumers want to buy more units of the product than producers want to sell. A shortage results. When prices are allowed to freely fluctuate, shortages are quickly eliminated. But when the government is responsible, shortages can persist indefinitely.

Things are just as bad when the government imposes a price floor. By forcing the price above the market-clearing level, the government creates a surplus. Producers keep churning out more units of the good than the consumers want to buy.

People should remain free to choose. Market prices are an expression of the voluntary choices of individuals. When policymakers complain about certain prices being too high or too low, they are really criticizing the decisions of men and women to dispose of their own property as they see fit.

Policy Implications

- ★ Voluntary trade between a willing buyer and a willing seller will ALWAYS produce the optimal result for each party. Government intervention inevitably picks a winner and loser in the transaction.
- ★ Unhindered market operations provide price signals to businesses that prompt them to allocate their resources and production most efficiently.
- ★ Government price ceilings create shortages, as consumers want more of a particular product than the producers are willing to sell.
- ★ Government price floors create gluts, as producers create more of a particular product than consumers are willing to buy.

The Issue

Although factors such as natural resources, climate, and education are certainly important, many economists have come to believe that institutions are far more significant in explaining economic development. After all, the U.S.S.R. had far more generous endowments of natural resources than Hong Kong, and yet the former had bread lines while the latter was an economic powerhouse. Or consider the differences between East and West Germany or North and South Korea—just about the closest thing to controlled experiments we have in macroeconomics. It is clear that institutions matter.

Private Property. The concept of private property seems obvious, but in fact it is a fairly recent historical development largely confined to the Western European countries. Besides the possible moral appeal of such an institution, a system of private property is the one most conducive to economic growth. By placing each piece of property under the sole control of particular individuals, the system (perhaps ironically) ensures greater attention to these resources than if “the community” owned everything collectively—as has been seen in the “tragedy of the commons.”

Recently, the assignment of private property rights as a solution to the tragedy of the commons has been ignored. Instead, such problems have been classified as externalities and seen as examples of market failure whereby the government must step in to remedy the problem. Pollution and fisheries are two of the most common externalities cited today.

Market Prices. When private individuals have the right to transfer ownership of their property, the free exchange of property generates prices that are simply a reflection of the ratios at which the underlying goods and services trade against each other. These market prices for final goods and resources allow firms to calculate the expected profit and loss from various ventures based on their evaluation of consumer preferences. They then shift their efforts out of losing areas and into what they hope will be profitable ones.

Market prices provide important signals to everyone in the economy, allowing for quick adjustments to new circumstances, such as a rapid increase in the demand for apples or a sudden decline in the supply of apples due to a hard freeze. However, market prices can only translate consumer preferences efficiently in the absence of price regulations. Interference with the pricing mechanism throws the entire system off kilter.

Free Enterprise. Private property and free markets have a moral component—people ought to generally be able to do what they desire with their own property. The interesting fact is that this freedom is not only “the right thing

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to do,” it’s also the efficient thing to do! In a free market, anyone is free to start a business and risk his own (or borrowed) capital, and let the consumers be the ultimate arbiters. This provides the best mechanism to harness the bits of knowledge and expertise that are dispersed throughout the economy. In contrast, under full-blown socialism an innovator would have to send his idea up the chain of command and wait for approval before carrying it out. Beyond the bureaucracy, this system suffers from the fact that no group of planners—no matter how smart—can possibly amass all the information possessed by the whole of society.

The Rule of Law. One of the cornerstones of Western society is the idea that the same set of laws should apply to everyone. Citizens must know what the rules are beforehand, and not live in constant fear of the arbitrary caprice of the king or sultan. This strikes most Americans as a simple matter of justice.

Yet as with the institution of private property, the rule of law performs a definitely utilitarian function too: it reduces uncertainty and allows businesses and consumers to invest in the future. There aren’t many real estate developments or major factories near active volcanoes, and the reason is obvious: People won’t build if there’s a good chance the fruits of their efforts will be destroyed at any moment. By the very same token, the Industrial Revolution only occurred in Europe after the *Magna Carta* and other political events carved out a niche of autonomy for the private sector. Today this is borne out by the fact that the wealthiest countries in the world are the freest with stable institutions.

Policy Implications

- ★ Private property is the most fundamental of all of our rights. Assaults on private property rights not only harm the rest of our rights, but interfere with the functioning of the free market.
- ★ Efforts to regulate prices and market share interfere with the efficient working of the marketplace.
- ★ Legislative efforts to “increase competition” are in fact efforts to replace the preferences of consumers with the preferences of policymakers.
- ★ Courts should enforce—and reinforce—private contractual agreements, rather than interfering with them.

The Issue

Variations in business climate—coupled with the free mobility of capital and labor within the U.S.—yield striking differences in economic performance among the states. It is important for policymakers at the state level to understand just how potent their decisions can be, not just for their citizens but also for the state's revenues.

With people, products, and capital free to cross state boundaries, state governments are ultimately competitors. Pro-growth and anti-growth state economic policies influence decisions on whether, where, and how much to work, save, and invest. These policies influence the ability of a state to retain and attract residents and businesses. The evidence suggests that pro-growth policies result in higher after-tax returns, increased economic activity, and an eventual improvement in overall state fiscal health; anti-growth policies result in the opposite effects.

Rankings. For more than two decades, Laffer Associates has specialized in the analysis of state and local economic policies. In fact, over the years Laffer Associates' State Competitive Environment model has repeatedly demonstrated its ability to forecast changes in state competitiveness and thereby economic health and asset values. The result is a supply-side ranking of the states' economic outlooks from best to worst.

Any ranking of the states can take on a multitude of forms and compare a wide spectrum of variables: measures of economic health such as production, employment, and income; housing prices; education; even the quality of the weather. Of course, all of these variables influence the desirability of living and doing business in a particular city and state. The Laffer Associates model only includes variables that state officials can directly influence, with a particular focus on taxation (in its many forms) and changes in taxation.

The *Economic Performance* measure is backward-looking and ranks the states based on their performance in three (self-explanatory) categories. Texas ranks 1st overall on this measure, because it did well according to all three criteria. In particular, the large influx of domestic (i.e., non-immigrant) migration into Texas during 2006 was both a sign of, and a contributor to, the state's economic strength.

As with stocks, when it comes to states, past performance is no guarantee of future success. The *Economic Outlook* rank is forward-looking and relies on 16 factors to predict the relative economic performance of the states. Texas ranked 10th overall in this measure.

Importance of Fiscal Policies. Just as the U.S. competes with other countries for the location of economic activity, states compete with each other for the location of factories, offices, and jobs within the U.S. Competition of this type

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WHAT MAKES A STATE COMPETITIVE?

can be seen through tax-cutting battles between neighboring states and targeted tax incentives to encourage corporate relocation. As states seek to hold companies and workers within their borders and attract new ones, the winners and the losers will be separated by their ability to understand the competitive environment in which they exist and take steps to enhance their own state's appeal. State and local fiscal policies are far and away the most important factors determining changes in the competitiveness and, hence, relative economic growth rates among the states.

The average performance of the nine states without a personal income tax bested the average performance of the nine states with the highest top marginal personal income tax rates in each broad category examined. Relative to the high-tax states, the no-income-tax states experienced: higher levels of gross state product growth; greater personal income growth; higher personal income per capita growth; higher population growth; greater domestic in-migration as a share of population; greater job creation; and, despite the massive population inflows to the no-tax states, lower average unemployment rates.

Policy Implications

- ★ Workers and investors are legally free to relocate within the 50 states in order to increase their after-tax earnings. This engenders competition for these individuals—and the tax base they provide—among the state legislatures.
- ★ Economic theory suggests that a pro-growth, business-friendly state environment attracts talented workers, entrepreneurs, and investment, spurring job creation and booming tax receipts to boot. The empirical evidence backs up this intuitive analysis: on every important criterion, pro-growth states outperform those with hostile business climates.

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The background of the entire page is a monochromatic, blue-tinted photograph of the Texas State Capitol dome in Austin. The dome is the central focus, with its intricate architectural details like the windows and the top finial visible. A large, white, five-pointed star is superimposed over the center of the dome, serving as a backdrop for the organization's name.

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