

2005/2006



# LEGISLATORS'

## GUIDE TO THE ISSUES

- FISCAL POLICY
- PUBLIC EDUCATION
- HEALTH CARE
- TRANSPORTATION
- INSURANCE
- TELECOMMUNICATIONS
- WATER POLICY
- TORT REFORM
- LIMITED GOVERNMENT

Texas Public Policy  
Foundation



“ I COMMEND THE TEXAS PUBLIC POLICY  
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IN SUPPORT OF PERSONAL LIBERTY AND  
FREE MARKETS. ”

— MILTON FRIEDMAN,  
NOBEL PRIZE IN ECONOMICS

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The Foundation's mission is to improve Texas government by generating academically sound research and data on state issues, and by recommending the findings to opinion leaders, policymakers, the media, and the general public. The work of the Foundation is conducted by academics across Texas and the nation and is funded by hundreds of individuals, foundations, and corporations. The Foundation does not accept government funds or take contributions to influence the outcomes of its research.

The public is demanding a different direction for its government and the Texas Public Policy Foundation is providing the research that enables policymakers to chart that new course.



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2005



2006

# LEGISLATORS' GUIDE TO THE ISSUES

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Foundation

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# Introduction

*“Sapere Vedere”*

—Leonardo da Vinci

Da Vinci's phrase, meaning “know how to see,” describes well the philosophy guiding this publication. The 2005-2006 *Legislators' Guide To The Issues* couples academically sound research with important, practical recommendations, providing lawmakers the tools to govern on the basis of ideas, and not politics.

The Texas Public Policy Foundation is a research institute governed by the core principles of free-market economics, individual liberty, personal responsibility, limited government, and private property rights.

In following our mission of providing policymakers, opinion leaders, the media, and the general public with the intellectual ammunition to construct a better tomorrow for all Texans, we offer our biennial *Legislators' Guide To The Issues* as a blueprint in that effort.

This guide underscores the importance of Texas' legislative process. For 180 days every other year, legislators gather in Austin to make decisions that touch almost every aspect of daily life in Texas. Indeed, the Texas of tomorrow – our economic achievement, academic attainment, and quality of life – will be shaped by the decisions of today.

For those elected to represent our citizenry, it is important to remember that the best public policies make for the best politics. The opposite, while often pursued, is rarely true.

Through this publication and our ongoing research, we note that the most important way to see the world is through the lens of sound research, refined by the precepts of liberty.

Noted economist F.A. Hayek, writing in his seminal *The Road To Serfdom*, observed: “The guiding principle that a policy of freedom for the individual is the only truly progressive policy remains as true today as it was in the nineteenth century.”

All of the Foundation's research is available online at [www.TexasPolicy.com](http://www.TexasPolicy.com). Of course, please feel free to call on us at any time if you need additional information on the issues addressed in this guide.





## I. FISCAL POLICY

*Legislators' Guide to the Issues*

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# State Tax System

## THE ISSUE

Should the state tax system be reformed or entirely restructured? This question is hotly contested by the Texas Legislature, fueled by: an economic downturn, the resulting 2004 budget crisis, rising health care costs, demands to expand education funding, growing dissatisfaction with property tax rates, and increasing state reliance on local property taxes to fund public schools. Some policymakers claim the tax system is inflexible, fails to raise sufficient revenue, and unfairly burdens the poor because it depends on regressive sales taxes; they call for new, higher taxes – including a personal income tax. Others propose new taxes or want to raise old taxes to increase the state's share of education funding and decrease property taxes. Yet others suggest a complete overhaul is needed to improve the fairness and equity of tax burdens, particularly in the corporate sector.

The issue is complicated. First, property taxes are local, not state, taxes. State legislators can “buy down” rates that may provide temporary relief but, in the long term, legislators merely encourage local entities to raise property rates even higher, as was evident with tax “relief” enacted by former Governor Bush. Although property taxes are locally determined, state government has a real interest in property rates because rates strongly affect the state economy.

Second, the current tax system has served Texans well for decades. Revenue has kept pace with population growth and inflation. It has fallen short only when confronted by expansive spending on public schools and health care – particularly on Medicaid. State spending, not revenue, is the real problem.

Third, despite its strength, the state tax system could be improved. Businesses in Texas generally pay higher taxes than they would pay in many other states, and the tax burden is unequally shared among businesses. Texans pay higher property taxes per capita than residents of 34 other states, according to the Tax Foundation. Texas did not make the Tax Foundation's top 10 states for business tax climate in 2004. Lowering business and property taxes would bolster the economy and benefit all Texans.

Fourth, less than half of the total net revenue of Texas state government comes from taxes; the bulk of state revenue comes from federal monies and state fees (licenses, permits, and fines). Changing the proportional amount of state tax revenue will exert far-reaching economic impact.



## THE FACTS

- ★ Texas' overall fiscal status is ranked 4th nationally by the 2003 *Tax Foundation's State Business Tax Climate Index*
- ★ Texas has the 2nd lowest state debt per capita in the nation
- ★ Only 9 states have a higher state obligation bond rating than held by Texas
- ★ At 8.1 percent, Texas ranks 45th lowest in the nation for state and local taxes as a percent of gross state product
- ★ Texas has the 3rd lowest state tax collection per capita in the nation
- ★ Average annual tax growth from 1992-2002 was 3.41 percent in Texas, compared to the national average growth of 3.07 percent
- ★ Inflation-adjusted state revenues per capita from tax collections rose over 77 percent from 1978 to 2003
- ★ Sales and general use taxes represent 50.8 percent of state tax collections – only 1 other state relies more highly on sales and use taxes than Texas
- ★ Tax revenues represent only 44.8 percent of total net revenue for state government
- ★ Other states' experiences demonstrate higher taxes mean lower economic growth
- ★ In 2001, if Texas had the national average tax burden, family income would have been \$1,724 lower for a family of four

## RECOMMENDATIONS

- ★ Prioritize state spending and increase efficiency of health care and education spending
- ★ Increase tax equity and decrease the overall tax burden
- ★ Introduce revenue-neutral reforms to lower state reliance on property taxes for education funding. A modest shift from the property tax to a sales tax on consumer items could positively impact employment, personal income, and state gross regional product
- ★ Enact tax reforms cautiously and incrementally

## RESOURCES

- *Effective, Efficient, Fair: Paying For Public Education In Texas* by Richard Vedder, Texas Public Policy Foundation, February 2004 (<http://www.texaspolicy.com/pdf/2004-02-25-vedderhall-all.pdf>)
- *Taxing Texans: A Six-Part Series Examining Taxes In The Lone Star State* by Richard Vedder, Texas Public Policy Foundation, September 2002 (<http://www.texaspolicy.com/pdf/2002-02-28-tax-taxingtexas1.pdf>)
- *Follow The Money: A 50-State Survey Of Public Education Revenues And Spending* by Chris Patterson, Texas Public Policy Foundation, October 2003 (<http://www.texaspolicy.com/pdf/2003-10-22-sf-followmoney.pdf>)
- *Weighing The Difference: An Evaluation Of The Unequal Burden Of State Taxes For Texas Businesses* by Milton H. Holloway, Texas Public Policy Foundation, May 2004 (<http://www.texaspolicy.com/pdf/2004-05-sf-mh-weighingdifference.pdf>)

# *Tax Reform Modeling:* TEXAS-STAMP

## THE ISSUE

Texas spend 8.7 percent of their annual income paying local and state taxes; residents of only four other states pay less, according to the Tax Foundation (*America Celebrates Tax Free Day*, 2004). Businesses, however, pay 18 percent of capitol income for local and state taxes, paying more than businesses in 14 other states, according to Ernst and Young (*Total State and Local Business Taxes*, 2004).

The issue is complicated. First, property taxes are local, not state, taxes. State legislators can "buy down" rates that may provide temporary relief but, in the long term, legislators merely encourage local entities to raise property rates even higher, as was evident with tax "relief" enacted by former Governor Bush. Although property taxes are locally determined, state government has a real interest in property rates because rates strongly affect the state economy.

The relatively low tax burden shouldered by taxpayers and businesses has enabled Texas to weather fiscal crises that have challenged most other states and to achieve a ranking of 4th best of 50 states in the Tax Foundation's Fiscal Balance Index.

While the state tax system has served Texas well, producing revenues that keep pace with inflation and population growth, it can be improved. It is clear that the corporate tax climate could be made more competitive with that of other states.

To help state leaders make informed decisions about tax reform, the Texas Public Policy Foundation developed the Texas State Tax Analysis Modeling Program (Texas-STAMP, produced by Beacon Hill Institute of Suffolk University). Accessed through the Internet, this computer-based model provides highly detailed information of the economic effects over time about a wide variety of state tax changes.

## THE FACTS

- ★ State-level tax increases have significantly negative effects on state economic activity
- ★ The potential impact of proposed tax changes can be quantified by a computable general equilibrium model, such as Texas-STAMP
- ★ Texas-STAMP can estimate the impact of implementing or changing the following state forms of taxation: sales, gross receipts, franchise, business activity, motor fuels, motor vehicle, personal income, cigarette, professional services for personal and corporate use, and property
- ★ Texas-STAMP will estimate how tax reforms impact: gross wage rates, numbers of private and government jobs, disposable real income, and revenues generated by other state and local taxes



★ For example, Texas-STAMP shows that job loss could exceed 500,000 and real disposable income would decrease by 2 percent if Texas enacted a state income tax with a 2 percent tax rate for income less than \$10,000, 3 percent for \$10,000-\$75,000, and 4 percent for above \$75,000

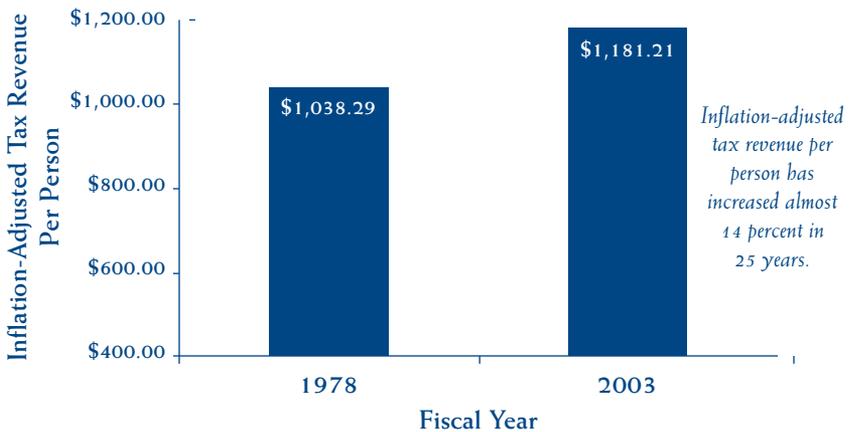
## RECOMMENDATION

★ Legislators should seek alternative measures of the quantifiable effects on taxable activities before tax reform is enacted to ensure that reform has a positive economic impact

## RESOURCE

- *Texas-STAMP (State Tax Analysis Modeling Program): A Sophisticated Tax Model For Texas*, developed by the Beacon Hill Institute at Suffolk University, Texas Public Policy Foundation, March 2004 (<http://www.texaspolicy.com/pdf/2004-03-10-stamp.pdf>)

### Texas State Tax Revenue Has Kept Up



# *Sales Tax*

## THE ISSUE

Sales tax reform is widely proposed as the primary means to increase state revenue and improve tax fairness in Texas and throughout the nation. Without a personal income tax, Texas relies on sales taxation as the primary source of state tax revenue. Heavy reliance on sales tax, a tax that is both stable and elastic, has enabled Texas to weather economic downturns without enacting draconian reductions that other states depending on revenue from personal and corporate taxes have found necessary. As a tax on consumption, sales taxes have a less adverse impact on economic growth than taxes on production, such as the personal income tax or franchise tax.

However, many argue that the sales tax tends to be regressive; it burdens lower income people more than the affluent – although opinion polls indicate people prefer a tax on sales to a tax on income. Additionally, sales taxes are not uniformly levied for either businesses or consumers; some goods and services in Texas are exempt from the sales tax.

Proposals to expand the sales tax base to include more items of consumption could allow the tax rate to be reduced while increasing sales tax revenue as well as tax fairness. However, items of production should be excluded from any expansion of the sales tax base to prevent tax pyramiding. Piling taxes on taxes increases the cost of doing business, drives up consumer prices, depresses production, reduces capital investment, shrinks job creation, lowers wages, and, ultimately, results in lower state revenue.

Proposals to reform the sales tax by significantly raising the rate or reforms that result in a higher overall tax burden will result in economic harm. Alternatively, revenues raised from a tax base expansion to lower rates on the sales tax – or to reduce or eliminate taxes with more adverse economic impact, such as the franchise and property taxes – would likely enhance economic growth in Texas.

## THE FACTS

- ★ Texas' 8.25 percent sales tax rate, a combination of the state and maximum local rate, is the 14th highest sales tax rate in the nation
- ★ Combined, sales and use taxes make up 51 percent of total state tax collections
- ★ Texas' sales tax revenues rose over 87 percent from 1990-2000
- ★ Sales taxes exert the least adverse economic impact of all forms of taxation
- ★ Economic modeling suggests that shifting \$5.6 billion of revenue in Texas from property taxes to an expanded sales tax, applied only to items of personal



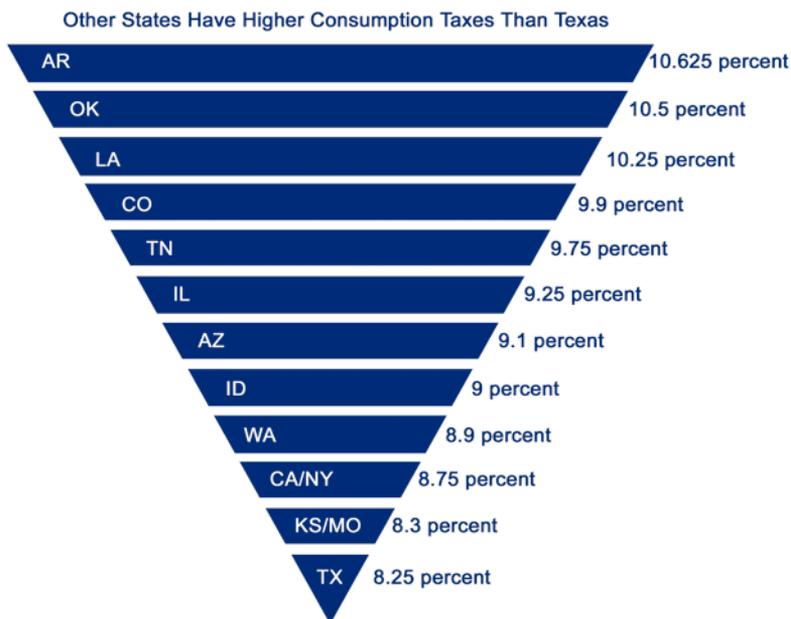
consumption, could result in positive impacts on employment, personal incomes, and the state gross regional product.

## RECOMMENDATIONS

- ☆ If policymakers determine that additional revenues are required, expansion of the sales tax base coupled with reductions in the rate and/or reductions in business taxes should be enacted
- ☆ Any expansion of the sales tax base should be modest
- ☆ Sales tax reform should resist raising the tax rate
- ☆ Sales tax reform should result in revenue neutrality – the overall tax burden should remain unchanged or be lowered

## RESOURCES

- *Effective, Efficient, Fair: Paying For Public Education In Texas* by Richard Vedder and Joshua Hall, Texas Public Policy Foundation, February 2004 (<http://www.texaspolicy.com/pdf/2004-02-25-vedderhall-all.pdf>)
- *An Economic Analysis Of Property Tax Relief Funded By A Sales Tax Increase* by Milton L. Holloway, Texas Public Policy Foundation, April 2004 (<http://www.texaspolicy.com/pdf/2004-04-sales-property-tax.pdf>)



# Property Taxes

## THE ISSUE

Property taxes are at the center of the tax reform debate because there is a close relationship between property taxes, the state economy, and public education. Unlike many other states', Texas' property taxes are levied entirely at the local level. From 1989 to 2000, property taxes increased 367.1 percent. This increase, primarily driven by demands from Texas public schools for increased funding, has fueled calls for property tax relief. Today, Texas' property tax burden is one of the highest in the nation and adversely affects economic development. How can Texans reduce property taxes?

The issue is complex. Local property taxes serve as the primary revenue for Texas public schools. Funding is shared by the state, the federal government, and local communities. The portion of school funding that the state provides has declined over the past decade and is projected to fall to 36 percent in fiscal years 2004 and 2005. Growing reliance on local property taxes to underwrite the major portion of public education has fueled legal challenges from more than 300 school districts. Some districts challenge the state's use of local property tax revenues to achieve funding equity by redistributing funds from property-wealthy districts to poorer districts, a practice known as "Robin Hood." Some districts argue that the state's reliance on local property tax revenues for public schools violates the constitutional prohibition against a state property tax.

Should the state reduce reliance on local property taxes and shoulder the greater share of school funding? This question is particularly difficult because research has demonstrated that a higher portion of local funding corresponds to improved student outcomes. Should the state eliminate Robin Hood? Questions about property tax reform open the door on a long history of school finance case law. Should the state lower local property tax rates to ensure the state's reliance on property tax revenues does not violate the constitutional prohibition against a state property tax? Should the state shoulder fiscal responsibility for educational equalizing now provided by local property tax revenues? All of these questions presume the collection of additional state funds for public education.

Policymakers are looking at property tax reform from several different perspectives. Some policymakers propose "buying down taxes" to offer property tax relief. However, this approach, as shown by tax reforms championed by former Governor Bush, likely will offer little or no relief and will, in the long term, merely encourage local taxing entities to raise property tax rates ever higher. Some policymakers have proposed creating a "split roll" property tax in which the state levies property taxes on business and local entities continue to levy taxes on residential property. Offering no clear economic advantage, this approach has gained little political purchase. Other policymakers propose sales, payroll, and business activity taxes to underwrite the cost of reducing state reliance on local property taxes and providing tax relief; these proposals are also examined in other sections.

Property tax reform raises fundamental, critical questions about the role of state



government. If property taxes are levied locally, should the state “buy down” rates? In other words, should the state raise state taxes to lower local taxes? Is it proper for state government to cap local government tax rates? Lastly, should the state have greater control over property tax rates because high rates harm the state economy and all Texans?

Property tax reform also provokes equally important and critical economic questions. How can the state produce additional education revenues without raising the total tax burden on individuals and businesses? How can Texas introduce property tax reform in a way that will help, not injure, the state economy?

## THE FACTS

- ★ Texas ranks as the 15th highest state in the nation for local property tax collections per capita, according to the Tax Foundation
- ★ Property taxes raise more money in Texas than any other tax, including sales taxes
- ★ From 1989-2000, property taxes increased 367.1 percent for Texans
- ★ School taxes represent more than 60 percent of Texans' property taxes
- ★ Between 1997 and 2001, school property taxes paid by Texas businesses increased 38 percent while property values increased only 28 percent
- ★ Texas businesses pay a 10 percent higher share of revenue from property taxes than the national average for businesses
- ★ Only 12 states, including Texas, do not levy a state property tax
- ★ Only Illinois surpasses Texas in reliance on property taxes to fund public education

## RECOMMENDATIONS

- ★ Maintain local property taxes as the primary source for education funding
- ★ Increase the uniformity and fairness of property tax rates
- ★ Enact property tax reform secondary to increasing the efficiency of school spending
- ★ Create a state property tax only if educational accountability were increased by public school choice
- ★ Substituting \$1 billion in new sales tax for \$1 billion in property tax would likely have a modestly positive impact on the economy

## RESOURCES

- *Putting The Sides Together: Twelve Perspectives On Texas Public School Finance* edited by Chris Patterson, Texas Public Policy Foundation, December 2003 (<http://www.texaspolicy.com/PTST/>)
- *Splitting The Difference: Residential And Business Property Taxes In Texas* by Byron Schломach, Texas Public Policy Foundation, January 2004 (<http://www.texaspolicy.com/pdf/2004-01-26-sf-splitroll.pdf>)
- *Effective, Efficient, Fair: Paying For Public Education In Texas* by Richard Vedder and Joshua Hall, Texas Public Policy Foundation, February 2004 (<http://www.texaspolicy.com/pdf/2004-02-25-vedderhall-all.pdf>)
- *The Lack Of Competition In Delinquent Property Tax Collections* by Byron Schломach with Aaron Gibson, Texas Public Policy Foundation, May 2004 (<http://www.texaspolicy.com/pdf/2004-05-sf-tax-delinquency.pdf>)
- *Follow The Money: A 50-State Survey Of Public Education Dollars* by Chris Patterson, Texas Public Policy Foundation, October 2003 (<http://www.texaspolicy.com/pdf/2003-10-22-sf-followmoney.pdf>)

# Corporate Taxes

## THE ISSUE

High state and local taxes are discouraging creation and expansion of businesses in Texas. Businesses pay taxes in many forms – franchise, sales, property, and severance – and, combined, the total tax burden for businesses in Texas far exceeds that paid by businesses in many other states. In particular, property and sales taxes paid by Texas businesses are significantly higher than the national average.

Because businesses move from high to low-tax states, the state tax system exerts an adverse impact on consumer prices and choices, job creation, increased wages, and quality of life improvement for all Texans.

The problem is not just high taxes. High taxes are coupled with unequal tax burdens for different types of businesses. The franchise tax is not levied on corporate “partners” whose corporate franchise resides outside the state. Nor does it reach the profits of corporations that technically pay all their profits to out-of-state corporations as fees for the use of logos. The tax system exerts strong economic disincentives on capital-intensive businesses. The franchise tax, property taxes, and sales taxes fall more heavily on capital-intensive businesses (such as manufacturing) than on labor-intensive businesses (such as service and retail). The observable decline in Texas manufacturing during the 1990s can be partly attributed to the penalties levied on capital investment.

## THE FACTS

- ★ Texas businesses pay 55.3 percent of state and local tax revenues, a share far exceeding the national average of 42.6 percent
- ★ The property tax burden is 9 percent higher for Texas businesses than the national average and 6 percent higher for sales taxes
- ★ Businesses pay a higher share of taxes than individuals pay in Texas
- ★ Businesses with the highest tax burden in Texas pay more than twice the taxes paid by those with the lowest burden
- ★ Wholesale, retail, and service businesses in Texas pay less in taxes than businesses in industries such as construction, agriculture, mining, and manufacturing
- ★ During the 1990s, capital per unit of labor in Texas manufacturing grew at less than half the national rate
- ★ Texas ranked 13th nationally in the 2004 Tax Foundation's *Business Climate Index*



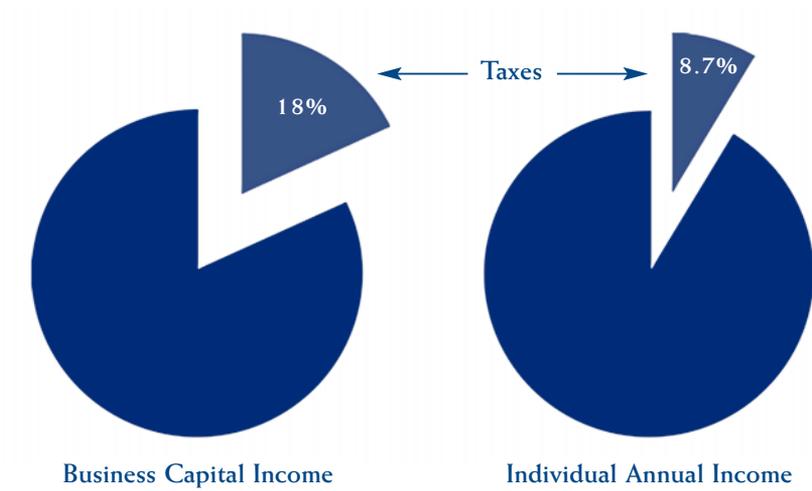
## RECOMMENDATION

★ Reduce and equalize the overall corporate tax burden

## RESOURCE

- *Weighing The Difference: An Evaluation Of The Unequal Burden Of State Taxes For Texas Businesses* by Milton H. Holloway, Texas Public Policy Foundation, May 2004 (<http://www.texaspolicy.com/pdf/2004-05-sf-mh-weighingdifference.pdf>)

### Texas Businesses Pay More Than Their Fair Share



# Income Tax

## THE ISSUE

Some policymakers propose establishing an income tax to provide increased revenue for expanding government services. Advocates of the personal income tax claim that Texas' tax system is a "three-legged stool," but the third leg – an income tax – is missing. They claim the absence of an income tax prevents Texas from raising sufficient revenue and that current revenue sources are inflexible while spending needs grow. Although these claims are largely unfounded – as described in other sections – demands to increase state funding for health care and education stimulate periodic discussions about the efficacy of the income tax.

While it is certainly true that an income tax would increase state revenues, the adverse economic impact heavily outweighs what some may identify as its benefit. In fact, the absence of an income tax has been the primary reason for Texas' prosperity in recent decades. The experience of states with income taxes demonstrates that income taxes are particularly pernicious in their adverse economic impact. This experience is mirrored internationally; analysis of 23 other nations indicates the increase in revenue raised by taxing income has a direct and negative correlation with economic growth. The overall tax burden increases more rapidly in states with taxes on income, and state spending in income tax states exceeds that of states without an income tax, as income taxes raise state revenue.

Despite the interest of some policymakers, few Texans support creation of an income tax. In a 2003 poll of Texas voters, only 17 percent favored establishing an income tax.

## THE FACTS

- ★ Texas is one of six states without a personal income tax
- ★ Twelve states that implemented income taxes during 1957-1999 experienced an average 37.2 percent overall tax increase, compared to 10.5 percent in states without income taxes
- ★ States with income taxes spend more than states without an income tax
- ★ Of all forms of taxation, taxes on income exert the most adverse economic impact – depressing capital investment, production, business expansion, job creation, wages, and living standards
- ★ Income taxes encourage government to "crowd out" more productive economic activity
- ★ In 2003, 76 percent of Texas voters stated they oppose establishing a state income tax



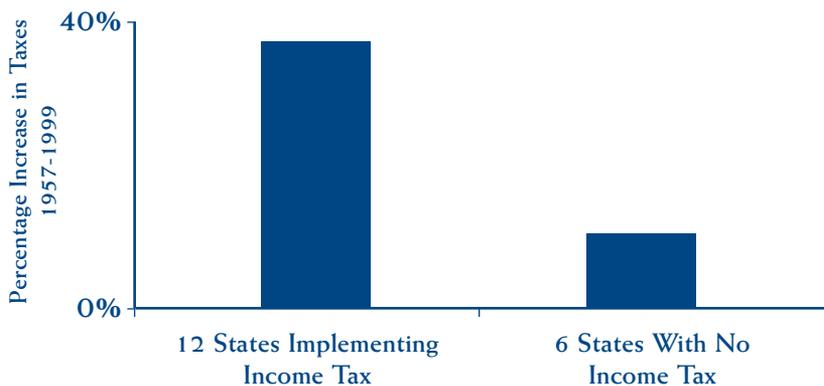
## RECOMMENDATION

★ Do not create a personal income tax

## RESOURCES

- *Taxing Texans: A Six-Part Series Examining Taxes In The Lone Star State* by Richard Vedder, Texas Public Policy Foundation, September 2002 (<http://www.texaspolicy.com/pdf/2002-02-28-tax-taxing-texans1.pdf>)
- *Effective, Efficient, Fair: Paying For Public Education In Texas* by Richard Vedder and Joshua Hall, Texas Public Policy Foundation, February 2004 (<http://www.texaspolicy.com/pdf/2004-02-25-vedderhall-all.pdf>)

### Taxes Rise Faster In States With Income Taxes



# *Business Activity Tax*

## THE ISSUE

Proposals to increase state revenues by introducing a business activity tax (BAT) in Texas should be carefully considered. The attractiveness of a BAT must be weighed against its potential for harming the state economy and adversely impacting public education.

### Advantages:

- ★ Potential replacement for the franchise, property, and severance taxes
- ★ Universality of application and fairness
- ★ Minimal economic distortions
- ★ Simplicity
- ★ Producing revenue necessary to eliminate "Robin Hood"

### Disadvantages:

- ★ Potential for increased spending
- ★ Negative effect on economic growth
- ★ Increased costs for businesses
- ★ Lack of transparency for taxpayers
- ★ Possibly unstable revenue

## THE FACTS

- ★ The BAT is a rare form of taxation in the U.S.
- ★ In Michigan, the state with the largest-scale implementation of a BAT in the United States, the BAT is being phased out after a decade of mediocre economic results
- ★ In Europe, the BAT corresponds to continuous and growing economic stagnation
- ★ Increased government spending is bad for the economy – each new dollar of state spending means one less dollar of private-sector spending
- ★ Higher levels of student performance in Texas public schools are directly proportional to the percentage of local funding
- ★ Because a BAT would apply to all forms of business, a BAT would be more fair than the current tax structure and remove economic disincentives for more heavily taxed industries, such as manufacturing
- ★ A BAT has the potential to significantly increase state revenue – a 1 percent BAT on the private sector could raise \$4 billion



## RECOMMENDATIONS

- ★ The dynamic economic impact of BAT and experiences of both Michigan and Europe caution against large scale tax reforms for Texas
- ★ State tax reform should reflect Texas' long term goals – economic growth, not simply increasing state revenues, should guide decision-making

## RESOURCE

- *The Business Activity Tax: Is The BAT A Homerun Or A Strikeout?* by Richard Vedder and Byron Schломach, Texas Public Policy Foundation, March 2004 (<http://www.texaspolicy.com/pdf/2004-03-19-BAT.pdf>)

### Texas Businesses Bear A Larger Share Of Taxes In Texas Compared To The National Average



Texas State/Local Taxes



Nationwide State/Local Taxes

# Payroll Tax

## THE ISSUE

Proposals to increase state revenues by introducing a payroll tax in Texas could damage the state's economy by discouraging businesses, particularly labor-intensive businesses, from moving to or expanding in Texas.

Economic activity is directly, strongly affected by corporate taxes. Businesses, as well as wage earners, move from high to low tax states.

Today, businesses pay higher taxes in Texas than in 24 other states, according to the Tax Foundation. Instead of adding new corporate taxes, such as the payroll tax, Texans should reduce corporate taxes to increase economic prosperity.

## THE FACTS

- ★ A payroll tax increases costs of production, lowers wages, encourages hiring of unregistered workers, and increases unemployment
- ★ Cuts in payroll taxes instituted in other states and nations have spurred economic prosperity with job creation and job growth
- ★ Introduction of a 1.25 percent payroll tax in Texas with a maximum tax of \$500 per employee would result in:
  - 62,000-71,000 private-sector jobs lost
  - 0.3 percent reduction in average wages
  - 0.4 percent decrease in real disposable income
- ★ Businesses in Texas already pay 56 percent of state tax revenue, 13.4 percent higher than the average national share, according to Ernst & Young's *Total State and Local Business Taxes* (2004)

## RECOMMENDATIONS

- ★ A payroll tax should not be introduced in Texas
- ★ Policymakers should balance the need to finance state programs with a tax structure that encourages economic growth



## RESOURCES

- *Texas Payroll Tax: Searching For New Revenues To Fund Public Schools* by John Barrett, Texas Public Policy Foundation, May 2004 (<http://www.texaspolicy.com/pdf/2004-05-sf-payrolltax.pdf>)
- *Weighing The Difference: An Evaluation Of The Unequal Burden Of State Taxes For Texas Businesses* by Milton L. Holloway, Texas Public Policy Foundation, May 2004 (<http://www.texaspolicy.com/pdf/2004-05-sf-mh-weighingdifference.pdf>)

## Projected Results Of A Payroll Tax:



-  62,000 to 71,000 jobs lost
-  0.3 percent drop in average wages
-  0.4 percent drop in real disposable income

# *Texas Fair Tax*

## THE ISSUE

**T**exans are displeased with the state's current tax system, especially when it comes to property taxes. Though property taxes are levied at the local level, school property taxes are widely considered a state issue and Texans are demanding change. Many alternatives to the current property tax have been considered. One alternative being considered is to broaden the applicability and increase the rate of the state's existing sales tax.

An even broader and bolder concept is to transform the Texas tax system into something more akin to the "Fair Tax" proposed at the national level. This proposal would replace all federal taxes with a single, nationwide sales tax levied on all final consumer purchases of goods and services.

A Texas Fair Tax could take many forms. The national Fair Tax proposal has as its major end the elimination of the national income tax. A Texas Fair Tax would at least replace a major portion of the school property tax that funds daily operations, as well as virtually all of the state's other taxes, including the corporate franchise tax.

Various possibilities considered for the Texas Fair Tax are that it could replace all or only half of the maintenance and operations (M&O) school property tax. Also, in order to reduce regressivity, there could either be a per capita tax refund or exemptions for goods and services associated with health care, food, and education.

It is estimated that the statewide sales tax rate under a Fair Tax (not including local rates) would range from 7.9 percent to 10.9 percent, depending on whether all or only half of the M&O school property tax is replaced and whether or not a per capita refund or exemptions are employed.

The most modest econometric modeling results show that investment in the state would increase over current projections by a fifth in five years. Employment would not grow as quickly as currently projected, but employment growth would be put on a path to likely surpass what would otherwise occur in ten years. Real disposable income would exceed current projections by 2 to 3 percent.

The econometric modeling assumes that a state sales tax, like a Texas Fair Tax, is not federal income tax deductible. However, with the passage of the American Jobs Creation Act of 2004, the sales tax becomes deductible again. This makes moving from the already deductible property tax to a sales tax all the more attractive as an alternative.

The idea of a Texas Fair Tax is worth additional consideration. The property tax issue is not going away. The current system depresses investment and ultimately employment in Texas. No change in the tax system, however, is likely to be effective without greater spending discipline.



## THE FACTS

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- ★ In Texas in the 1990s:
  - Real per capita property taxes rose 17 percent
  - Real per capita property tax for public education rose 25 percent
- ★ Almost half (47 percent) of Texas' current sales tax revenue comes from business purchases
- ★ A Fair Tax would only tax final consumer purchases by Texans
- ★ From 1980 to 2002, the percentage of Texas taxes represented by the property tax increased from 35 percent to 42 percent
- ★ Texas' property tax burden increased by over \$7 per \$1000 in personal income while the property tax burden nationwide decreased by \$2 per \$1000 in personal income
- ★ Relative to the rest of the nation, Texas' tax burden has risen
- ★ According to economic modeling by the Beacon Hill Institute, replacing 50 percent of the school property tax and the bulk of state taxes with a Fair Tax would require a state tax rate of about 7.9 percent, and in five years would increase real disposable income per capita by 2.6 percent, increase investment by 21 percent, and decrease private employment by 0.6 percent

## RECOMMENDATION

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- ★ Conduct a detailed study, using state expertise, of the possibility of instituting a Texas Fair Tax taking care to closely study how to properly define taxable transactions and how to enforce such a tax.

## RESOURCES

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- *Changing Texas' Tax Structure: A Fair Tax For Texas?* by Richard Vedder and Byron Schlomach, Texas Public Policy Foundation (Forthcoming 2005)
- *Tax And Expenditure Limitation Reform: Is It Needed In Texas?* by Byron Schlomach, Texas Public Policy Foundation, August 2004 (<http://www.texaspolicy.com/pdf/2004-08-TEL.pdf>)

# *Tax and Expenditure Limitations*

## THE ISSUE

Recent challenges to balance the state budget have refocused attention on fiscal discipline and the efficacy of Texas' tax and expenditure limitation (TEL), enacted constitutionally in 1978. Weaknesses of the Texas TEL have become clear, and in 2003, Representative Carl Isett proposed to strengthen the law by making Texas' TEL similar to Colorado's Taxpayer's Bill of Rights – the TEL considered the nation's most successful. Although the 78th Texas Legislature failed to amend Texas' TEL, there is still strong interest in and sound reasons for strengthening it.

Unlike Texas' TEL, Colorado's law has effectively limited government spending growth to a rate equal to population and inflation growth – a standard of government need that is widely recognized. Colorado's TEL has resulted in budget stabilization and tax rebates, and has helped the state cope with revenue shortfalls in the recent recession.

Texas' TEL is one of the weakest such statutes in the nation. Based on criteria for a strong TEL established by the Cato Institute, Texas' TEL falls short because it:

1. Lacks sufficient constitutional specificity;
2. Applies only to a small part of the state budget;
3. Caps only appropriations, not spending;
4. Limits appropriations growth to personal income rather than population growth and inflation;
5. Allows a simple legislative majority to overrule the statute;
6. Applies only to state, not local, governments;
7. Requires easily amended enabling legislation to be enacted;
8. Fails to allow taxpayers to hold the state accountable by not giving them standing to sue to enforce statutory provisions; and
9. Provides no provision for tax refunds or rebates.

## THE FACTS

- ★ Approximately 26 states have tax and expenditure limitations – Colorado's is the most effective and Texas' is one of the least effective
- ★ Colorado's TEL resulted in \$3.25 billion in tax rebates to Colorado residents from 1997 to 2001
- ★ Real, per capita, non-federal Texas state expenditures increased 28.5 percent from 1990 to 2003
- ★ If real, per capita, non-federal Texas state expenditures in 2003 were the same as in 1990, Texas taxpayers could have saved \$8.7 billion in state taxes in 2003 –



almost \$1,600 for a family of four

- ★ States with effective spending limitations experience lower tax increases in periods of recession than states without such limitations

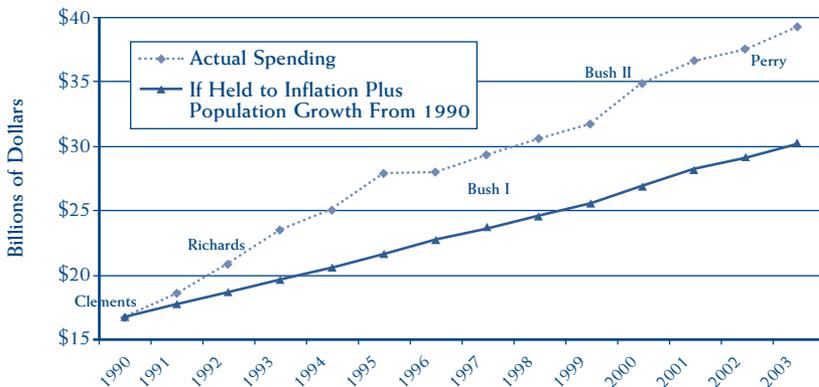
## RECOMMENDATION

- ★ Enact a truly effective TEL in the Texas Constitution

## RESOURCE

- *Tax And Expenditure Limitation Reform – Is It Needed In Texas?* By Byron Schломach, Texas Public Policy Foundation, August 2004 (<http://www.texaspolicy.com/pdf/2004-08-TEL.pdf>)

### Texas State Non-Federal Spending History







## II. PUBLIC EDUCATION POLICY

*Legislators' Guide to the Issues*

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# *State System of Public Education*

## THE ISSUE

Public education is the highest priority of Texans and represents the largest investment of state taxpayer dollars. Today, as in decades past, questions pertaining to funding and student performance dominate the legislative debate on Texas public schools.

On school finance, questions center on how much money the state should provide and how the money should be distributed. Sufficient funding (adequacy) and fair funding (equity) shape the debate. Student-centered funding (school choice) represents a critical incentive for improving school performance and student outcomes that must be addressed in school finance reform.

Equally critical questions focus on student performance. How well are public schools meeting state goals for student performance? What proportion of students leave high schools with a diploma? Are students prepared for a post-secondary experience, either skilled vocational training or university education?

These questions serve as the basis of a series of court cases, extending over decades and continuing today as a legal challenge by a group of school districts suing for additional taxpayer funds. Preliminary rulings on “West Orange-Cove” challenge the state Legislature to provide explicit definitions of constitutional obligations and state expectations for student learning to guide financial decisions.

## THE FACTS

- ★ Texans invested just over \$30 billion in public education during the 2002-03 school year
- ★ 36 percent of state revenue is invested in public education – Texas ranks second among the 50 states in total education expenditures
- ★ Texas ranks 3rd in the nation for the percentage of total state expenditures devoted to public education
- ★ To pay for public education, the average Texan works 90 days a year – up from 63 days in 1970
- ★ Over four million children attend Texas public schools – Texas has the 2nd largest student enrollment population in the U.S.
- ★ There are 1,224 school districts and charter schools in Texas, providing 571,119 full-time jobs
- ★ Almost 14 percent of students in Texas public schools are enrolled in Bilingual Education or English as a Second Language programs
- ★ Almost 12 percent of students in Texas public schools are enrolled in Special Education



★ Almost 60 percent of students in Texas public schools are economically disadvantaged

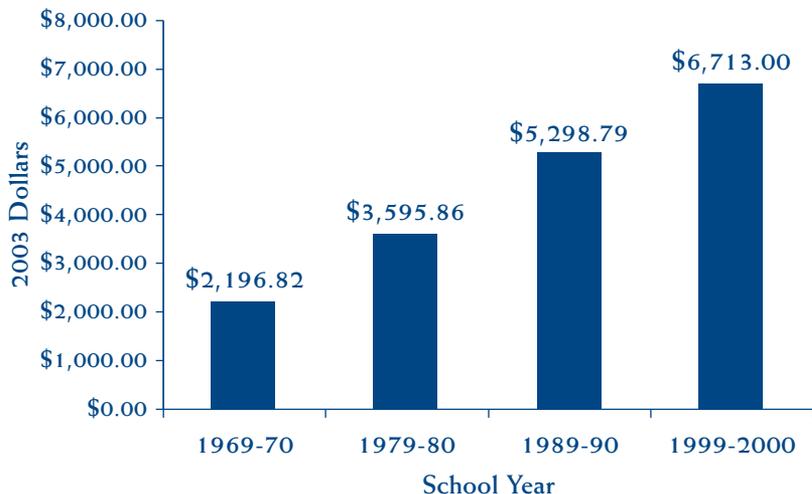
## RECOMMENDATIONS

- ★ Explicitly define constitutional obligations for an adequate education in terms of standards for school completion and academic proficiency
- ★ Base standards for school accreditation on state expectations for school completion and academic proficiency
- ★ Create a school finance system that links education dollars with expected education outcomes
- ★ Establish incentives for public schools to spend money efficiently and effectively

## RESOURCES

- *Follow The Money: A 50-State Survey Of Public Education Dollars* by Chris Patterson, Texas Public Policy Foundation, October 2003 (<http://www.texaspolicy.com/pdf/2003-10-22-sf-followmoney.pdf>)
- *Effective, Efficient, Fair: Paying For Public Education In Texas* by Richard Vedder and Joshua Hall, Texas Public Policy Foundation, February 2004 (<http://www.texaspolicy.com/pdf/2004-02-25-vedderhall-all.pdf>)
- *Education: Letting Principles Guide The Solution* by Brooke Rollins, Texas Public Policy Foundation, November 2003 testimony before the Texas House Select Committee on Public School Finance (<http://www.texaspolicy.com/pdf/2003-11-03-pp-rollinstestimony.pdf>)

**Inflation-Adjusted Spending Per Pupil,  
Texas Public Schools, 1970-2000**



# *Education Standards & Performance*

## THE ISSUE

After 10 years of intensive, expensive public education reform, students in Texas public schools score near the national average on measures of elementary and middle school performance, but are well below the national average in high school graduation and at the bottom of the nation on measures of post-secondary readiness.

While state-developed assessments show rising student achievement and a decreasing gap between student groups, independent evaluations of student outcomes show stagnant or declining performance – despite increasing real, per student spending 20 percent in the 1990s, and despite new state curriculum standards, new instructional materials, and new state assessments. There is no evidence that an increased proportion of students is completing high school, and no more students are graduating with the academic proficiency required to be successful in skilled vocational training or higher education. Independent measures provide no evidence that the achievement gap between student groups has demonstrably narrowed.

The reasons for the disappointing progress of Texas public schools are clear:

- ★ The state's "college preparatory" curriculum – the Recommended High School Program – is not sufficiently rigorous;
- ★ Passing state assessments does not mean students are on grade-level, according to either state or national standards;
- ★ Academic proficiency of elementary and middle school students is not sufficiently strong to prepare students to succeed in a true college preparatory course of study in high school;
- ★ Too few students master basic literacy skills by grade 3, particularly Hispanic and African-American students, and this failure has been shown to increase the likelihood of their dropping out; and
- ★ Focusing resources on simply passing state assessments leads some school districts to neglect higher academic standards.

## THE FACTS

- ★ Texas scores on the National Assessment of Educational Progress (NAEP) are near the national average, although lower in reading and science
- ★ 17 percent to 33 percent of students in Texas public schools drop out, depending on the measure – a number far above the national average
- ★ The most highly educated of Texas students – those who take college readiness tests – score at the bottom of the nation



- ★ Texas' SAT and ACT scores remain unimproved over the past decade
- ★ The percentage of Texas students taking college readiness tests is declining
- ★ The achievement gap between student groups has not significantly narrowed and in some cases is growing, according to the NAEP, ACT, and SAT

## RECOMMENDATIONS

- ★ Strengthen the academic rigor of state curriculum standards
- ★ Couple or replace state assessments with a standardized, nationally normed test
- ★ Focus grades 1 through 3 on reading and mathematics, increase time on task, and assess frequently
- ★ Assign under-performing students to highly effectively teachers and use instructional programs of proven effectiveness
- ★ Administer the three transitional ACT assessments at grades 8, 10, and 12 to assess progress toward post-secondary readiness
- ★ Establish high standards for school completion, post-secondary readiness, and closing the achievement gap as the basis for school accreditation
- ★ Develop an explicit, realistic measurement of high school completion that is based on achievement of a high school diploma

## RESOURCES

- *Paying For Education – What Is The True Cost?* by Chris Patterson, Texas Public Policy Foundation, May 2004 (<http://www.texaspolicy.com/pdf/2004-05-sf-payingforeduc.pdf>)
- *Testimony On Post-Secondary Readiness* by Chris Patterson, Texas Public Policy Foundation, May 2004 (<http://www.texaspolicy.com/pdf/2004-05-10-testimony-patterson-pp.pdf>)

# Education Spending & Learning

## THE ISSUE

Efforts to reform the state's school finance system provoke fundamental questions about education spending, learning, and the relation between the two. School districts and professional educational associations claim that schools need more money to meet state demands for higher student performance. Looking at current expenditures, various studies identify different costs for schools to provide the education needed for students to pass state assessments. A study commissioned by the Texas Legislature determined that it takes about \$6,400 per student annually for schools to reach a passing rate of 55 percent on state assessments (the minimum rate set for school accreditation). All of these studies are based on the erroneous assumptions that current investment of education funds is efficient and that there is a relationship between spending and learning – i.e., more money results in higher student performance.

To the contrary, decades of national and international research have demonstrated no empirical, scientific relationship between money and learning. While increased education spending generally correlates with lower student performance, a cause-effect relationship has yet to be demonstrated. The United States, for example, spends more than other industrialized nations on public schools, and our students score at the bottom of international tests. Kansas City and Washington, D.C., cities with the highest per pupil spending, post the lowest test scores in the nation. Even in Kansas City, where courts mandated steep increases in spending and strict equalization, there was no significant improvement in student performance.

Statistical analyses of the relationship between spending and learning in Texas public schools proved no exception to national and international research. Two independent studies found economic status of the student population was far more important in determining education outcomes than the amount of money that Texas public schools spend. Neither study found that increasing district spending increased student performance; in some cases, higher spending was associated with lower student achievement.

However, *targeted* increases on instructional spending are associated with higher student performance, according to research. When schools put instructional spending first – instead of spending on administration, technology, and facilities – educational outcomes improve. Spending by Texas school districts offers an explanation for languishing student performance; spending on non-instructional activities has risen remarkably over the past decade, dwarfing classroom spending.

While real, per student funding has tripled for Texas public schools over the past three decades, there is no evidence student performance has improved. Nor have schools offered any evidence that current funding is insufficient for them to meet state requirements. On the contrary, there is ample evidence that discretionary, optional spending continues unabated while schools claim to be forced to cut essential programs. In fact, there is no way that schools could prove they have insufficient funds to meet state requirements because



they do not differentiate between optional and necessary spending in their accounting systems. Wiser spending, not more money, is needed to improve Texas public schools.

## THE FACTS

- ★ It is scientifically impossible to determine the cost of an adequate education or the provision of any level of education – science can only determine how much schools spend
- ★ Student performance is generally not improved by increasing school funding, across-the-board pay increases for teachers, increasing the number of teachers with advanced degrees, or decreasing class size
- ★ Increasing the percentage of funding from local sources does increase student performance
- ★ Decreasing administrative spending and increasing instructional spending does increase student performance
- ★ How money is spent is much more important than how much money schools can spend
- ★ Texas spent more than \$6,700 per student in 2004, but only 50 percent of those dollars reached the classroom
- ★ Austin ISD increased instructional spending 27 percent from 1997 to 2002 but increased extracurricular activities spending 134 percent and data processing spending 344 percent

## RECOMMENDATIONS

- ★ Define an “adequate” or required education in terms of explicit standards for student performance rather than in terms of spending
- ★ Prioritize instructional spending and redirect more of the education dollar to the classroom
- ★ Create incentives for districts to spend money more effectively and efficiently
- ★ Require districts to establish accounting systems that differentiate between spending on state required and optional activities

## RESOURCES

- *Effective, Efficient, Fair: Paying For Public Education In Texas* by Richard Vedder and Joshua Hall, Texas Public Policy Foundation, February 2004 (<http://www.texaspolicy.com/pdf/2004-02-25-vedderhall-all.pdf>)
- *Assessing Performance: Spending And Learning In Texas Public Schools* by Sanjiv Jaggia and Vidisha Vachharajani, Texas Public Policy Foundation, March 2004 (<http://www.texaspolicy.com/pdf/2004-03-19-BH-Educ.pdf>)
- *The High Costs Of Texas Public Education: A Study Of Three Texas School Districts* by Milton Holloway, Texas Public Policy Foundation, March 2004 (<http://www.texaspolicy.com/pdf/2004-03-25-holloway-costs.pdf>)
- *Building For The Future: A Look At School Facilities Funding In Texas* by Wendell Cox and Byron Schломach, Texas Public Policy Foundation, April 2004 (<http://www.texaspolicy.com/pdf/2004-04-facilities.pdf>)

# Public School Finance

## THE ISSUE

School finance reform is inarguably the most important and complex challenge facing the Texas Legislature. It is complicated by the intimate connections between education funding, public school outcomes, local property taxes, the state tax system, the state budget, and the state economy. The issue raises fundamental questions about constitutional obligations for public schools, local control and the role of state government, and the efficiency and effectiveness of public schools.

During the 78th Texas Legislature, policymakers shouldered the task of school finance reform for the purposes of providing tax relief and increasing the state's share of public education funding. This proved a daunting task, remaining unresolved after a special legislative session on school finance following the 78th session. The challenge has become increasingly complicated; some policy leaders now press for the Legislature to completely overhaul both the school finance system and the state tax system.

The broad debate focuses on these questions:

- ★ What is the proper proportion of public education funding that should be borne by the state and the local community?
- ★ How can the state eliminate "Robin Hood" and fulfill its responsibility for equalizing education funding without redistributing local property tax revenues?
- ★ Where can the Legislature find additional state revenue to provide property tax relief by lessening reliance on local property taxes for funding public schools?
- ★ Do public schools need additional funds?
- ★ How can public schools operate more efficiently and effectively?
- ★ How can the school finance system establish incentives for public schools to be more efficient and effective?

These questions are integral to a lawsuit filed by more than 300 school districts against the state. Some districts claim the state provides insufficient funding to meet state mandates and others claim the state's reliance on local property tax revenues for education funding violates the constitutional prohibition against a state property tax. It is likely that this suit, like others filed by districts against the state throughout the last several decades, will stimulate significant reforms of the state's school finance system.

Whatever shape school finance reform assumes, policymakers must address the sharp increases in school spending. Sharply rising expenditures for Texas public schools are unproven as a means to improve public education. Clearly, the primary challenge for school finance reform is to control, prioritize, and target education spending.



## THE FACTS

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- ★ Real, per pupil spending has tripled in Texas since 1970 – a tripling even after accounting for inflation and enrollment growth
- ★ Texas spent more than \$6,700 per student in 2004, but this investment may reach as high as \$10,000 per student when indirect as well as direct costs are measured
- ★ Texas ranks 20th in the nation for per pupil spending when cost of living is considered, according to the Manhattan Institute
- ★ Although state funding for public schools continues to increase, the percentage of the state budget that goes to education reached its zenith in 1985 at 52.2 percent and declined to 36.3 percent in 2002

## RECOMMENDATIONS

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- ★ Define constitutional obligations for public education
- ★ Hold public schools accountable for efficient, effective spending and higher student outcomes
- ★ Protect and enhance local control
- ★ Allow local communities to underwrite the greater share of total education funding
- ★ Prioritize state dollars for underwriting the provision of state education mandates
- ★ Establish student-centered funding
- ★ Tie new money for public education to enrollment growth and inflation
- ★ Focus the tax part of the school finance debate on property tax relief
- ★ Let the scientific research on spending and learning guide school finance reform
- ★ Enact fiscally neutral reforms that will improve the state economy, encourage public schools to exercise fiscal prudence, and stimulate higher educational productivity

## RESOURCES

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- *Effective, Efficient, Fair: Paying For Public Education In Texas* by Richard Vedder and Joshua Hall, Texas Public Policy Foundation, February 2004 (<http://www.texaspolicy.com/pdf/2004-02-25-vedderhall-all.pdf>)
- *Putting The Sides Together: Twelve Perspectives On Texas Public School Finance*, edited by Chris Patterson, Texas Public Policy Foundation, December 2003 (<http://www.texaspolicy.com/PTST/>)
- *The High Costs Of Texas Public Education: A Study Of Three Texas School Districts* by Milton Holloway, Texas Public Policy Foundation, March 2004 (<http://www.texaspolicy.com/pdf/2004-03-25-holloway-costs.pdf>)
- *General Principles For Conservatives – School Finance: Education Spending And Taxation* by the Texas Conservative Coalition Research Institute and Texas Public Policy Foundation, April 2004 (<http://www.texaspolicy.com/pdf/2004-04-TCC-TPPF-First-Principles-SF.pdf>)
- *Four Myths Of Public School Finance* by the Texas Conservative Coalition Research Institute and Texas Public Policy Foundation, May 2004 (<http://www.texaspolicy.com/pdf/2004-05-sf-TCCRI-TPPF-Myths.pdf>)
- *Follow The Money: A 50-State Survey Of Public Education Dollars* by Chris Patterson, Texas Public Policy Foundation, October 2003 (<http://www.texaspolicy.com/pdf/2003-10-22-sf-followmoney.pdf>)
- *Thinking About School Finance In Texas* by Eric Hanushek, Texas Public Policy Foundation, October 2003 (<http://www.texaspolicy.com/pdf/2003-10-22-hanushek.pdf>)

# *School Choice*

## THE ISSUE

After decades of reform, Texas public schools show no improvement in the academic proficiency of high school graduates or the rate of educational completion. After attempting to improve public schools with more money and more resources, many Texans have turned to school choice as a way to improve schools.

School choice is closely intertwined with school finance, representing a proven means to increase public school productivity, reduce education costs, and improve student outcomes. Vouchers can represent a component of school funding or student-centered funding and can serve as the entire mechanism for financing public education.

Vouchers have proven remarkably successful for students who exercise school choice. Ten large, comprehensive, scientific studies of voucher programs show student achievement increases for some or all students who participate in voucher programs. School choice has proven the most educationally beneficial for under-performing and disabled students who have failed to thrive in public schools.

There is also evidence that school choice raises the achievement of all students whether or not students exercise choice. Students enrolled in public schools that compete with charter or private schools out-perform their public school peers in communities where students cannot exercise choice. Decades of state, national, and international research offer scientific evidence that competition among educational providers results in higher academic outcomes for all students at lower educational cost.

School choice is broadly supported by all Texans, particularly African-American and Hispanic voters, according to voter polls. This support is unsurprising, recognizing the history of Texas. The original form of public education established by the 1876 State Constitution was financed by vouchers issued to parents that could be used to enroll children in any municipal or private school of the parents' choice.

## THE FACTS

- ★ Standardized test scores of voucher recipients are consistently, statistically positive
- ★ In voucher programs in Dayton, New York, and Washington, African-American students reduced the achievement gap by one-third within just two years
- ★ Students who use vouchers in private schools have higher academic achievement and a higher likelihood of high school graduation, college enrollment and attaining a post-secondary degree – even after controlling for differences in race, ethnicity, and income
- ★ Per pupil operating costs of private schools participating in voucher programs were nearly half of the per pupil expenditure of public school students



- ☆ Student achievement increases 28 percent in public schools when public schools compete with private schools – without any increase in public school spending
- ☆ 60 percent of Texas voters support a school choice program in which scholarships would be given by the state to pay for a child's education at any public, private, or parochial school, according to a 2003 Baseline & Associates Poll
- ☆ School choice represents the highest form of school accountability
- ☆ School choice offers the most effective way to control education costs and improve performance of all students

## RECOMMENDATIONS

- ☆ Introduce publicly funded vouchers as a pilot program for under-performing and disabled students
- ☆ Inject competition into the public school system, beginning with public school or inter-district choice
- ☆ Establish student-centered funding and offer school choice as the new form of public education for all children

## RESOURCES

- *Paying For Education – What Is The True Cost?* by Chris Patterson, Texas Public Policy Foundation, May 2004 (<http://www.texaspolicy.com/pdf/2004-05-sf-payingforeduc.pdf>)
- *Individual Education Plan: The Case For Choice For Texas Students With Disabilities* by Matthew Ladner, Texas Public Policy Foundation, April 2004 (<http://www.texaspolicy.com/pdf/2004-04-sf-ladner-special.pdf>)
- *Putting The Sides Together – School Choice In Texas?* edited by Chris Patterson, Texas Public Policy Foundation, March 2004 (<http://www.texaspolicy.com/pdf/2004-04-sf-puttingsides-txsc.pdf>)
- *Testimony Commending School Choice As A Component Of School Finance Reform* by Patrick Wolf, Texas Public Policy Foundation, August 2003 (<http://www.texaspolicy.com/pdf/2003-08-22-SFSC-Wolfe-testimony.pdf>)





### III. HEALTH CARE POLICY

*Legislators' Guide to the Issues*

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# State Health Care

## THE ISSUE

Three inter-connected issues dominate the state policy debate on health care: 1) financing health and human services, 2) reducing the number of uninsured, and 3) increasing the affordability of private sector health insurance. As policymakers face the rising costs of health care and the limits of state revenue, these issues are at the forefront for the Legislature.

Health and human services consume an ever increasing share of the state budget. Welfare spending, which is rising faster than spending on any other government function, will soon eclipse public education as the state's single largest expenditure category. Spending is on the rise because medical costs are increasing, enrollment in state-sponsored health programs is rising, and enrollment in private sector insurance is declining.

Health insurance coverage in the private sector is declining because the cost of insurance premiums is rapidly rising at the same time that businesses are shouldering higher state taxes and fees. The number of businesses offering health insurance benefits is decreasing. At the same time, the number of employees declining employer health insurance is growing because some of these employees are choosing to enroll their families in Medicaid or the Children's Health Insurance Program. Meanwhile, the number of uninsured Texans is growing.

Some policymakers press to expand funding for Medicaid and CHIP while others seek ways to control costs with more efficient, effective services. Because rising expenditures will soon make the current level of welfare services unsustainable, there is growing scrutiny of state revenues and spending priorities. Some policymakers believe Texas needs comprehensive, fundamental health care delivery reform. As the number of uninsured swells, there is a more intense focus on incentives to increase personal responsibility and develop affordable health care alternatives.

These issues stimulate fundamental questions for policymakers:

- ★ How can state government make health care more accessible and affordable for all Texans?
- ★ Is government the more efficient and effective provider and financier of health care?
- ★ What responsibility for health care should be taken by state government, communities, individuals, and employers?

## THE FACTS

- ★ State spending on health and human services, adjusted for inflation, grew at an annual compounded rate of 6 percent annually from 1978 to 1990 but grew at nearly 9 percent from 1990 to 2003
- ★ Health care spending grew nearly four times faster than the economy



- ★ Texas spent close to \$23 billion on health and human services in 2003
- ★ For per capita state welfare expenditures, Texas ranks 45th among states while ranking 27th in the nation for welfare recipients as a percentage of population
- ★ 27 percent of Texans are without health insurance – Texas ranks 1st among states for percent uninsured
- ★ Over the past several years, health care premiums in Texas increased by an average of 25 percent, far above the national average of 15 percent
- ★ Average cost of an employer-based health policy increased from \$3,817 per employee in 1998 to \$9,068 in 2003
- ★ Health insurance premiums increased 2.2 percent faster than inflation and 3.1 percent faster than wage gains for non-supervisory employees
- ★ State mandates drive up private health care costs almost 10 percent a month for each insured employee
- ★ Only two other states – Vermont and Maryland – impose more mandates on health insurance than Texas
- ★ Analysts predict health care costs will double within the next 3 to 5 years

## RECOMMENDATIONS

- ★ Control costs of Medicaid and CHIP and improve the quality of services
- ★ Focus state funds on the most needy of Texans
- ★ Expand consumer-directed alternatives – such as health savings accounts and defined contribution health plans
- ★ Eliminate state regulations that increase the cost of health insurance and restrict different types of benefit plans
- ★ Increase the number and kinds of private health insurance options
- ★ Expand incentives for small employers to provide health care coverage
- ★ Create incentives for increased personal choice and responsibility in both government and private sector health care

## RESOURCES

- *Medicaid And The Uninsured* by Beau Egert, Texas Public Policy Foundation, September 2004 (<http://www.texaspolicy.com/pdf/2004-09-medicaid.pdf>)
- *Defined Contribution Health-Care Plans Benefit Consumers, Employers, Physicians And Insurance Companies*, Haavi Morreim, Texas Public Policy Foundation, April 2003 (<http://www.texaspolicy.com/pdf/2003-04-08-health-morreim.pdf>)
- *Securing The Safety Net For Texas Children: Cutting The Budget And Strengthening The Children's Health Insurance Program* by Chris Patterson and Devon Herrick, Texas Public Policy Foundation, May 2003 (<http://www.texaspolicy.com/pdf/2003-05-19-health-chip.pdf>)
- *Critical Condition: How Lawsuit Abuse Is Hurting Health Care & What Texans Can Do About It* by Chris Patterson, Colleen Whalen and John Pisciotta, Texas Public Policy Foundation, April 2003 (<http://www.texaspolicy.com/pdf/2003-04-29-CRITICALCONDITION.pdf>)

# Medicaid

## THE ISSUE

Medicaid is becoming Texas' top fiscal priority, superseding the position that public education has held for decades. Consuming an ever greater share of the state budget, sharply rising costs undermine the ability of taxpayers to sustain this essential program for the neediest of Texans, as well as other state-funded programs. Traditional reforms have proven unequal to the task of achieving long-term savings, and today, the sustainability of Medicaid depends on comprehensively changing the ways care is delivered and services paid for, and on creating incentives for recipients to increase the efficiency of Medicaid dollars.

The Medicaid debate is complicated by more than "simple" questions about funding. Because it is perceived as an alternative to private insurance, Medicaid encourages people to drop coverage paid for by themselves and employers. In Texas, Medicaid enrollment has risen as enrollment in private health care coverage has fallen. Preventing "crowd out," the substitution of government-subsidized health care for private insurance described later in this guide, is critically important.

The serious and growing problem of the uninsured also is linked to Medicaid. There are widely held misperceptions that Medicaid is both the cause of and solution for Texans who lack health care coverage. Some claim that efforts to reduce Medicaid costs have bolstered the uninsured population and that expanding Medicaid enrollment will shrink it. These claims and the problem of the uninsured are examined in a later section of this guide.

Nearly half of the states in the United States, including Texas, anticipate shortfalls in Medicaid spending for the current fiscal year, and this shortfall will grow increasingly severe annually as costs and enrollment rise. To solve this problem, the choices are clear. Policymakers can slash other government services such as public education, raise the state tax burden with disastrous economic consequences, or enact cost-control measures.

## THE FACTS

- ★ Medicaid is an entitlement program – Texas must provide medically necessary care to all eligible individuals who seek services
- ★ Health and human services represent 34 percent of the total state budget for 2004 – Medicaid accounts for about 75 percent of the state's health and human services budget
- ★ \$17 billion is the total projected amount to be spent by Texas on Medicaid in 2004 (all funds, including the Disproportional Share Hospital Funding)
- ★ Medicaid is jointly financed by state and federal governments – the federal share for Texas in 2004 is 60.22 percent
- ★ 2,951,945 Texans received Medicaid-funded services during 2002
- ★ 1 out of 9 Texans received Medicaid as of January 2004



- ★ 59 percent of Texas Medicaid recipients are children, but they account for 25 percent of Texas Medicaid spending
- ★ 20 percent of Texas Medicaid recipients are the aged and disabled, but they account for 62 percent of Medicaid spending
- ★ The elderly and disabled accounted for almost 60 percent of the national growth in Medicaid spending from 2000 to 2002
- ★ Over one-third of Texas' Medicaid population is enrolled in some form of managed care
- ★ 28 states, including Texas, anticipate shortfalls in Medicaid spending for the current fiscal year
- ★ Medicaid will bankrupt every state if spending is not controlled, according to some health care analysts
- ★ Direct Medicaid costs are expected to nearly double within the next 3 years
- ★ Increasing Medicaid enrollment has demonstrated little or no success in reducing the percentage of uninsured Texans
- ★ A study by the National Bureau of Economic Research found that a 50 percent increase in Medicaid coverage is associated with a 50 percent reduction in private insurance coverage

## RECOMMENDATIONS

- ★ Reduce and control Medicaid costs while improving health outcomes
- ★ Secure a federal waiver to allow full integration of Medicaid and Medicare funding
- ★ Seek a federal waiver to expand consumer-directed services beyond personal assistance services to transportation, assistive technologies, and modification of home/vehicles
- ★ Integrate acute and long-term care services on a provider, instead of insurer, level
- ★ Establish a team delivery model that coordinates resources and services for both the elderly and disabled with the locus on the home
- ★ Expand reliance on non-traditional agencies for administrative and fiscal services
- ★ Utilize premium assistance for implementing a benefit phase-out rate for Medicaid
- ★ Create incentives for Medicaid recipients to use managed care and more cost-effective forms of medical delivery
- ★ Strengthen strategies to eliminate waste, fraud, and abuse
- ★ Establish a pilot program for sending Medicaid funding as a block grant to local communities
- ★ Establish a long-range plan for transitioning the state's Medicaid program into private sector health care

## RESOURCES

- *Medicaid And The Uninsured* by Beau Egert, Texas Public Policy Foundation, September 2004 (<http://www.texaspolicy.com/pdf/2004-09-medicaid.pdf>)
- *Using Market Forces To Control Texas Medicaid Costs And Improve Health Outcomes* by Michael Bond, Texas Public Policy Foundation (Forthcoming 2005)

# *Children's Health Insurance Program*

## THE ISSUE

The Children's Health Insurance Program (CHIP) underwent significant reforms during the 78th Texas Legislature to control costs and focus funding on the neediest of children who are ineligible for Medicaid. The Legislature decreased some benefits to bring them in line with private insurance plans, increased some co-payments and premiums, and shortened re-application periods.

The enrollment rate in CHIP declined during 2004 and the total estimated caseload for the spring was approximately 20 percent less than 2003 enrollment. About 40 percent of the decline in CHIP resulted from parental decisions not to re-enroll their children while an additional 25 percent of the children transferred health coverage to Medicaid. Despite the decline in CHIP enrollment, 200,000 new children were enrolled in CHIP and Medicaid over the two-year period.

In August of 2004, the Governor requested that the Health and Human Services Commission indefinitely delay the removal of 20,000 children from CHIP because parents declined to pay the monthly premium and co-payment required for families with incomes 101 to 200 percent above the federal poverty level.

Despite fears that state reforms of CHIP were draconian and would swell the already large population of uninsured Texans, there is evidence that reforms are achieving some success. State resources appear to be targeting and increasing resources for the neediest of Texas children. There is no appreciable increase in the number of uninsured children, and parents are taking a more active role in decisions about their children's health coverage.

However, the refusal of parents to contribute a nominal fee toward the cost of insuring their children and the subsequent reversal of requirements for parental contributions present difficult challenges for state policymakers. Should the state provide "free" health care for families with significant earnings above the federal poverty level? What incentives can be created to encourage parents to shoulder some financial responsibility for their children's health care? What reforms would make CHIP valued by parents and encourage wise investments of state health dollars? How can the state encourage health care providers to hold parents more accountable for their children's health care?

Answers to these questions are necessary if CHIP is to fulfill its goal of providing transitional support for families moving from welfare to independence. Otherwise CHIP will become another entitlement, destroying opportunity and personal responsibility. Recognizing that decreasing enrollment is the ultimate goal of CHIP and the signal of success, it is clear that comprehensive, systemic reform is necessary for CHIP to be preserved as a safety net for Texas' most needy children and a bootstrap for families to help themselves.



## THE FACTS

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- ★ The percentage of uninsured children living in poverty is declining in Texas – from 2000 to 2001, almost 300,000 more children had health coverage than did in 2000
- ★ 200,000 new low-income children were enrolled in CHIP and Medicaid in the past 2 years
- ★ 406,760 children are enrolled in Texas CHIP (estimated caseload)
- ★ \$808 million was appropriated for CHIP for fiscal year 2004-05
- ★ CHIP is jointly funded by the state and federal government – the federal share of 2004 CHIP is 72.15 percent
- ★ CHIP serves uninsured children under age 18 with family incomes up to 200 percent of the federal poverty level, as well as legal immigrant children who have been in the country less than 5 years, children of retired school employees, and children of state employees who meet income requirements
- ★ State reforms enable more children and more needy children to enroll in CHIP and Medicaid
- ★ State requirements for parents earning above the federal poverty level to pay a \$15 to \$20 monthly premium and a \$7 to \$10 co-payment for care have been shelved for an indefinite period

## RECOMMENDATIONS

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- ★ Preserve CHIP for the neediest of Texas children, with eligibility for families with incomes no more than 150 percent above the federal poverty level
- ★ Expand incentives for parents to contribute to and participate in children's health care
- ★ Restore requirements for monthly premiums and co-payments
- ★ Create health savings accounts for CHIP recipients
- ★ Enact a premium support program to help parents secure health coverage through their employers
- ★ Increase the affordability and choice of private health insurance options by eliminating state regulations over benefits

## RESOURCES

- *Securing The Safety Net For Texas Children: Cutting The Budget And Strengthening The Children's Health Insurance Program* by Chris Patterson and Devon Herrick, Texas Public Policy Foundation, May 2003 (<http://www.texaspolicy.com/pdf/2003-05-19-health-chip.pdf>)
- *The Problem With The CHIP Debate* by Brooke Rollins and John Colyandro, Texas Public Policy Foundation, September 2004 ([http://www.texaspolicy.com/commentaries\\_single.php?report\\_id=595](http://www.texaspolicy.com/commentaries_single.php?report_id=595))

# *The Uninsured*

## THE ISSUE

**T**exas is home to the largest population of uninsured persons in the nation. The uninsured pose a particularly complex problem for state policymakers because there are cornucopias of reasons why people lack health insurance, and few common characteristics among the uninsured. Also, membership in the uninsured population changes constantly.

Among the problems in trying to identify the uninsured:

- ★ Most of the uninsured are members of families with full- or part-time employment;
- ★ Slightly over half of the employed uninsured are poor, earning below the federal poverty level – most are not offered the opportunity to purchase health insurance through their employers;
- ★ About a third of the uninsured are eligible for Medicaid or CHIP;
- ★ A significant number of the uninsured have annual incomes above \$50,000 – this is the fastest growing segment of the uninsured population ;
- ★ Non-citizens represent almost a fifth of Texas' uninsured population;
- ★ Most of the uninsured are young and relatively new to the workforce; and
- ★ Most of the uninsured go without insurance for a relatively short period of time.

Texans pay a high price for the uninsured. Some costs are visible. Although most of the uninsured are in good health, the remainder have serious medical problems. Most uninsured individuals procure health care in hospital emergency rooms, although most of the reasons for care do not represent emergencies. The comptroller estimates that Texas spends about \$1,000 a year on “free care” for every uninsured person in the state. Texas hospitals spent over \$2.1 billion to provide uninsured and un-reimbursed Medicaid services in 1998, according to the Texas Department of Insurance.

Some costs of the uninsured are less visible. Non-emergency use of hospitals can cause true emergencies to be re-routed to distant medical facilities, creating potentially life-threatening delays in care. To pay for what is viewed by some as “free” health care, Texans underwrite the cost of treatment for the uninsured by paying higher health insurance premiums for themselves, and by paying higher taxes. However, the highest cost is paid in health outcomes; individuals who rely on government-subsidized programs have poorer health and medical outcomes than individuals who have private health coverage.

The proportion of Texans who are uninsured has not changed significantly over the past decade, although enrollment in government-subsidized health care programs is growing.

The stability of Texas' uninsured population argues against the erroneous, widespread belief that the expanding Medicaid and CHIP is the way to reduce the uninsured population. In fact, a growing body of well-designed research finds no



evidence of any relationship between government-subsidized health care and the uninsured. Expansions or reductions in Medicaid and CHIP have no appreciative effect on the size of uninsured population. However, growing enrollment in Medicaid and CHIP does correspond with decreasing enrollment in private health care programs. This effect, known as "crowd out," is described in the next section of the guide.

Although the percentage of uninsured Texans has not changed significantly over the past decade, some predict it will soon rise. An increasing number of small businesses in Texas say they are considering the elimination of employee health benefits. Climbing health care costs and rising taxes erode the ability of employers, particularly small employers, to fund health care premiums.

The costs of the uninsured make solving this problem a high priority for Texans. Its complexity argues for multiple solutions and systemic reforms that will fundamentally change the delivery of health care for all Texans. Because choice and financial priorities lie at the heart of un-insurance for many, policymakers will have to address prevailing assumptions about "free care" and difficult questions about personal responsibility. As the alternative to expanding government-subsidized care, private sector health care will have to be expanded, strengthened, and made more affordable, particularly through consumer-directed alternatives.

## THE FACTS

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- ★ 25 percent of Texans are uninsured – Texas is at the top of national rankings on uninsured statistics
- ★ The percentage of uninsured Texans is largely unchanged over the past decade
- ★ 75 percent of the uninsured are without health insurance for no more than 12 consecutive months
- ★ 19 percent of Texas' uninsured are non-citizens
- ★ 82 percent of the uninsured have some connection with either part- or full-time employment
- ★ 66 percent of the uninsured are at or below the federal poverty level
- ★ 25 percent of the uninsured earn more than \$50,000 annually for a family of four, and 13.7 percent earn over \$74,000
- ★ 60 percent of the uninsured are between the ages of 18 and 34
- ★ Between 33 percent and 40 percent of the uninsured are eligible for, but have declined, enrollment in Medicaid or CHIP
- ★ 75 percent of the increase in the uninsured over the past several years represents individuals from households earning more than \$50,000 annually
- ★ In a survey of the uninsured in California, 60 percent indicate health insurance is not a financial priority
- ★ More than 50 percent of uninsured treated by Dallas' Parkland Hospital who are eligible for Medicaid or CHIP refuse enrollment
- ★ 58 percent of Texans are covered by employer-sponsored health care, compared to 64 percent nationally

THE FACTS *(continued)*

- ★ Small businesses employ almost half of working Texans, and the number of small businesses offering health insurance is declining – one-third of Texas' small businesses say they are likely to discontinue insurance within the next five years because the cost is too high
- ★ From 2001 to 2003, the proportion of Americans enrolled in welfare rose by 6.1 percent while coverage in employer-based plans decreased by 4.9 percent and the rate of uninsured fell about one-half of one percent

## RECOMMENDATIONS

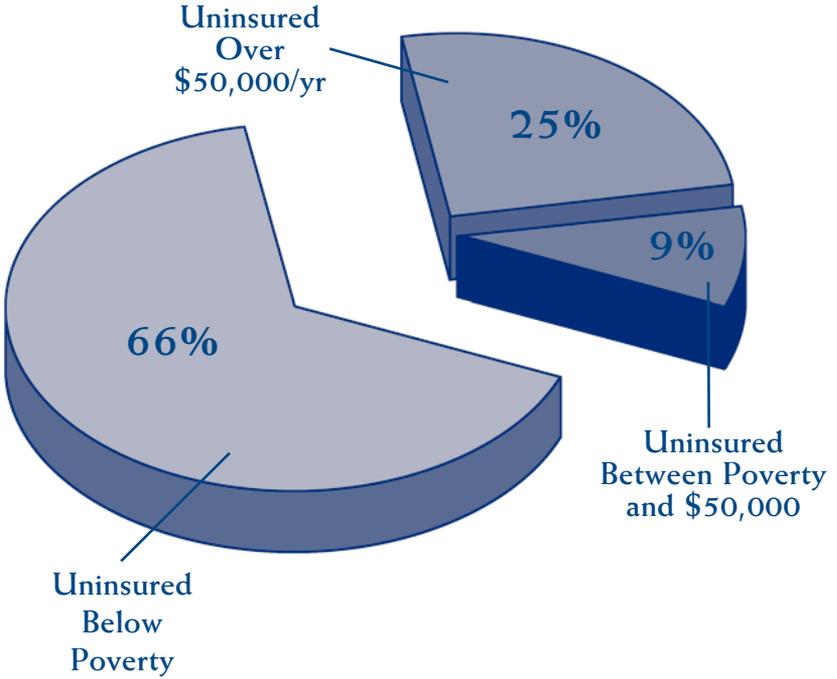
- ★ Establish incentives to increase employer-based health care, such as tax credits and business cooperatives/purchasing pools
- ★ Expand consumer-directed health care alternatives, such as health savings accounts
- ★ Promote county-level strategies to develop and pilot health care programs for the uninsured through more flexible use of Disproportionate Share Hospital Funding
- ★ Reduce the cost of basic insurance by eliminating state regulations that require benefits beyond basic coverage
- ★ Triage non-emergency uninsured cases to the most cost-efficient forms of health care delivery (clinics and nurse practitioners)
- ★ Establish statutory protections for medical providers to triage non-emergency care
- ★ Create incentives for individuals and health care providers to increase patient responsibility for state-subsidized health care (including co-pays and premiums)
- ★ Develop a state resource bank for medical consumers – listing health care plans, premiums, and prices of medical services

## RESOURCES

- *Medicaid And The Uninsured* by Beau Egert, Texas Public Policy Foundation, September 2004 (<http://www.texaspolicy.com/pdf/2004-09-medicaid.pdf>)
- *Securing The Safety Net For Texas Children: Cutting The Budget And Strengthening The Children's Health Insurance Program* by Chris Patterson and Devon Herrick, Texas Public Policy Foundation, May 2003 (<http://www.texaspolicy.com/pdf/2003-05-19-health-chip.pdf>)



### Some Texans Choose To Go Without Health Insurance



# *Crowd Out*

## THE ISSUE

Substitution of government-subsidized care for private health insurance poses a financial burden on all Texans. Some individuals give up private insurance because they have an opportunity to enroll in Medicaid or CHIP. This substitution drives up state health care spending, results in higher state taxes, and, in the long run, results in higher private insurance premiums as the private market constricts.

Over the past several years, the number of individuals purchasing health insurance through employers has decreased while, at the same time, enrollment in Texas Medicaid and CHIP has increased at a corresponding rate.

State estimates of crowd out are somewhat reassuring; it is reported that Texas only experiences a 1 percent crowd out rate. However, the state's calculation is based on unverified self-reporting of Medicaid and CHIP applicants. Unlike many states, Texas does not verify prior insurance information and, therefore, does not have the most reliable measure of crowding out. Texas' actual crowd out rate, if based on other states' data, is probably closer to 7 percent. Several national studies calculate real crowd out may approach 50 percent.

Crowd out, in the long term, depresses private insurance enrollment and discourages employer provision of health insurance because it raises the cost of private health insurance premiums. Crowd out also undermines the health of Texans. Individuals who rely on private insurance have improved medical outcomes over individuals who rely on state-subsidized care.

## THE FACTS

- ★ When CHIP was enacted in 1997, enrollment of children in welfare increased from 29 percent to 33 percent throughout the nation while the percent of children covered by private programs fell from 47 percent to 42 percent
- ★ 24 percent of children enrolled in Texas CHIP have access to employer-based health insurance
- ★ For every 10 new Medicaid recipients, three people substitute government coverage for private coverage
- ★ For every additional dollar spent on Medicaid, private sector health care spending was reduced by \$.50 to \$.75
- ★ Texas' Health & Human Services Commission report on crowd out falls well below numbers reported by states that use more precise measures – if the crowd out rate in Texas is similar to that in other states, 7 percent is a more likely number rather than 1 percent



- ☆ Enrollment in Texas CHIP and Medicaid has increased proportionally to the decline of private insurance enrollment
- ☆ Several national reports indicate crowd out rates may actually run at a one to one ratio – for every individual who leaves private health insurance, one individual enrolls in Medicaid or CHIP
- ☆ Costs of state-subsidized health care are generally higher than costs incurred by individuals with private insurance, and health outcomes of state-subsidized patients are worse than those for patients with private insurance

## RECOMMENDATIONS

- ☆ Enact a precise measurement of crowd out similar to that used by other states and require reporting accordingly
- ☆ Strengthen enrollment procedures in CHIP and Medicaid to reduce crowd out, such as eliminating waiting period waivers for more highly paid applicants
- ☆ Implement a premium support program to enable CHIP and Medicaid recipients to purchase health insurance through employers
- ☆ Strengthen the law to enable small employers to use purchasing cooperatives for health insurance
- ☆ Create tax incentives for employers to offer health insurance benefits

## RESOURCES

- *Effects Of Crowd Out* by Chris Patterson, Testimony to the Select Committee on State Health Care Expenditures, Texas Public Policy Foundation, March 2004 (<http://www.texaspolicy.com/pdf/2004-03-24-pp-chipcrowd.pdf>)
- *Securing The Safety Net For Texas Children: Cutting The Budget And Strengthening The Children's Health Insurance Program* by Chris Patterson and Devon Herrick, Texas Public Policy Foundation, May 2003 (<http://www.texaspolicy.com/pdf/2003-05-19-health-chip.pdf>)

# Health Savings Accounts

## THE ISSUE

**H**ealth savings accounts (HSAs) offer all Texans a new alternative for purchasing health insurance – an alternative that is particularly beneficial for individuals and employers who cannot afford to pay the soaring costs of traditional health insurance. Combining a high-deductible, catastrophic policy with a tax-exempt savings account that can be used to pay medical expenses such as preventive care and immunizations, HSAs provide individuals greater control over health care at lower costs.

Since HSAs were incorporated into Medicare reform last year, enrollment has rapidly grown. Consequently, there is substantially more information available about how consumer-centered insurance works.

For example:

- ★ HSAs appeal to individuals of all income levels;
- ★ Families with children are more likely to select HSAs than single adults;
- ★ HSAs serve an older population than those purchasing traditional insurance;
- ★ Average health care spending for individuals with HSAs is significantly less than monthly premiums for traditional insurance plans; and
- ★ Individuals enrolled in HSAs purchase more preventive care than individuals enrolled in traditional insurance plans.

Companies that have switched from traditional insurance to HSAs for employee benefits are realizing significant reductions in cost; one company reports cost-savings that approach 20 percent. Although there is not much experience with HSAs because consumer-directed insurance is relatively new, surveys indicate that cost-savings are convincing a large number of companies to offer HSAs to their employees. These surveys also indicate a high level of employee satisfaction with the plans.

Offering affordable health care, HSAs offer promise to help resolve the critical problem of the uninsured. In fact, HSAs have already reduced the number of uninsured Americans. Almost half of the individuals now enrolled in HSAs did not have prior health insurance coverage, according to their applications.

For Texas employers, HSAs are a way to offer or maintain employee health benefits and, for individuals, HSAs furnish the opportunity to purchase affordable health care. For policymakers, HSAs provide the means to control state-subsidized health care (Medicaid and CHIP), as well as state-sponsored insurance (state and public school employees), while improving health care quality.



## THE FACTS

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- ★ 79 percent of individuals purchasing HSAs are over the age of 40, approximately half earn under \$50,000 a year, and over 75 percent are families with children
- ★ 70 percent of HSA purchasers pay less than \$100 a month for health insurance premiums – average annual individual premium for the nation represents a monthly cost of \$151
- ★ Companies that replaced traditional insurance with HSAs saw health costs fall by 11 percent, while workers' use of preventive health care increased 23 percent
- ★ 90 percent of individuals enrolled in consumer-centered plans indicate interest in continuing enrollment
- ★ 60 percent of large companies in the United States are likely to offer HSAs to their employees
- ★ The largest insurer offering HSAs is experiencing a 60 percent increase in applications
- ★ 43 percent of individuals applying for HSAs indicate no prior insurance coverage

## RECOMMENDATION

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- ★ Introduce HSAs as an option for Medicaid, CHIP, public school employees, and state employees

## RESOURCES

- *Health Savings Accounts: Defining The Future Of Health Care For Texans* by Devon Herrick, Texas Public Policy Foundation, November 2004 (<http://www.texaspolicy.com/pdf/2004-11-HSAs.pdf>)
- *Defined Contribution Health-Care Plans: Benefits For Consumers, Employers, Physicians, And Insurance Companies* by Haavi Morreim, Texas Public Policy Foundation, April 2003 (<http://www.texaspolicy.com/pdf/2003-04-08-health-morreim.pdf>)





## IV. TRANSPORTATION POLICY

*Legislators' Guide to the Issues*

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# Roadways

## THE ISSUE

For many years now, road congestion in Texas has seemed to become steadily worse. Today, Austin is considered to be the most congested city of its size in the nation and the obvious traffic headaches in Houston and Dallas/Fort Worth are actually worse than those in Austin. Roadways serving as major freight arteries between cities, like IH-35, are under increasing pressure as a result of NAFTA traffic. Contributing to the problem, Texas ports are positioned to get much busier because important shippers such as Wal-Mart and Home Depot, seeking to minimize the risk of a repeat of the strike that occurred at major California ports a few years ago, have plans to make Houston's port their primary point for receiving goods from overseas. Traffic from ports will increase truck and rail traffic as these import giants distribute goods throughout the nation using Texas roadways. Despite growing road demand in Texas, little has been added to the state's road network in recent years.

The policy of the Texas Legislature in the past has been to provide roads on a pay-as-you-go basis. In other words, as revenues from the federal government and Texas' fuel taxes have been collected, they have been spent on construction and maintenance. The state has historically not borrowed funds for road projects. However, federal funds have not always been reliable and Texas contributes more in federal transportation taxes than it receives in federal road funding. Because fuel taxes do not automatically adjust to inflation, the purchasing power of the Texas fuel tax has been falling since it was last increased in 1991. Revenues from fuel taxes have not increased as much as road travel due to improvement in automobile and truck fuel efficiency. At the same time, critical road-building resources such as steel, asphalt, and concrete have all seen price increases as a result of phenomenal economic growth and increased demand in India and China.

All of these circumstances make it necessary for state policymakers to consider new and innovative ways to fund and improve the state's road infrastructure. Roads are a valuable commodity that historically has been given away. Fuel taxes have proven a very poor substitute for directly pricing roads. Tolls, associated with delay and inconvenience in the past, now offer a viable alternative with the development of new technologies that do not require the driver to even slow down.

Having realized the need to develop more road infrastructure quickly, the Texas Legislature has been increasingly open to allowing the Texas Department of Transportation to experiment with new contracting and funding methods necessary to get road infrastructure built in a timely manner, instead of relying on relatively piecemeal strategies used in the past. With the passage of HB 3588 by the 78th Legislature, Texas is now considered a leader in innovative road financing and contracting, a description that, even four years ago, few would have thought would ever apply.



Today, regional mobility authorities are being formed to aid in planning and implementing toll funding strategies. Road funds are being leveraged through the issuance of bonds with tolls to aid in paying back the bonds. Unsolicited proposals to develop what has been called the Trans-Texas Corridor are being considered by the Texas Turnpike Authority. State-level toll roads in the Austin area are being rapidly constructed, partly through a design-build contract.

Changes in state policy have not been without controversy. Texans are not used to the idea that new limited-access capacity will be at least partially financed through tolls and will probably be constructed using innovative contracting practices. Tolls are controversial among people across the political spectrum and the new contracting practices are considered suspect by some, even though taxpayers are generally exposed to less risk than they had faced under the old contracting practices. The Texas Legislature will, therefore, be subject to some pressure to retrench on new transportation policy.

## THE FACTS

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- ★ As of 2002, there were 301,778 miles of public roads in Texas – 79,493 miles were owned by the state, 142,636 were owned by counties, and 78,653 were owned by municipal authorities
- ★ 79.4 percent of Texans commute to work alone in their personal vehicles
- ★ Only 12.5 percent of Texans carpool and fewer than 2 percent use public transportation, including taxis
- ★ The number of vehicle miles traveled per person in Texas in 2000 was 800 miles greater than the national average
- ★ 8 percent of all the vehicle miles traveled in the United States in 2000 occurred in Texas
- ★ From 1990 to 2003, the number of lane miles of public road on the Texas state system increased 4 percent while the number of total vehicle miles traveled on the state system increased 52.8 percent
- ★ In 2001, 22 percent of all Texas road bridges were functionally obsolete or structurally deficient, representing 10,555 structures, more than in any other state
- ★ Travel delay caused by congestion in Texas increased from 750 million hours in 1982 to 3.6 billion hours in 2000
- ★ Between 1990 and 2000 congestion in Texas' eight major metropolitan areas cost over \$45 billion in lost time and wasted fuel
- ★ Passenger cars and light duty trucks accounted for some 78 percent of carbon dioxide emissions in 2001
- ★ Truck imports by weight from Mexico to Texas increased 9 percent from 1997 to 2000. Truck imports by weight from Canada increased 36 percent during the same period
- ★ Of the top 50 U.S. foreign trade freight gateways (by value of shipments), 8 are in Texas, with 4 on the Texas/Mexico border

### THE FACTS *(continued)*

- ★ The 2000 U.S. Census shows that since 1990 carpooling declined from 13.4 percent of work trips to 11.2 percent of work trips, despite billions being spent on carpool lanes (HOV) on congested highways
- ★ A study by the Minnesota Department of Transportation indicated that opening HOV lanes to general use would reduce congestion, save fuel, and possibly reduce pollution
- ★ As of 2001, there were 8 toll roads in Texas – 5 owned by the Harris County Toll Road Authority, 2 owned by the North Texas Tollway Authority, and 1 privately owned – totaling 135 miles in length

## RECOMMENDATIONS

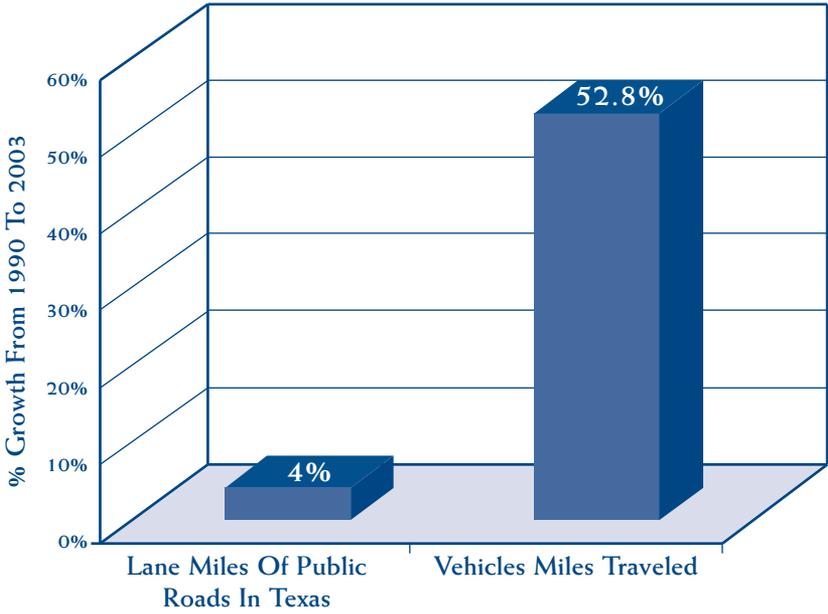
- ★ Refine reforms in HB 3588 as necessary in order to make procedures smoother and lines of authority clearer, but preserve the fundamental reforms
- ★ Enhance urban mobility through tolled “managed lanes” and convert high-occupancy vehicle (HOV) lanes, currently offered for free, to tolled lanes
- ★ On tolled intercity highways that might be developed, include concessions within the rights-of-way where possible so that they are accessible only from the toll lanes. Simultaneously eliminate or substantially reduce state fuel taxes on gasoline and diesel sold from these concessions
- ★ Adjust state policy to allow for funding projects to expedite freight rail traffic, taking pressure off the road network and improving traffic flow on roads
- ★ Limit incompatible land development along railroad rights-of-way
- ★ Establish procedures and metrics to make sure tax-financed road projects that expand capacity are properly prioritized to produce the greatest possible net benefits for the state
- ★ Make greater use of contracting for routine maintenance, expanding the model established with the VMS, Inc. contracts for routine maintenance on IH-35 and IH-20
- ★ Eliminate the old design-bid-build road construction strategy and make greater use of design-build strategies
- ★ Establish disincentives for the diversion of local resources to transit projects, which have shown themselves to be almost universally cost ineffective

## RESOURCE

- *Texas Road Policy: Keeping Up With Demand* by Byron Schlomach, Texas Public Policy Foundation (Forthcoming 2005)



### Roadway Expansion Doesn't Keep Up With Increasing Use



# Rail Transit

## THE ISSUE

Rail transit is perhaps the most contentious aspect of transportation policy, although it is the least used form of travel by Texans. Viewed by many as a local issue, rail transit is still worth being addressed as a matter of state policy for several reasons. First, the state mobility plan offers transit as an option for regional mobility plans. Second, though only federal pass-through funds are funneled through the state to help pay for transit, it does divert resources from more effective congestion-relieving strategies. Third, state resources are being used to fund other, more effective congestion-relieving strategies such as road construction, and transit diverts local resources from leveraging the state resources. Fourth, combining state and federal gas taxes and tolls, it can be argued that the state's road network is financially self-supporting whereas no such argument can be made for any transit system, especially rail transit.

Some policymakers support rail transit as a cost-effective way to transport Texans in urban areas and the way to reduce energy consumption while protecting air quality. Houston, Dallas, and Fort Worth operate rail transit. San Antonio has considered rail, and Austin voters in November 2004 accepted a commuter rail project.

Studies of rail transit in Texas and cities throughout the nation offer strong evidence that rail transit is:

- ★ The most expensive form of transportation;
- ★ Unsuccessful at reducing urban congestion;
- ★ Ineffective at conserving energy;
- ★ Dangerous for drivers and pedestrians; and
- ★ The least effective way to control air pollution.

## THE FACTS

- ★ Of the 23 largest rail transit systems in the United States, transit lost market share of commuters in 60 percent of rail regions
- ★ Buses provide faster travel than rail – moving at least 15 mph more quickly
- ★ Highways are 14 times more cost-effective than rail, and buses are 1.7 times more cost-effective than rail
- ★ Rail transit is generally more dangerous than alternative forms of transportation
- ★ Most rail systems consume more energy per passenger mile than cars
- ★ Rail pollution costs about \$1 million per ton of ozone precursors eliminated – a cost considerably higher than the widely accepted efficiency standard of \$10,000 to \$20,000 cost per ton of air pollutants



- ☆ Construction of rail transit is strongly associated with increased congestion and less affordable housing

## RECOMMENDATIONS

- ☆ Use transportation dollars on the most effective investment – measured by the cost per hour of reduced delay
- ☆ Construct or improve highways instead of investing in rail transit
- ☆ Use traffic signal coordination, freeway ramp metering and incident management as cost-effective solutions to congestion – capacity expansions are not necessarily the best solution
- ☆ Consider bus rapid transit as an alternative to transit rail, particularly in high occupancy lanes
- ☆ Create incentives to encourage cities to accommodate private bus or van transit services that currently do not exist only because they are outlawed

## RESOURCE

- *Great Rail Disasters: Impact Of Rail Transit On Urban Livability* by Randal O'Toole, Texas Public Policy Foundation, June 2004 (<http://www.texaspolicy.com/pdf/2004-06-GRD.pdf>)



Highways are  
**14 times** more  
cost-effective  
and buses are  
**1.7 times** more  
cost-effective  
than light rail





## V. INSURANCE POLICY

*Legislators' Guide to the Issues*

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# Homeowners' Insurance

## THE ISSUE

The Texas Legislature has devoted considerable effort to ensuring accessible, affordable homeowners' insurance, gradually loosening regulatory restrictions since 1991. Rate setting was replaced first by benchmark standards, and then by file and use. Today the price of homeowners' insurance in Texas is regulated only by the insurance commissioner's authority to disapprove of "excessive" rates.

Deregulation of homeowners' insurance has been driven by necessity and economics. Over the past decade, the cost of insurance premiums has steadily risen to a rate that many Texans consider unaffordable. At the same time, many Texans could not find insurance to buy at any price because companies stopped selling policies in the state. Recognizing that consumers have more insurance choices and lower prices in states with less regulatory control over rates and policy coverage, state policymakers introduced a series of regulatory reforms.

The number of insurance companies offering coverage has grown and prices have slightly fallen, as the Texas Department of Insurance begins the process of replacing benchmark pricing with file and use. Because file and use has yet to be implemented, increased affordability and availability results solely from belief in the marketplace that Texas has made a long-term commitment to deregulation. For Texans to enjoy significantly lower prices and more choice in homeowners' insurance, market forces of supply and demand must be the sole determinant of price and coverage.

## THE FACTS

- ★ Texans pay the highest average homeowners' insurance premiums in the nation
- ★ Regulation of insurance rates results in higher premiums and fewer insurance choices
- ★ Experience of other states demonstrates that competitive market forces can protect consumers and insurers better than regulations
- ★ Illinois, with no regulation since 1970, has the highest number of companies writing homeowners' policies in the nation with rates at or below the national average
- ★ Since South Carolina recently enacted reforms modeled after Illinois, the number of companies offering homeowners' insurance doubled and rates steadied and declined in some cases
- ★ If the Department of Insurance implements file and use as an informational process, instead of using it to control rates, Texans should see increased choice and decreased price in homeowners' insurance



## RECOMMENDATIONS

- ★ Codify terms to ensure a true, least-regulatory form of file and use is implemented
- ★ Codify standards for the commissioner's disapproval decisions to ensure decision-making limits, rather than increases, regulation
- ★ Phase out file and use over time and allow competitive pricing of supply and demand to determine the cost of insurance premiums
- ★ Establish a long-term plan for enacting deregulation in code
- ★ Focus state resources on solvency, market conduct, licensing, and consumer information, rather than rates

## RESOURCES

- *Deregulation, Pricing And Availability Issues In The Texas Personal Homeowners' Insurance Market* by Patrick Brockett, Texas Public Policy Foundation (Forthcoming 2004)
- *Implementation Of Property & Casualty Filing Requirements* by Chris Patterson, Texas Public Policy Foundation, September 2004 (<http://www.texaspolicy.com/pdf/2004-09-insurance-pp.pdf>)
- *Shopping For A Solution: Effective Consumer Protection Through Competitive Regulation Of Insurance Rates* by Nathaniel Shapo, Texas Public Policy Foundation, April 2003 (<http://www.texaspolicy.com/pdf/2003-04-01-insurance-shapo.pdf>)

# *Workers' Compensation*

## THE ISSUE

The Texas Workers' Compensation System is widely considered one of the worst in the nation despite aggressive reforms introduced by the state Legislature over the past several decades. Employers participating in the state system pay the third highest insurance rates in the nation, and employees who are treated by the system experience the second lowest recovery rates in the nation. Texas' system was given a D-minus by the Work Loss Institute; only five states earned a lower rating.

The state system works better for some than for others. For a small group of employers who secure approval from the system to develop self-insured programs, costs are lower and health outcomes of injured employees are better. But costs are even lower and health outcomes are even better for employers who decline to participate in the state system and purchase workers' compensation programs that are not state-approved. Because Texas allows employers to elect not to participate in the state workers' compensation system – it is the only state in the nation to do so – Texans have the unique opportunity of comparing the state system with programs established by the private sector.

The private sector beats the state system hands over fists for efficiency, effectiveness, and satisfaction of employees and employers. To ensure employers can obtain workers' compensation programs at lower costs and employees recover rapidly and fully from workplace injuries, the state system of workers' compensation should be dismantled. Eliminating state regulation of workers' compensation will reduce the competitive disadvantage that Texas businesses now face with businesses in other states – a disadvantage that presently diminishes profitability, wage growth, and state economic growth.

Most of the reasons for establishing a state system of workers' compensation no longer exist. Medical protocols have been established by the American Medical Association, and state boards certify health care providers. The federal Occupational Health and Safety Administration sets, monitors, and enforces standards for workplace safety. In fact, there is no demonstrable need for state regulation, given current economic incentives that businesses face to keep employees productive and to avoid liability. Businesses and employees would be better served by government activities that focus on consumer protections for occupational insurance and benefits.

## THE FACTS

- ★ Texas is the only state that allows private sector employers the freedom to elect not to purchase workers' compensation insurance or participate in the state workers' compensation system (although several states allow small employers this option)
- ★ 38 percent of Texas employers do not participate in the state workers' compensation system, up from 35 percent in 2001



- ★ 24 percent of Texas employees are not covered by the Texas Workers' Compensation System, up from 20 percent in 1993 – about 80 percent of individuals employed by nonparticipating employers receive health and wage benefits from their employers when injured
- ★ 40 percent of employers who decline to participate in the state system say the state-approved insurance costs too much, but the same percentage say they would not participate if costs were lower because the system's health care is inadequate
- ★ The state workers' compensation system governs the expenditure of about \$4 billion annually and determines the medical outcomes of approximately 200,000 Texans
- ★ Workers treated by the state workers' compensation system have the lowest recovery rate in the nation – 25 percent of treated workers never regain full function and productivity
- ★ Employers in the Texas Workers' Compensation System pay the 3<sup>rd</sup> highest insurance rates in the nation based on covered payroll
- ★ Cost of the average claim processed by the state workers' compensation system is the highest of 12 states surveyed – the average medical cost per claim increased 21 percent for the system between 1999 and 2001
- ★ Medical costs for workers treated by the state system were six times higher than the cost of care for a similar injury treated by a group health plan
- ★ The Texas Workers' Compensation System received a D-minus on a ranking of state systems by the Work Loss Data Institute – only 5 states received a lower rating than Texas

## RECOMMENDATIONS

- ★ Dismantle the state system of workers' compensation
- ★ Provide employers the freedom to select and manage workers' compensation insurance – stop government regulation of insurers, premium rates, wage replacement, and the defining and distribution of medical services
- ★ Require disputes to be resolved by employer-funded, independent arbitration with decisions guided by a tribunal of medical experts – binding if employer is OSHA compliant
- ★ Focus government on consumer protections – ensuring solvency of insurers and providing a clearinghouse of information (including cost of insurance premiums, insurers' experience, medical care, providers, and patient outcomes)
- ★ Limit the liability of employers by extending immunity to all employers that comply with OSHA and maintain workers' compensation or occupational benefits programs

## RESOURCE

- *Making Workers' Compensation Work For Texans* by John Colyandro and Chris Patterson, Texas Public Policy Foundation (Forthcoming 2005)





## VI. TELECOMMUNICATIONS POLICY

*Legislators' Guide to the Issues*

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# Telecommunications

## THE ISSUE

Telecommunications remains one of the most regulated industries in Texas, although the state Legislature shouldered a program of comprehensive reform in 1995. When state and local taxes are combined, Texas telecommunications is one of the most highly taxed services in the nation. Consequently, most Texans pay a higher price for telecommunications and enjoy a smaller selection of services than residents of many other states.

Although state regulations were established in decades past to protect consumers against a franchised telephone monopoly, today that monopoly no longer exists and regulations do more harm than good.

Currently, state government regulates rates, terms, and service packages, hampering competition and hurting consumers:

- ★ State regulations limit consumer choice and artificially raise the price of some services to subsidize the price of other services at below-cost rates;
- ★ Rate fixing discourages new carriers from selling in Texas because they must compete against subsidized, artificially low price for basic services;
- ★ Rate fixing makes new technologies, such as wireless, appear unreasonably expensive in comparison to subsidized services; and
- ★ Proposals to submit emerging technologies, such as Voice Over IP, to the same regulation imposed on traditional services chill investment in, development of, and marketing of new services.

The 79th Texas Legislature has a responsibility to ensure that state law encourages development of a fully competitive marketplace for telecommunications. A recent federal court ruling on the role of state public utility commissions coincides with the state's Sunset Review for the 1995 Texas Public Utility Regulatory Act. This juncture offers state policymakers the sweeping opportunity to improve telecommunication services by replacing state regulation with market forces.

## THE FACTS

- ★ Texas levies the second highest state and local taxes on telecommunications services in the nation – 28.56 percent vs. the national average of 17.9 percent
- ★ State regulations that sustain cross-subsidies increase the cost of service by at least \$200 million annually
- ★ Intrastate access charges in Texas, such as for calls from Houston to Dallas, are higher than the total charge for many transcontinental calls today



- ★ The price of telecommunications equipment has declined by more than 50 percent since the federal government issued a final decision allowing competitive pricing
- ★ Long distance rates have fallen 68 percent since telephone carriers were allowed to compete with AT&T in 1984
- ★ Intrastate long distance charges have only fallen 56 percent since 1984 because states continue to regulate prices and competition
- ★ Inflation-adjusted wireless prices fell 40 percent during the past 6 years since the federal government allowed the number of providers to increase from two to at least six per market
- ★ There are almost as many Texans using wireless today as there are using regular wired telephone lines (11.3 million vs. 12.5 million)
- ★ Texas broadband subscribership has increased 12-fold since 1999

## RECOMMENDATIONS

- ★ Reduce state taxes and fees on telecommunication services
- ★ Eliminate state regulation of prices for telecommunication services
- ★ Eliminate all state regulations pertaining to quality and delivery of services
- ★ Eliminate cross-subsidies – regulations that reduce the cost of some residential services while inflating the cost of other residential and business services
- ★ Allow price of service to reflect the cost
- ★ Allow competition to determine the level of sustainable telephone rates
- ★ Restrict universal service to low-income households and fund universal service through general tax revenues or a fixed monthly charge on telephone bills
- ★ Eliminate state requirements for tariff filings
- ★ Refrain from taxing the Internet or new technologies, such as Voice Over IP

## RESOURCES

- *Principles For Texas Communications Law* by Raymond L. Gifford and Adams Peters, Texas Public Policy Foundation, March 2004 (<http://www.texaspolicy.com/pdf/2004-03-22-telecom.pdf>)
- *Texas Telecommunications: Everything's Dynamic Except The Pricing* by Robert Crandall and Jerry Ellig, Texas Public Policy Foundation (Forthcoming 2004)





## VII. WATER POLICY

*Legislators' Guide to the Issues*

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## *Current Issues*

### THE ISSUE

Water promises to be one of the most urgent, complex, and contentious issues for the 79th Texas Legislature. Demands of an expanding population compete with agricultural, industrial, and environmental needs for a plentiful water supply. While shortages have required some cities to transport water from distant sources over the past several years, there is more than sufficient water to meet the needs of all Texans today. However, water shortages could loom in the future if population growth fulfills expectations and drought constricts supply.

The State Water Plan proposes that future water needs be largely met by voluntary redistribution of water. The challenge is to find the means to redistribute water and to supplement this supply with emerging technologies, such as desalination. The high cost of redistribution and technologies have stimulated state government to expand public-private partnerships and private markets to help underwrite the cost. Now fundamental principles of state water law – state “ownership” of surface water, state regulation of ground water, prior appropriation, beneficial use, and rule of capture – must be reconfigured to meet the rapidly changing needs of Texans.

Although future water supply will largely depend on private sector engagement, at present the private sector is allowed a very restricted role in water production and distribution. Because ground and surface water are highly regulated, the current water debate focuses on the role of government. Policymakers ask if government regulation is the best way to protect public interest, determine fair water use, and protect the environment.

Some policymakers press to curtail private rights and increase government regulation to protect public interest and the environment against ruinous exploitation. Others press for the alternative to water regulation – water marketing – where supply and demand determine production, allocation, and use. Based on the experience of several western states, some policymakers believe water marketing is more effective than regulation in increasing water supply, conservation, and environmental protection. These policymakers propose strengthening private property rights for all water uses, making water rights freely transferable, and creating a legal system that will enforce these rights.

### THE FACTS

- ★ Texas' current population of 21 million is expected to double by 2050
- ★ Texas has approximately 191,000 river miles flowing through 23 major river basins



- ☆ Texas has 9 major and 20 minor aquifers
- ☆ Texas is home to the Ogallala, the world's largest aquifer – it stretches across 8 states and underlies 174,000 square miles
- ☆ Over half of the water Texans drink comes from aquifers
- ☆ The average Dallas resident uses 250 gallons of water each day
- ☆ Over three-quarters of irrigation comes from groundwater
- ☆ By 2050, almost 50 percent of municipal demand for water may not be met if a drought occurs
- ☆ Water development strategies proposed by regional water groups have a price tag of almost \$18 billion
- ☆ Texas needs 8 new major reservoirs and 10 minor reservoirs at a cost exceeding \$4 billion, according to a report issued by the Texas Water Development Board
- ☆ Almost 66 percent of future water needs will be met by voluntary redistribution
- ☆ Almost 14 percent of future water needs could be met by water conservation measures

## RECOMMENDATIONS

- ☆ Strengthen private property rights
- ☆ Make water rights freely transferable
- ☆ Strengthen enforceability of private property rights
- ☆ Allow individuals and associations to lease or purchase surface water from the state
- ☆ Create a long-term plan for divesting the state of water ownership and regulation
- ☆ Replace contested regulations with explicit legislation
- ☆ Implement a long-term plan for water marketing to serve as the primary means of providing an adequate water supply for human, agricultural, industrial, and environmental needs
- ☆ Transfer regulatory authority to local boards
- ☆ Expand incentives for soil and water conservation
- ☆ Focus state resources on serving as a clearinghouse for water marketing and banking, coordinating regional boards, providing scientific information, and proposing voluntary standards
- ☆ Expand public-private partnerships for developing and delivering water
- ☆ Encourage public utilities to privatize services

## RESOURCE

- *Choppy Waters: Understanding The Challenges To Texas Water Policy* by Susan Combs, Katharine Armstrong, and Kathleen Hartnett White, Texas Public Policy Foundation, August 2004 (<http://www.texaspolicy.com/pdf/2004-08-choopy-waters.pdf>)

# Desalination

## THE ISSUE

Texas is now embarked on one of the most promising ways to meet future water needs – desalination of seawater. For decades, Texas has desalinated brackish ground and surface water, primarily for agricultural purposes, but no state, including Texas, is now using desalinated seawater. In late 2004, Florida is scheduled to open a major seawater desalination facility, the first in the nation, and California is now considering several major seawater desalination projects. If construction is completed as planned, Texas will open its first major seawater desalination plant on the Gulf Coast in 2006.

Although seawater desalination is new in the United States, it has been widely used throughout the world for decades. Many nations rely on seawater for drinking, agriculture, and industrial purposes. Water from seawater desalination is a reliable water supply that is becoming cost competitive.

The primary challenge of seawater desalination for Texas is financial; the costs of plant construction and delivery systems are prohibitively expensive for taxpayers. Texas has solved this problem by inviting the private sector into public-private partnerships, and privately owned companies are shouldering the larger share of responsibility for new seawater desalination plants. A secondary challenge for desalination is disposing of brine in a way that does not harm the environment; for seawater desalination, this challenge is lessened because salt can be returned to the sea without adverse impact.

## THE FACTS

- ★ More than 10,000 desalination facilities are operating throughout the world today in over one hundred countries
- ★ 20 percent of the world's desalination facilities are located in the United States – Saudi Arabia produces nearly 25 percent of the world's desalinated water
- ★ Texas has more than 100 desalination plants operating today, using brackish ground or surface water to produce more than 40 million gallons of fresh water a day
- ★ The first desalination facility in the nation to process saltwater is about to open in Tampa, Florida, and a facility is under construction in San Diego
- ★ Texas plans to construct three seawater desalination plants on the Gulf Coast – Corpus Christi, Freeport, and Brownsville – the largest facility is expected to cost \$226 million
- ★ Cost of desalinating seawater has fallen from \$6 per 1000 gallons in 1991 to less than \$2 per 1000 gallons in 2004



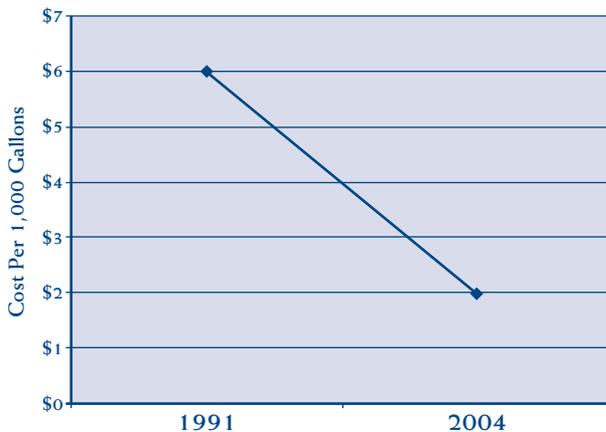
## RECOMMENDATIONS

- ★ Utilize desalination as one important alternative for Texas' future water supply
- ★ Increase private sector involvement in desalination projects
- ★ Strengthen contractual law to encourage public and private owners to engage in creative partnerships – designing, constructing, operating, maintaining, and financing desalination projects
- ★ Identify environmentally safe methods of disposing brine

## RESOURCE

- *Hold The Salt: The Promise Of Desalination For Texas* by James C. Smith, Texas Public Policy Foundation, September 2004 (<http://www.texaspolicy.com/pdf/2004-10-desal.pdf>)

### The Cost Of Desalinating Seawater Is Falling



**To compare:**  
 1,000 gallons of Sparkletts drinking water cost \$1,290

# Water Transfer

## THE ISSUE

Within the next 50 years, the population of Texas is expected to double. Finding sufficient water to meet rapidly growing demands presents a critical challenge for Texas policymakers. Both the 1997 and 2002 State Water Plans identify voluntary redistribution of water as one of the primary means to meet future water needs. Water transfer has been successfully used in Texas and throughout the American West to:

- ★ provide water for growing cities, recreational purposes, and environmental needs;
- ★ promote efficient water use and conservation;
- ★ provide an alternative to reservoir construction; and
- ★ encourage bargaining between divergent interests.

Cities, ranchers, farmers, and industries have been transferring water for decades. These transactions have proven that voluntary redistribution, instead of government-compelled reallocation and regulation, serves as the best means to meet growing water needs.

Private property rights must be strengthened and state regulatory burdens must be eased to encourage and expand efforts to transfer water from areas of surplus to areas of need.

Certain Texas laws and policies need rethinking.

- ★ *Junior Water Rights.* Created in 1997 to discourage interbasin transfer, the junior water rights law makes rights to transferred water secondary to other rights in the basin. This rule makes ownership conditional on available supply; consequently, in times of water scarcity, purchasers of water have no rights to the water they purchase.
- ★ *Regulatory Costs.* Regulatory requirements of the Texas Commission on Environmental Quality make small water transfers uneconomical. Although small transfers of 3,000 acre-feet have been determined to have no impact and are exempt from the junior water rights rule, the commission is required to subject small transfers to potentially expensive contested hearings.
- ★ *Regulatory Brakes.* Groundwater districts exercise regulatory authority that acts as a chilling effect on water transfers. Districts have the authority to limit the amount of water that can be sold and can impose an export fee on transfers; they can also limit where water is transported and how it is used.
- ★ *Legal Barriers to Private Sector Engagement.* Changing water needs require state law to allow the private sector a larger role in developing water sources, transporting water, and distributing water – particularly in municipalities.

## THE FACTS

- ★ Texans use about 16.5 million acre-feet of water annually
- ★ Nine aquifers supply almost 97 percent of groundwater used in the state
- ★ Groundwater accounts for about 60 percent of Texas usage



- ★ Conservation districts cover 90 percent of groundwater in Texas
- ★ 80 percent of groundwater is used for irrigation – municipal, industrial, mining, and livestock use accounts for the remaining 20 percent
- ★ 65 percent of surface water is used for municipal and industrial purposes – irrigation only accounts for 35 percent of use
- ★ Municipal and industrial use of water is expected to increase 5.4 million acre-feet annually and increase 28 percent over current use within the next 30 years
- ★ Water transfer and marketing is now occurring in the Texas Panhandle, Far West Texas, the Lower Rio Grande Valley, and the Hill Country – Amarillo, Lubbock, and nine other Panhandle cities are pumping water from wells in rural areas
- ★ 14 of the 16 Regional Planning Groups propose water transfer projects – groups propose transferring approximately 33 percent of Texas surface water and 25 percent of groundwater used today
- ★ The Brazos Valley Water Alliance, a landowner cooperative, has accumulated 133,000 acres of land in Brazos, Burleson, and Milam counties and currently seeks a purchaser for its groundwater

## RECOMMENDATIONS

- ★ Reduce regulatory burden – allow transactions of less than 3,000 acre-feet to be exempt from the no-injury and contested case hearing rule if TCEQ determines there is minimal impact
- ★ Eliminate the Junior Water Rights rule on interbasin transfers to strengthen private property rights and develop efficient water markets
- ★ Remove legal barriers to private investment in providing surface and groundwater for municipal use
- ★ Redefine the role of groundwater districts – restrict their authority to regulate private property rights to water and to limit the use of transferred water, and restrict their authority to impose export fees
- ★ Provide specific authorization for local governments to contract with private entities for developing water sources, transporting water, and distributing water
- ★ Examine the feasibility of developing a common carrier system to convey and transport water – regulating the conveyance system but allowing competing carriers within the piping network

## RESOURCES

- *Solving The Texas Water Puzzle: Market-Based Allocation Of Water* by Ronald Kaiser, Texas Public Policy Foundation (Forthcoming 2005)
- *A Free Market Solution To Groundwater Allocation In Texas: A Critical Assessment Of The House Natural Resources Committee Interim Report On Groundwater* by Clay J. Landry, Texas Public Policy Foundation, December 2000 (<http://www.texaspolicy.com/pdf/2000-12-01-environ-water.pdf>)





## VIII. TORT REFORM

*Legislators' Guide to the Issues*

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# Asbestos

## THE ISSUE

The number of suits filed against manufacturers, contractors, suppliers, distributors, retailers, and property owners for asbestos damages has doubled over the past decade. Claimants, recruited by law firms and mass screenings, are rapidly increasing, although production and use of new asbestos products largely stopped in the early 1970s and most claims are filed by individuals who exhibit no medical injury, suffer no functional impairment, and may never be sick.

Asbestos-related litigation touches every industry as companies with distant, peripheral connection to asbestos are named as defendants. Today, over 8,500 companies have been named in litigation. Approximately \$70 billion has been spent in asbestos litigation, and analysts predict an additional \$130 billion in cost.

Despite costly litigation, there is little evidence the investment in asbestos awards are helping people who have suffered harm from exposure. A large percentage of plaintiffs have been awarded compensation for potential, future harm that research demonstrates may never occur, and many cases have been decided on faulty medical information.

The cost of asbestos litigation reaches beyond businesses to workers and communities. Litigation has pushed scores of companies into bankruptcy, costing workers hundreds of thousands of dollars in lost wages and economically depressing communities.

For individuals who have been harmed by asbestos, explosive litigation is clogging the civil justice system and delaying hearings. Excessive litigation is also draining limited resources needed to compensate the sick and injured. In the face of rising claims, trusts established by bankrupt companies have reduced compensation to 15 percent or less of claim value. Examining rising costs of litigation, the RAND Corporation questions whether there will be sufficient money to compensate future asbestos claims.

In Texas, the problem of asbestos litigation is catastrophic. From 1988 to present, Texas has led the nation in the number of cases filed and established landmark rulings for high awards without demonstrated injury. In 2001, Texas awarded \$3 million to three plaintiffs exposed to asbestos who sued because they were afraid of, but did not have, cancer. In the same year, another court awarded \$35 million to 22 plaintiffs for future medical impairment, although there was no evidence to suggest any would incur future asbestos-related disease.

To protect present and future individuals who truly suffer harm from asbestos, Texans must create a fair and expedient process for asbestos litigation.

## THE FACTS

- ★ Texas leads the nation in asbestos claims filed from 1988 to 2000
- ★ The number of asbestos claimants has increased almost six-fold since 1982



- ★ The number of asbestos defendants has increased over eight-fold since 1982
- ★ Over 105,000 new asbestos claims were filed in 2003, although production and use of new asbestos products largely stopped in the early 1970s
- ★ The average asbestos claimant sues 60 to 70 defendants
- ★ 90 percent of new asbestos claims are filed by individuals who have no medical evidence of injury and may never be impaired by exposure
- ★ 50 percent to 90 percent of judgments were decided on the basis of faulty medical information
- ★ Only 43 percent of asbestos litigation dollars goes to compensate plaintiffs
- ★ Total cost of asbestos litigation to American businesses increased from \$1 billion in 1982 to \$70 billion in 2002 – total cost is estimated to be up to \$210 billion
- ★ Approximately 70 companies have been driven into bankruptcy by asbestos litigation – costing 60,000 jobs and \$200 million in lost wages
- ★ Payouts of bankrupt companies from trusts have been reduced to 7.5 percent to 15.5 percent of claims

## RECOMMENDATIONS

- ★ Establish objective medical criteria to delay or dismiss claims where there is no evidence of functional impairment
- ★ Extend relevant reforms from House Bill 4 (78th Legislature) to pending asbestos cases – remove the 15 percent threshold for joint and several liability, establish proportional responsibility, create multidistrict litigation panel for factually similar cases, and refuse cases that have no connection to Texas
- ★ Disallow cases that join impaired plaintiffs with unimpaired, resulting in over-compensation for the unimpaired and under-compensation for injured plaintiffs
- ★ End repetitive, punitive damages that reduce compensation for injured plaintiffs

## RESOURCES

- *Asbestos Litigation Industry: Reforms Needed To Protect The Truly Sick* by Tammi L. McCoy, Texas Public Policy Foundation (Forthcoming 2005)
- *Asbestos And Its Impact On Texas* by Kay Andrews, 2nd Annual Policy Orientation for the Texas Legislature, Texas Public Policy Foundation, January 2004 (<http://www.texaspolicy.com/pdf/2004-PO-asbestos-ka-PPT.pdf>)
- *The Growing Asbestos Litigation Crisis In Texas* by Richard Faulk, Veritas, Texas Public Policy Foundation, January 2002 (<http://www.texaspolicy.com/pdf/2001-veritas-3-1-asbestos.pdf>)

# *Medical Liability*

## THE ISSUE

The 78th Texas Legislature limited non-economic damages in medical liability lawsuits, limits later buttressed by voters' approval of a constitutional amendment. There is ample evidence that House Bill 4 and Proposition 12 are beginning to fulfill hopes that tort reform will ameliorate Texas' medical crisis. The cost of medical malpractice insurance has been reduced for many physicians in Texas. Decreasing costs and relief from the threat of unmerited, exorbitant lawsuits are now encouraging more health care providers to practice in Texas and some medical facilities to expand.

However, it will take some time for the full impact of reforms to be realized. In the months before Proposition 12 took effect, there was a barrage of malpractice lawsuits; consequently, dramatic reductions in the cost of medical liability premiums will not be seen for several years – until insurers deal with costs incurred in winning or losing newly filed litigation. Using state regulation to set or roll back the rates of medical liability premiums to an artificially low cost can provide short-term relief for health care providers but will result in reduced availability of insurance in the longer term. Allowing insurance rates to be determined by market competition is the only proven way to reduce the cost of insurance and increase consumer choice.

The medical system has begun to heal, but state policymakers are still challenged to repair the damage resulting from years of legal and financial jeopardy. Tests and treatment that are medically unnecessary but ordered to protect against lawsuits (defensive medicine) and fear of acknowledging medical errors have undermined health care quality. Although health care professionals have taken strong steps to enforce strong standards of care and safety, providers must be assured that efforts to improve care by identifying errors will be protected. Some states now shield institutions and health care professionals engaging in formal procedures to improve health care outcomes.

## THE FACTS

- ★ More than half of all Texas physicians had been sued prior to 2003
- ★ The cost of liability depressed the number of health care providers for Texans – after Proposition 12, the number of providers has increased
- ★ From 1999 to 2003, the number of liability insurers selling policies to Texas medical providers dropped from 17 to 3 – after Proposition 12, 10 new insurers filed to sell malpractice policies
- ★ Nueces County – known to have one of the state's highest number of medical



malpractice and personal injury cases – anticipates a 75 percent drop in lawsuits as a result of a state law passed in 2003

- ★ Texas' largest medical malpractice insurer reduced premiums 12 percent after Proposition 12 was passed and will make an additional 5 percent reduction at the beginning of 2005 – in some states without liability caps malpractice insurance rates doubled in 2003
- ★ A Corpus Christi hospital chain is projecting a \$21 million reduction in annual liability costs and has earmarked savings for expanding patient services
- ★ Over 76 percent of physicians surveyed believe that defensive medicine has eroded the quality of care
- ★ In the first 9 months of 2003 before Proposition 12 went into effect, there was a 300 percent to 500 percent increase in medical malpractice lawsuits filed in Texas – it is likely to take 2-3 years for these suits to be decided

## RECOMMENDATIONS

- ★ Establish immunity for health care providers engaged in peer review or quality assurance programs that identify past errors to develop systems for improving patient care outcomes
- ★ Allow the market to determine the price of medical liability insurance premiums – refrain from enacting rate roll-backs and replace current state rate regulatory powers with a system of file and use for medical liability insurance, similar to the system for homeowners' insurance established by the 78th Legislature

## RESOURCE

- *Critical Condition: How Lawsuit Abuse Is Hurting Health Care & What Texans Can Do About It* by Chris Patterson, Colleen Whalen & John Pisciotta, April 2003 (<http://www.texaspolicy.com/pdf/2003-04-29-CRITICALCONDITION.pdf>)





## IX. LIMITED GOVERNMENT

*Legislators' Guide to the Issues*

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# Principles for Governing

## THE ISSUE

The opportunity to improve the benefits of government programs is offered by limited revenues, competing budget priorities, and revenue deficits. Using the principle of public benefit, state policymakers can make agencies and programs more efficient and effective by focusing on outcomes. Public benefit requires policymakers to guide decisions with the following questions:

- ★ How much money is available to be spent on government activities?
- ★ How should government functions take priority in the budget?
- ★ What is the goal of each government activity and what programs are most effective at achieving these goals?
- ★ How do tax and spending policies improve economic competitiveness?
- ★ How does the state budget reduce deficits and increase surpluses?

Competition is an essential tool for increasing the public benefit of government activities. The cost and quality of government services can be improved by introducing market forces, such as competition and economic incentives, into agency activities.

The most effective way of making government more responsive and responsible to the public is through comprehensive, whole-cloth reform. Partial, incremental, and gradual reforms have shown small success in changing the way government operates. Public school reforms furnish an example of the failure of incremental reform, while the success of school choice provides evidence that comprehensive, market-based reform maximizes public good.

New Zealand offers a model for governing according to the public benefit principle. In 1984, New Zealand was considered one of the most socialistic of nations. Government took 44 percent of the Gross Domestic Product and the budget deficit represented 15 percent. A new majority in parliament took control and initiated comprehensive, immediate systemic reform. Parliament halted deficit spending, cut taxes and reduced government services while improving public programs and increasing public satisfaction with essential services.

## THE FACTS

- ★ New Zealand fully eliminated its budget deficit within six years and produced annual budget surpluses within nine years
- ★ When New Zealand cut incomes taxes by 50 percent, revenue rose 20 percent in the first year
- ★ When Turkey cut taxation by 40 percent, revenues rose 27 percent



- ★ By introducing competition to road construction and maintenance, New Zealand cut costs 40 percent and improved the quality of roads
- ★ By allowing agencies to keep a percentage of annual efficiency gains, New Zealand achieved as much as 11 percent to 15 percent productivity gains by each government agency
- ★ After school choice was established in New Zealand, more cents on the education dollar went to the classroom, more money was available to build schools and raise teacher salaries, and the achievement gap between public and private schools disappeared
- ★ When legislators focus on public benefit, government services improve and costs decline

## RECOMMENDATIONS

- ★ Apply the principle of public benefit to all policy decisions
- ★ Conduct ongoing budget analyses of spending and results
- ★ Eliminate government activities except required activities or activities expressly required to achieve statutory charges
- ★ Eliminate government activities that are ineffective or inefficient
- ★ Fund only essential activities that produce direct public benefits
- ★ Encourage private capital investment
- ★ Do not increase taxes
- ★ Introduce competition in all functions of government

## RESOURCE

- *Converting Challenges To Opportunities* by Maurice McTigue, Texas Public Policy Foundation, February 2003 (<http://www.texaspolicy.com/pdf/2003-02-03-mctigue.pdf>)

# Role of Government

## THE ISSUE

State and local governments replicate many commercial services that are available to Texans today. Government production of commercial goods and services pre-empts competition in the private sector, depresses economic growth, raises the cost of services, and lowers average family income.

Governments are directed to provide certain essential services that are deemed public good and cannot be commercially purchased – such as police protection and welfare. However, state law does not require that governments or government agencies be responsible for producing these services themselves.

Many states are increasing use of competitive contracting because the private sector can provide services more efficiently and effectively – finding that the private sector is capable of providing most government functions. Some states are divesting themselves of commercial operations, recognizing the financial penalties of state ownership on taxpayers.

In Texas, state and local governments are contracting out some administrative and support services today, but competitive contracting represents a small portion of government activity. Governments still command a sizeable segment of the commercial consumer market in Texas and compete with private enterprise at a significant advantage – bolstered by subsidies and tax breaks.

The cost of government competition challenges state policymakers to redefine the role of state and local government in Texas. What is the business of government? Should government own businesses? Should government produce consumer goods and services? Is government responsible for maximizing the economic good of its citizens? Is the primary job of government deciding policy or providing services?

## THE FACTS

- ★ State government operates hospitals, correctional institutions, and universities; it runs licensing bureaus and maintains roadways
- ★ Local governments operate airports, utilities, transit lines, radio stations, emergency services, and convention centers; they pick up garbage and run animal shelters
- ★ Government businesses get subsidies and tax breaks – putting private enterprise at a significant financial disadvantage
- ★ Texas governments earn more than \$11 billion annually selling consumer services that duplicate services that can be purchased from the private sector
- ★ Texas governments spend more than \$8 billion annually operating support services for which there are well-developed commercial markets



- ☆ Government competition accounts for nearly \$20 billion dollars in Texas – the equivalent of 3 percent of Gross State Product
- ☆ Taxpayers pay extra when government gets involved with business – government costs are higher and government prices are usually subsidized below cost
- ☆ Government involvement in commercial businesses depresses personal income – depressing economic development, job creation, and wages

## RECOMMENDATIONS

- ☆ Prohibit state and local governments from establishing commercial activities that are conducted by the private sector
- ☆ Annually review all government commercial activities to determine the potential and implications for privatization
- ☆ Subject commercial activities of government to the same taxes and regulations as levied on private sector commerce
- ☆ Create incentives for governments to increase competition in all activities – administration, support services, and direct services
- ☆ Establish a "Petition of Interest" process to allow private companies to notify government of interest in providing a government service and initiate a competitive bidding process

## RESOURCE

- *The Business of Government? Competition Between Texas Governments & The Private Sector* by Wendell Cox, Texas Public Policy Foundation, September 2003 (<http://www.texaspolicy.com/pdf/2003-09-24-govt-competition.pdf>)





## X. POLICY FACTS: ADDITIONAL SOURCES

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# Policy Facts:

## ADDITIONAL SOURCES

### I. FISCAL POLICY

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## XI. PROPOSED RESEARCH AGENDA FOR 2005

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# *Proposed Research Agenda for 2005:*

## I. FISCAL POLICY

1. Measuring Effectiveness And Accountability Of State Agencies
2. Texas Fair Tax
3. Property Tax Relief For Texans
4. Tax And Spending Report Card On The 79th Texas Legislature
5. Who's Paying Taxes In Texas?

## II. PUBLIC EDUCATION POLICY

1. Progress Report On Texas Charter Schools
2. Cost Of Remedial Education And Texas Public Schools
3. Compilation Of School Finance Research
4. Current Exercise Of School Choice In Texas
5. Impact Of Robin Hood On Property-Wealthy School Districts
6. Financial Practices Of Effective Schools
7. Early Childhood Education Programs
8. Teacher Pay For Performance And Terms Of Employment
9. Bilingual Education

## III. HEALTH CARE POLICY

1. New Directions For Texas Medicaid & The Children's Health Insurance Program
2. Reducing The Number Of Uninsured Texans
3. Cost Of Health Care
4. Assessing And Reducing The Number Of Texans Replacing Private With State-Subsidized Health Care
5. Consumer-Centered Health Care Alternatives
6. Evaluation Of State Health Care Consolidation

## IV. TRANSPORTATION POLICY

1. Texas Roadways: Keeping Up With Demand
2. How HOV Lanes & Toll Roads Work In Texas And Other States

## V. INSURANCE POLICY

1. Reforming The Texas Workers' Compensation Program



## VI. TELECOMMUNICATIONS POLICY

1. Emerging Technologies: A Blueprint For Deregulation

## VII. NATURAL RESOURCES & THE ENVIRONMENT

1. Solving The Texas Water Puzzle: Market-Based Allocation Of Water
2. Rule Of Capture And Water Marketing
3. Airing Facts On Air Quality

## VIII. TORT REFORM

1. Progress Report On Asbestos Reforms Of The 78th Texas Legislature
2. Over-criminalization Of Civil Actions And Public Safety In Texas

## IX. ROLE OF GOVERNMENT

1. Standards For Contracting And Privatization
2. Government Challenges To Private Property Rights
3. Identity Theft: State Government As Protector Or Perpetrator
4. Size And Cost Of Public Employment

*Notes*





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